

2020

and beyond

A NEW ERA OF TRANSFORMATION FOR
BUY-SIDE LEADERS

ASSET SERVICING

With our vision of engineering a flexible, robust and efficient data-driven open architecture, we will work together with you to tackle the challenges and position you for growth and success.



Hani Kablawi

Head of International, Chairman of EMEA
BNY Mellon

Executive Summary

The global investment industry is on the cusp of an initial wave of disruption and our competitive landscape and market outlook are shifting. How are buy-side leaders navigating the trends sweeping the sector? As we look ahead, we highlight some of the key themes shaping the industry.

Powerful forces rocking the investment landscape today include volatility in global markets, uncertainty caused by unprecedented technological disruption, the complexity of more stringent regulatory requirements and ambiguities in data. These forces together are creating a perfect storm demanding that investors and their service providers rethink, re-engineer and transform amid a surge in competition from non-bank service providers.

We can see these forces playing out in multiple ways today. Investors are demanding servicing solutions in environmental, social and governance (ESG) investing, as well as accessing untapped markets such as China. The trend is to rely on fewer service providers in order to achieve economies of scale and pricing power. This could result in a smaller number of one-stop-shop service providers dominating the market, offering extensive capabilities in addition to core custody services.

Alongside this, a “barbell” of investment strategies – which sees institutional investors allocating at both ends of the risk spectrum – is concentrating assets in passive investments as well as alternative products such as private equity, private credit and real estate.

Cutting across these themes is a growing focus on data and digital innovation.

Firms operating today are under pressure not only to unlock their internal data, but also to integrate data from a range of third-party providers and derive analytics and insights to power decision-making. Achieving this means using technology and digital innovation to shape the operating model into one that is automated, resilient and responsive to new market realities.

More importantly, Asia’s growing economic clout has translated into greater roles and responsibilities for the region in the global economy, in which it is poised to play a pivotal role in shaping the future financial ecosystem. Buy-side leaders must be prepared to face unparalleled challenges and navigate a rapidly evolving environment.

EMBRACING DIGITAL AT BNY MELLON

BNY Mellon is out in front of these changes to equip our clients to adapt and capitalize. We are fully digitizing our company, reinventing each process, product and client interaction to adapt to new ways of thinking and working so everything we do is digital and in line with best standards and client expectations.

In doing so, we are deploying cutting-edge technology, such as machine learning and Artificial Intelligence (AI), to simplify processes and proactively deliver additional insights to clients. We have also adopted an open and cooperative approach to navigating the digital future of the investment industry, working alongside clients and together with other service providers to build an innovation network and digital ecosystem to provide enhanced value for our clients. And we are unlocking the value in data by deploying foundational data services that drive data-driven decision-making, business growth and innovation.

For our Asset Servicing clients, we are focused on improving and accelerating client information delivery, transforming client oversight and transparency, and providing data and analytics leveraging our established leadership in data management to unlock the power of data. By digitizing our business, we will be able to deliver new capabilities more quickly, provide our clients with richer insights, and integrate our core capabilities and digital delivery with that of best-in-class third-party solutions to offer our clients modular choices across their front, middle and back offices.

It is therefore paramount that institutional investors such as yourself consider how such trends will impact the growth of your organizations. This paper presents expert views from BNY Mellon and other industry leaders on the themes we see shaping the future of the investment industry.

20 key trends in 2020

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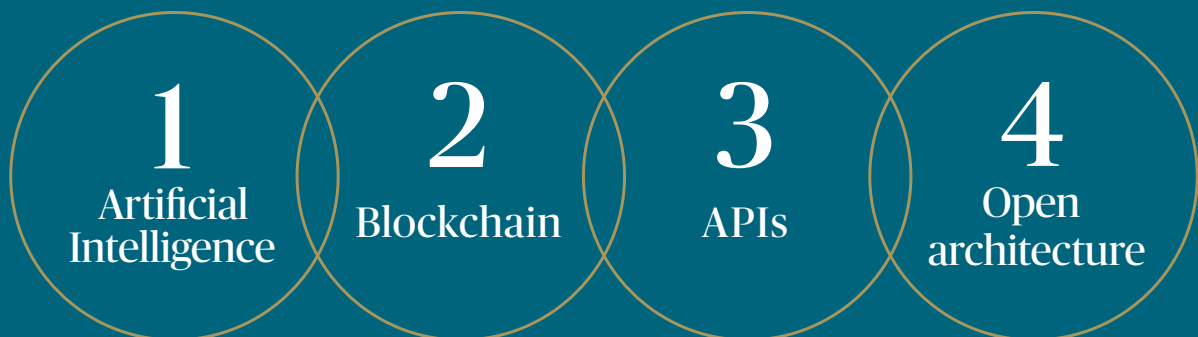
REDEFINING 'BUSINESS AS USUAL'

