Asia ETF Forum 2018

Growing an institutional footprint in Asia's ETFs market

Hong Kong Exchanges and Clearing (HKEX) explores the burgeoning impact of institutional investors in Asia's exchange-traded funds (ETFs) market – which is demonstrating the potential to establish itself as a global force – with a focus on the rapid uptake of ETFs in investment portfolios and the significance of Hong Kong to the Chinese ETFs market

Institutional investors have been a growing force that has shaped Asia's exchange-traded funds (ETFs) market, which has grown to account for 22% of the total number of ETFs listed globally.[1]

According to a survey conducted by the Asia ETF Forum, 88% of Asian institutional investors have included ETFs in their portfolios, while 72% of respondents intend to increase their allocation to ETFs in the next 12 months.[2]

Compared with the rest of the world, Asia's ETFs market is still in its "nascent stages", according to Chris Pigott, head of Hong Kong ETF services at Brown Brothers Harriman, but is "positioned for growth". Nearly 90% of total financial assets in Asia are outside the asset management industry, according to a report from McKinsey, meaning there is approximately $110 trillion in unmanaged asset pools made up of deposits and internally managed assets with institutions in Asia, signalling tremendous room for growth in the ETFs industry.

Capital efficiency – The key to ETFs adoption

Among reasons cited for the growing interest in ETFs, efficiency of capital utilisation is a primary consideration for institutional investors. This is especially true in the global bond markets, as constructing a diversified bond portfolio through ETFs requires a smaller capital outlay than buying the underlying.

According to a study by Greenwich Associates, 60% of respondents consider bond ETFs an alternative vehicle for fixed-income exposure, and 60% have increased utilisation of bond ETFs in the past three years. Meanwhile, 30% plan to increase their exposure in the coming three months.

"Fixed-income ETFs continue to grow more popular with institutions in Asia, driven by the efficiency and cost benefits versus trying to purchase the individual bonds," says Pigott. "Insurance companies in Asia believe ETFs are a valuable tool to diversify their portfolios, manage volatility and lower transaction costs. The liquidity needs of these institutions are also addressed through the multiple layers of liquidity that come with the ETF wrapper," he adds.

A gateway to mainland China and beyond

China is one of the most closely watched markets of late, and the recent correction may signal a good entry point. ETFs tracking Chinese stocks have witnessed a surge in inflows recently. In Hong Kong – the first port of call for international investors seeking Chinese exposure – fund inflows to A-share ETFs have been accelerating in the second half of 2018. Hong Kong-listed A-share ETFs registered HK$2.3 billion of inflows in October.[3] This amount was close to the net inflow of HK$2.7 billion garnered in the previous three months.

Chris Pigott, Brown Brothers Harriman

On top of a high level of offshore renminbi liquidity – the prerequisite for trading A-shares outside China – Hong Kong also possesses other advantages for A-share investors, such as easy accessibility to the Chinese market enabled by Chinese regulators. The 'opening up' of capital markets in China, as seen in initiatives such as the Renminbi Qualified Foreign Institutional Investors scheme and Stock Connect, has led to the the proliferation of physical A-share ETFs whereas, in the past, exposure to Chinese equity markets via ETFs was limited to synthetic, swaps-based products.

In addition, Hong Kong-listed ETFs give investors the ability to reduce tax costs because of a favourable domestic tax regime, EY has reported. Hong Kong has entered into a growing number of tax treaties in the region, creating a springboard for institutional investors to capture opportunities in Asia.

The prospect of the city's ETF development is also holding up in part because of regulatory push. Hong Kong's ETF product range is set to widen with the Securities and Futures Commission consulting on new rules that may see the first listing of active ETFs next year. Currently, only passive funds are allowed to be listed in Hong Kong.

[1] *Data compiled by the Securities and Futures Commission showed that the number of ETFs in the Asia-Pacific region has grown to account for 22% of all ETFs listed globally in 2017, equivalent to assets under management of $430 billion.*

[2] *The Asia ETF Forum survey was conducted in Taiwan, Hong Kong, Seoul, Bangkok, Singapore and Tokyo between 17 April and 27 September 2018. 275 forum attendees responded.*

[3] *Bloomberg data, correct as of 26 October 2018.*