Revenues have plateaued, and margin pressure is driving buy-side leaders to revisit their operating models. While the urgency for change arises both from within and without, exogenous factors, such as market volatility, fee pressure from new entrants and complicated regulatory requirements are largely beyond the control of individual firms.

Endogenous factors, conversely, may be leveraged to future-proof organizations. With the right approach, technology can be a silver bullet.

FOUR DIGITAL TRENDS FOR A FUTURE-PROOF BUSINESS TRANSFORMATION ROADMAP

As asset owners and asset managers seek to shape business models that are responsive to new market realities, there is significant potential in adopting digital technologies within the investment services space to create value and unlock the latent potential of organizations.



1

Artificial Intelligence rewriting the future of the investment industry

Applied alongside process automation, AI could further enhance efficiency as machines learn from the activities they perform and improve over time.

Two-thirds of those surveyed in the BNY Mellon Investment Management 'Future 2024' report said that developments in AI would 'definitely' rewrite the future of asset management globally. Portfolio managers and quantitative specialists are increasingly using tools such as cognitive computing, machine learning and social media to obtain informational advantages, while robotic process automation is being applied in the asset servicing space to enhance client experience.

BNY Mellon is using AI – natural language processing, in particular – to identify the intent of client inquiry emails so they can be routed to the right teams for rapid resolution. We are also using machine learning to classify and understand incoming trade instructions to eliminate manual processing.

Human intelligence is catching up on how to make the best use of Artificial Intelligence by implementing machines for repetitive processing activities, greatly reducing the time spent on data gathering and processing. This is enabling the human workforce to work closely with clients to enhance the overall user experience.



Keith Carter

Associate Professor
National University of Singapore

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Blockchain moving from hype to reality

With the convergence of fintech companies and financial institutions in the investment space, we see increased acceptance and implementation of blockchain. The concepts behind blockchain or distributed ledger technology (DLT) have been around for few decades, but it was the creation of Bitcoin that brought all these technologies together and demonstrated the benefits to the wider investment market. Large financial institutions and regulators around the globe are now looking at blockchain as a means by which to eliminate unnecessary or duplicative processes, reduce costs and increase efficiency, transparency and resilience.

The world of assets is changing. Blockchain or DLT is transforming the way traditional securities are being issued, traded, cleared and settled. In the not-too-distant future, you will see various kinds of assets being tokenized – whether they are financial assets, commodities or store-of-value assets.



Subhankar Sinha

Head of Blockchain
BNY Mellon

3

APIs forming the cornerstone of the client experience

With an exponential rise in demand for data, asset servicing providers are now developing application programming interfaces (APIs) to give institutional investors the ability to receive data the way they want it, with on-demand frequency. Coupled with analytics tools, such data empowers buy-side leaders to boost investment performance, increase asset flows and improve client experience with the aim of generating value for end-clients and across the organization. Asset servicing providers such as BNY Mellon are already solving real-life operational and investment problems using APIs today. Implementing our suite of custody APIs helped a large sovereign institution reduce latency in its cash positions by 50%, resulting in better cash management by the client's front office.

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Open architecture is defining the future-state operating model

In our experience, many of our clients use multiple legacy systems with limited integration, creating an inconsistent data source that creates challenges for data consolidation and demands endless reconciliation.

Having an open ecosystem provides institutional investors with the flexibility to choose best-in-class systems for their investment activities and capture insights from a wide variety of data sources and vendors. This open, 'plug-and-play' model thereby provides deeper intraday insights and more real-time transparency around trade activities and NAV construction, helping chief investment officers, chief data officers and chief risk officers to achieve a single source of trusted information and insight.

BNY Mellon's open platform strategy offers our clients choice. We are exploring partnerships with everyone from small fintechs to large tech firms, as well as working with clients, providers and even competitors to develop flexible, insightful and effective solutions.

The biggest transformation needed is a transformation of mindset. We need to think differently and work differently – changing every process, every client interaction, and every product. And it's not about being better than yesterday. It's about being in line with client expectations and on par with the leading world-class examples from other industries.



Roman Regelman

Head of Asset Servicing and Digital
BNY Mellon

Key components of a future-state operating model



Data-centric

- Strong control of data
- Transparency and traceable data lineage
- Synchronized data across providers
- Standards-driven interfaces
- Optimized for real time (e.g., IBOR)



Open architecture

- Standardized connectors for common services
- Rapid adoption of new solutions
- Technology that fits to workflows



Modular

- At-scale components, configurable integration
- Tighter integration with client workflow and change agenda
- Intelligent interfaces that increase STP (Straight Through Processing)
- Limit “blast radius” of provider change



Resilient

- Client-controlled, cloud-native delivery platform
- Retire redundant servers and systems to maximize uptime
- Robust cybersecurity and disaster recovery measures in place

Data Management:

THE DEMOCRATIZATION OF DATA

Data quality, consistency, availability and accessibility stand as the enduring challenges of data management. But today's business environment is heightening all of these for institutional investors as a result of the widely varied demands of agents, including compliance officers, accountants and risk managers, as well as the operational requirements of portfolio management and trade processing systems. New issues, such as rising data volumes and the need to manage alternatives and unstructured data sources, add to the challenge. The combined impact of such a complex web of demands makes the goal of a single source of truth as elusive as ever.

MAKING DATA MANAGEMENT A TOP PRIORITY

Institutional investors are demanding more timely, transparent and credible data for their investment decision cycles. We have found that many of our largest asset owner clients subscribe to multiple asset servicing and technology firms. This multi-provider model is useful for diversification of risk exposure, but creates challenges from a data aggregation perspective. The concept of creating a single data source, which standardizes and stores data from multiple providers to carry out instant, informed and intelligent activities, is gaining importance.

To help address those needs, our Data and Analytics Solutions business has expanded our leading capabilities in this area, providing data-driven, modular solutions that enable clients to simplify and modify their businesses, as well as serve their own clients more effectively. Data and Analytics Solutions offers access to an ecosystem of proprietary and third-party business applications to help firms manage their core investment process and beyond.

Four trends shaping the future of data management

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Democratized data empowering strategy and decision-making

As unstructured data becomes mainstream, non-traditional/ unstructured data will increasingly be combined with traditional data sources. And the easy availability of diverse, high-quality data will create the expectation that data will be the basis for all decision-making in financial institutions.

The foundation for reliance on this data will be the data quality metrics available to end-users, including details on its sources and veracity. Supporting APIs will include data payloads, metadata and data confidence indicators.

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Client journey reimaged with data-driven innovations

With access to broader datasets, end-users will expect extensible data platforms that are highly configurable to create differentiation.

Significant progress will be made in user friendliness, predicting next moves and minimizing options through constantly improving learning loops. Users will expect to be able to access and experiment with data without being beholden to technology, while still maintaining the required governance. Advances in physical and behavioral biometrics and cybersecurity technology will lead to the development of advanced predictive models, thereby enhancing user experience for end-clients.

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Faster growth for investment domains with open data ecosystems

Machine learning and other automated approaches to identify data, when enriched and combined with other data, will make it highly valuable in decision-making. This will lead to a dramatic increase in systems exchanging data in an automated fashion across industry participants.

The pace of innovation in data management applications will accelerate as data science labs proliferate and a culture of cooperation between AI communities spreads.

Institutional investors will expect continuous flows of enhancements and innovations that will be best served through open data ecosystems. Research systems will align with traditional mid- and back-office platforms to leverage new sources of insights.

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Formalized data usage frameworks giving access to broader datasets

Sharing data across geographical boundaries will heighten compliance considerations and hasten convergence with global standards. Existing frameworks in place for retail individuals will likely be extended to institutional users.

Institutions are expected to accept these more formal data usage frameworks in order to gain access to broader datasets.

Industry bodies and regulators are also likely to endorse these changes in an effort to further promote open financial systems.

Growing demand for data is one industry trend. Clients want better, faster and more granular operational data that can help them manage cost, control risk and market their product more efficiently.

As the dissemination of data becomes more immediate (not just daily but real-time), its relevance moves up the value chain from operations departments to risk, distribution and portfolio and treasury management functions.

Future-ready data management infrastructure will need two key attributes which are crucial to its completeness and effectiveness. They are to have a single source of truth and an open ecosystem.



Rohan Singh

Managing Director
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Emily Portney

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Alternative Investments:

COMING TO THE FOREFRONT

Alternatives have matured over the past 30 years, gaining greater attention and acceptance from both investors and regulators to become mainstream investments.

The alternatives industry had a record US\$9.5 trillion in assets under management (AUM) in December 2018 (US\$3.45 trillion in hedge funds; US\$6.05 trillion in private capital), with Preqin predicting this will rise to US\$14 trillion by 2023 as asset owners continue to diversify their portfolios to reduce volatility and seek new ways to increase returns.

AUM GROWTH OF ALTERNATIVE ASSETS GLOBALLY¹: PROJECTED INCREASE IN ASSETS

2017		2023	2017		2023
Natural Resources			Private Equity		
US\$0.2tn	+300% →	US\$0.8tn	US\$3.1tn	+58% →	US\$4.9tn
Private Debt			Real Estate		
US\$0.7tn	+100% →	US\$1.4tn	US\$0.8tn	+50% →	US\$1.2tn
Infrastructure			Hedge Funds		
US\$0.4tn	+150% →	US\$1.0tn	US\$3.6tn	+31% →	US\$4.7tn

Source: Preqin

SCOUTING THE ALTERNATIVES LANDSCAPE

Private capital dry powder stood at US\$2.11 trillion in December 2018, with a steadily increasing proportion of available capital focusing on Asia. The region accounted for 9% of total dry powder in 2006, and this doubled to 18% in 2018². Preqin noted that investors remain upbeat about the performance of alternatives, but are less optimistic about the future. High equity valuations and huge levels of dry powder suggest many investors worry that equity valuations are peaking, and that a market drop is imminent. While hedge funds can be disappointing to investors as an asset class, investors have also seen the possibility of these vehicles weathering volatile and potentially falling markets. Four trends will play out as the alternatives industry matures.

¹ Preqin: The Future of Alternatives' report, October 2018.

² Preqin blog -Alternatives in 2019: Private Capital Dry Powder Reaches US\$2 trillion

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Private equity set to dominate soon

Although fundraising has slowed, private equity returns remain appealing for institutional investors given the low yield environment. According to Preqin data, private equity will overtake hedge funds to become the largest alternative asset class by 2023, growing by 58% to US\$4.9 trillion AUM vs a forecast of US\$4.7 trillion for hedge funds.

Real estate, infrastructure and private debt remain compelling assets with strong returns. The application of AI, big data and ESG are likely to help meet investors' needs for transparency and increased granularity when reporting on investments. In addition, healthcare, fintech and AI are up-and-coming targets for venture capital.

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Real estate poised for successful digitization

The impact of digital assets will be seen across private markets, especially real estate, in the coming years. This shift is poised to fundamentally alter the better how capital is deployed, increasing transparency and liquidity, and bolstering risk management.

Digital innovation is beginning to address the needs of the property industry, with blockchain as one of the most talked about of the so-called 'proptech' technologies. The process of digitizing real estate assets through the creation and sale of tokens will provide real estate owners and developers with access to domestic and global markets that were previously unavailable due to barriers inherent in the traditional process of raising capital.

For example, tokenizing limited partner commitments to real-estate funds that can be traded on secondary markets, thereby accessing a broader base of liquidity options and opening up access to retail investors.

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Emerging Asia rising as a hot spot for alternatives

According to Ajay Narang, Head of Asia Sales at Preqin, China will emerge as a major source of alternative investment capital in the next five years, with Southeast Asia and China as key global investment targets.

Emerging Asia, which includes Southeast Asia, needs basic infrastructure, such as roads, bridges, hospitals and power plants.

Such assets have traditionally been funded by governments or multilateral organizations such as the Asian Development Bank. Although these funding sources remain important, they are no longer sufficient to meet the region's demands. This is where private capital can play a role in bridging the gap in public finances.

There has been a growing interest from US alternative managers to access the Chinese market and set up business in China.



Michael Bugel

Managing Director and Co-Head of APAC
Alternative Investment Management
Association

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Private credit heading for new levels of transparency

Investing in loans, whether they be widely syndicated leveraged loans or private debt, is a booming area of the investment landscape. Private debt assets were US\$768 billion as of the end of the 2018, having grown 223% over the previous decade, according to the Alternative Credit Council (ACC). As banks have reduced their lending activities, credit managers have stepped up to fulfill demand. Furthermore, institutional investors are increasing allocations to private credit, which has demonstrated a record of attractive returns and risk profiles. According to Cambridge Associates, private credit has delivered average annual returns of 8.75% during the past five years and 10.42% during the past 20 years.

Continued growth in this market will require managers to address regulatory requirements and investor demand for transparency. 82% of respondents to a recent ACC survey said transparency and reporting are one of the most important factors in achieving alignment of interests with their investors.

The ability to accurately measure positions using standardized, comprehensive analytics can help managers differentiate themselves in a competitive market. However, this will require managers to tackle issues related to timing, restructuring and loan-tracking systems that are not typically integrated with accounting systems.

With the right investment in tools and technology, either in-house or through the scale of an external service provider, credit managers can achieve the efficient, accurate and insightful performance and risk analytics that their front offices require and their investors expect.

As the drive for yields grows, alternatives present great opportunities for those that can harness the right data and expertise to navigate local nuances around the world.



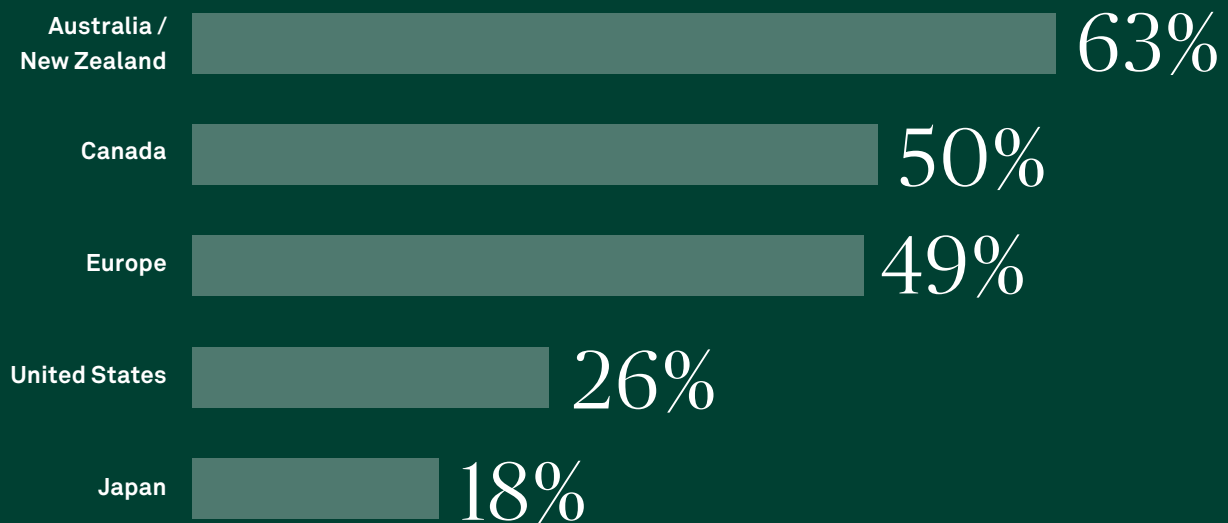
Alan Flanagan
Managing Director
Global Head of Alternatives
BNY Mellon

ESG Integration:

A SEISMIC SHIFT BEGINS

Sustainable investment is becoming mainstream around the world. According to the 2018 Global Sustainable Investment Review, total sustainable assets across five key markets – Japan, US, Europe, Canada and Australia/New Zealand – grew 34% in the two years to early 2018 to stand at US\$30.7 trillion.

RESPONSIBLE INVESTMENTS VS TOTAL MANAGED ASSETS (2018):



Source: Global Sustainable Investment Alliance, 'Global Sustainable Investment Review 2018'

ESG At a Glance

Australia

The Australian Sustainable Finance Initiative was launched in March 2019 to redefine the financial system with recommendations on climate change.

An Australian Council of Superannuation Investors May 2019 policy paper called on regulators, government and investors to strengthen investment stewardship and mandate ESG integration into investment decision-making.

The A\$48 billion Cbus super fund drew up a plan in September 2019 to reduce the carbon emissions of its property portfolio to zero by 2030.

Canada

Following Prime Minister Justin Trudeau's re-election in 2019, it is expected that the administration will fulfill its commitment to reducing greenhouse gas emissions to 30% below 2005 levels by 2030 and make progress in clean tech. If successful, these efforts would support the favorable trajectory for ESG, where responsible investment AUM grew by 42% over a two-year period ¹.

China

ICBC, the world's largest bank by assets, issued a US\$2.2 billion green bond in April 2019.

Ping An became the first Chinese asset owner to sign up to the UN Principles for Responsible Investment (UNPRI) in August 2019.

The China Securities Regulatory Commission will make ESG information disclosure mandatory for all listed companies by 2020.

Japan

76 local firms committed to the Taskforce on Climate-Related Financial Disclosure in April 2019.

The Government Pension Investment Fund currently allocates JPY 3.5 trillion across five ESG benchmarks, requires all asset managers to integrate ESG into their investment analysis, and plans to increase its range of sustainable indices beyond Japan.

Malaysia

Large asset owners, including the Employees' Provident Fund and Khazanah are signatories to UNPRI.

Netherlands

Known as a socially progressive nation, the Netherlands is well suited to adopting ESG investing. In 2018, more than 70 Dutch pension funds with combined assets of nearly €1.2 trillion signed a covenant with NGOs, trade unions and the Dutch government, pledging worldwide cooperation on sustainable investment in alignment with the United Nation's Guiding Principles for Businesses and Human Rights and OECD guidelines.

In one recent industry study, half of Dutch pension fund members accrue pension funds with rights that pursue an integrated sustainability policy.

South Korea

The National Pension Service announced in April 2019 that it would publish an annual report on its ESG practices.

In June 2019, the government issued its first green bonds, raising US\$500 million. Korea Electric Power Corporation also issued a US\$500 million green bond focused on renewable energy.

United States

A 2019 survey conducted by the CFA Society of New York showed that asset owners are committed to continued learning about ESG, with 42% planning to educate their supervisory boards on its importance and on sustainability issues; 39% said they were planning to integrate ESG more formally into their investment processes by updating existing policies or adopting new ones.

¹ Canadian Responsible Investment Trends Report 2018

Three emerging trends in ESG

The advantages of sustainable investment go beyond ESG benefits. Several academic studies have shown a strong correlation between ESG scoring models and financial performance. Listed companies that incorporate ESG principles into their governance have also been shown to have lower reputational risk and a reduced likelihood that they will lose their licenses to operate.

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Climate change transforming the investment industry

With carbon emissions on the rise since 2015, it is looking unlikely that the world will be able to hold the increase in the global average temperature to well below 2°C above pre-industrial levels, as set out in the Paris Agreement.

Heatwaves, flooding and drought will be considerably more severe at 2°C than at 1.5°C.

According to the BNY Mellon Investment Management 'Future 2024' report, 57% of the chief investment officers, portfolio managers and strategists surveyed viewed climate change as both a risk and opportunity, reflecting widespread uncertainty about how global warming might affect asset returns.

Institutional investors are increasingly integrating climate considerations into investment decisions to increase low carbon investments and screen out companies with high emissions and fossil fuel reserves. Forward-looking analysis of potential sources of risk and return can inform the strategic asset allocation decision-making process by calculating how exposed the institution's investments are to changes in global temperatures.

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Impact investing redefining the role of capital

According to Frances Barney, Head of Global Risk Solutions at BNY Mellon, in addition to regulatory requirements for greater disclosure, there is now tremendous energy behind the push for sustainability from institutional and individual investors alike. Through shareholder activism and sustainable investments, millennial investors in particular are scrutinizing their investments to understand what they own and how it impacts society.

Investors are demanding transparency on ESG issues and looking for additional investment options that may lead to positive ESG outcomes.

Some investors are pursuing impact investing as a way to drive innovation in alternative technologies that may reduce the environmental impact of more traditional solutions.

As millennials accumulate wealth, financial services firms should shift strategies and create values-based investment options and products.

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Material ESG factors driving positive financial returns

Some institutional investors have embraced the idea of “materiality” to determine which ESG concerns are relevant to particular investments.

For many years, investors have been concerned that ESG investing requires compromises on investment return objectives. In fact, there is some evidence to suggest that a focus on ESG investing does not require a reduction in investment return expectations. According to a recent study, which used the materiality framework of the Sustainability Accounting Standards Board, companies that address material ESG issues and ignore immaterial ones outperform those that address both material and immaterial issues by 4% and outperform companies that address neither by nearly 9%.

With global regulations gaining momentum, investors should adopt sound practices to determine materiality and evaluate managers. Institutional investors need to change their investment and capital allocation processes in the ways required for this kind of investing to take off.

Similarly, a number of studies have shown a positive relationship between integrating material ESG factors and financial performance, supporting the notion that managing ESG risk factors can be beneficial for long-term financial returns, risk reduction and identifying alpha across a range of asset classes.

Asset owners can no longer afford to view ESG integration as a value-oriented “nice-to-have” impact strategy. Regulatory shifts responding to government commitments to sustainability will materially impact market structures and valuations. There is a clear business case for the investment community to adjust portfolios to mitigate risks and identify the opportunities from the transition to a sustainable growth path.



Danae Kyriakopoulou

Chief Economist & Director, Research
OMFIF

Opportunities Untapped:

CHINA OPENS ITS DOORS

China's continuing liberalization of its capital markets is opening the door for buy-side investors in search of alpha. To build a presence in China, a trusted global partner is the key to finding the right path through the next phase of deregulation and to unlocking new investment opportunities.

GATEWAY TO CHINA

No investor can afford to ignore the world's second-largest equities and bonds market as China shifts into the global investment mainstream. The Chinese government has been gradually relaxing its capital market regulatory framework to ease access and promote capital mobility with the aim of increasing foreign participation. In recent years, China appears to have accelerated the pace in which it is pursuing a market liberalization agenda. This is an interesting development, and it remains to be seen how market reforms will play out to capture those impending flows. We see five trends that will emerge over the next five to 10 years.

KEY MARKET DEVELOPMENTS



* Phase 1 will add 25% of the investable market cap of eligible large, mid and small cap China A-Shares to FTSE Global Equity Index Series and derived indexes

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Foreign participation will increase

Undoubtedly, the liberalization of China's financial industry will create a more level playing field for foreign players. The foreign ownership cap will be lifted for asset management companies in April 2020, and for securities companies in December 2020. These moves will be important for China's integration into the global financial ecosystem.

The inclusion of China equities and bonds in global indices will bring an estimated foreign inflow of up to US\$400 billion in the next five to 10 years¹. The increased inflows will improve liquidity in the capital markets and boost foreign players' presence from 3% to 10% for China equities² and 2% to 15% for China bonds, according to some estimates³. Market reforms such as the introduction of true delivery vs. payment, the expansion of the settlement cycle for China A-Shares, and the alignment of holiday trading arrangements between the onshore market and the Stock Connect program will lead to an increase in foreign participation.



¹ HKEX Research Report on 7 June 2018; Bloomberg Barclays Index announcement released on 11 February 2019; Reuter news on 29 March 2019; Bloomberg announcement FTSE Country Classification Update and FAQ document on 26 September 2018

² Hong Kong Stock Exchange

³ Bond Connect Company Limited (BCCL)

⁴ International Monetary Fund

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Greater harmonization of access schemes

We expect the harmonization of access schemes will continue, alongside the further relaxation of regulations that allow foreign investors to invest in onshore securities.

Clear moves towards harmonization can be seen – the most obvious examples being the proposed merger of the QFII and RQFII schemes, the removal of the QFII and RQFII investment quotas, the easing of market entry rules and the liberalization of the FX market.

We expect the current access schemes to co-exist for the next few years, however, we feel there is a likelihood that onshore securities holdings will be fungible across various schemes. Already we are seeing this occurring: China bonds can now be transferred freely between the QFII, RQFII and CIBM direct schemes.

Additionally, we have seen an increased focus from market participants, collaborating to advocate for change to allow China bonds to serve as collateral within global transactions. Although a number of hurdles remain to be surmounted, clear progress has been made and will continue in 2020.

It is clear from all the proposed regulations issued by China in the past year that their road to market reform and opening continues, which may even be accelerated due to the US-China trade war.



Eugenie Shen

Managing Director

Head of Asset Management Group

ASIFMA

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Rising influence of the RMB

China's economic performance in recent decades has been exceptional. However, its growing economic clout on the international stage, where it is the world's largest trading nation¹, has not been matched by growth in the adoption of the RMB as a global payment currency. According to a SWIFT transactions report, the RMB accounted for a 1.46% share of global payments by value in 2017, putting it in seventh place internationally. Despite significant policy reforms by China's regulators, this position has not changed dramatically in the past two years. In October 2019, the RMB moved up one notch to sixth position at 1.65%².

As the world's second-largest economy, the gap between China's trading power and its currency share of world payments suggests there is huge potential for growth in the use of the RMB. China has been making rapid progress in internationalizing its currency, with trading in the onshore (CNY) market now available in Hong Kong through People's Bank of China-licensed FX settlement banks. This allows foreign investors to trade CNY without the need to open accounts in Hong Kong and remit the USD equivalent into China. We expect to see greater cross-border transactions and RMB advancements from its role as a trade settlement currency to an investment currency and potentially a reserve currency.

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Broadening the investor base

With the recent inclusion of China's securities in global indices, we have seen a greater diversity of investors with differing risk appetites increasing their allocations to China. Some of these include US and European pension funds, hedge funds, sovereign wealth funds and insurance companies. One of the benefits of broadening participation is that it is more likely to promote price discovery and make markets less susceptible to extreme volatility.

Although the opening up of China's capital markets presents burgeoning opportunities, existing market challenges and new policy reforms being introduced at a rapid pace are making it challenging for investors, especially those new to the market. New inflows will need trusted global partners to help navigate the next phase of China's deregulation. As global investors access the market, key factors to consider will be the choice of access schemes, FX optionality, ease of repatriation and counterparty risks.

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Expansion of investment scope

Global investors are calling for regulators to introduce hedging tools as they scale their portfolios in China and seek to manage more complex risks. China's regulators are heeding these calls and are expanding their investment scope in line with the government's plan to integrate China's capital markets with those of the rest of the world. New asset classes that will emerge in 2020 include:

- Shares traded on the National Equities Exchange and Quotations market (NEEQ, or the New Third Board)
- Futures
- Options
- Repo
- Margin trading
- Securities lending
- Private investment funds

While an expansion of asset classes is welcomed, immediate attention is needed regarding the ease of repatriation and the ability to efficiently trade in these instruments. For instance, clarity on hedging rules and legal agreements between global investors and FX counterparties can be improved. More reforms are necessary before we see growing demand for these new asset classes.

¹ World Integrated Trade Solution

² SWIFT RMB Tracker November 2019

Generally, foreign investors appreciate China's efforts to make its capital market more accessible, but some accessibility issues remain.

Among key upgrades, many investors would like to be given access to a listed futures market and other derivative products to enhance risk management as they scale their portfolios with higher inclusion ratios.



Zhen Wei

Executive Director and Head of China Research
MSCI

China A-Shares inclusion has important implications for investors, as many are currently under-weight in China equities.

Ultimately, however speedy China's growth, the main challenge for global investors will continue to be charting the right path into unfamiliar territory. Choosing the right investment services partner to link the global with the local can be the answer to finding an approach that works.



Magdalene Tay

Custody Product Manager, Asset Servicing, Asia Pacific
BNY Mellon

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