Fund Management in Hong Kong and Singapore

By Matthew Harrison[1], HKEx

Hong Kong and Singapore are close rivals within the Asia-Pacific region as fund management centres. Hong Kong is somewhat ahead in terms of business volume, although the lead is shrinking. The strategies of each centre are different, although there has been some convergence recently. Opportunities for Hong Kong appear greater, but improvements in policy are needed.

INTRODUCTION

Singapore and Hong Kong both claim to be major fund management centres in the Asia-Pacific region. Fund management is a geographically mobile activity; hence the two jurisdictions compete for business. Given the demographic and economic similarity between the two cities, it is interesting to compare their respective strategies and policies, and the degree of success each has achieved.

This article seeks to compare the two cities as fund management centres. An outline of the industry in the two centres is given. Based on available data from surveys, a quantitative comparison of the two centres is then made, putting them in the context of the fund management industry globally. The respective policy initiatives of the two centres are also compared on a more qualitative basis, utilising findings of interviews conducted with fund managers and related professionals in Hong Kong over the past year. Some potential policy improvement opportunities for Hong Kong are outlined in the final section.

What is fund management?

"Fund management is a loose term that is commonly applied to a wide range of activities. In this article, fund management is defined as the management of pooled monies on behalf of investors with the objective of providing the investors with a return from the securities acquired with this pool over the medium to long term in accordance with a pre-set strategy. Fund management so defined would include the activities of professional fund managers managing mutual funds, pension funds and portfolios for clients, and some private banking activity, but would exclude self-managed investment and the treasury operations of banks or corporations.

Factors that support fund managers aggregating in a centre like Hong Kong or Singapore include the quality of communications and supporting infrastructure, supporting business services such as brokerage and custody, availability of quality legal and accounting services, a reasonable regulatory environment, low tax rates and a clear tax regime, and the potential demand for their products from the individuals and businesses in the economy.

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Business model

The business models of the global fund management firms differ; some are independent, others are linked to insurance companies or investment banks. One example can be described as follows.

One international fund manager is a global firm which is also a major insurer. Its Hong Kong office is responsible for Asia ex-Japan; the Singapore office manages Asian fixed income and reports to Hong Kong. The Hong Kong office handles investment in its region of responsibility, ie a European-sourced Asian equity fund would be managed by Hong Kong and not, for example, by the London office. Global strategy (say 80% of the allocation) is determined by the firm's European headquarters, while tactics (say 20%) are decided by the Hong Kong office. For institutional clients, the fund manager will construct a portfolio; however, unless the mandate exceeds US$100 million, the portfolio will be constructed out of the firm's global fund family – ie as a fund of funds – rather than directly out of the underlying stocks. The firm used to run a stable of Cayman Island-incorporated funds out of the Hong Kong office, but to achieve better economies of scale, this fund family was merged into the firm's European fund family. The Hong Kong office thus does less management than before and focuses more on marketing and sales of the global product.

The firm has a global dealing system such that an order for an overseas stock entered in the Hong Kong office will be routed to the dealing desk of the respective local office for execution there. The Hong Kong office outsources much of its back office operation to a trustee bank, one of two major players in this segment in the Hong Kong market. The bank performs the following functions for the fund manager: accounting and valuation of portfolios, transfer agency services, banking and custody of securities.

The firm is watching the China market closely. It has insurance licences already, but hesitates to enter a joint venture with a Mainland fund management firm, preferring a wholly-owned operation.

NATURE OF FUND MANAGEMENT IN THE TWO CENTRES

Singapore

In accordance with its government-led economic philosophy, the Singaporean authorities have expressly targeted the development of the fund management as a key element of the financial sector. A range of incentives are provided by the government to encourage international fund managers to set up in island state. At the same time a large part of the sector can be said to be controlled by the Government in the sense that much of the funds under management are managed directly by the Central Provident Fund (CPF).

The CPF, a compulsory government-managed retirement savings scheme, was set up in 1955. Current contribution rates are very high – up to 20% of salary from the employee and 16% from the employer, subject to a cap. As at the end of September 2002, the CPF accumulated balances total S$95 billion (US$53 billion)[2], the majority of which is invested in Government bonds. Because of its size, the CPF absorbs much of the population's savings. However, in recent years CPF account holders have been permitted more flexibility in usage of their accounts. Drawdowns for major items such as house purchases are permitted, and CPF account holders may even invest a portion of their fund in stocks.

The fund management sector was identified as a key area for development in the national Development Plan for the Eighties. A range of incentives are offered to fund managers, including tax concessions, grants, and also allocations of CPF money. Following the Asian Financial Crisis, which hit Singapore's neighbours such as Indonesia particularly hard, the Singaporean authorities redoubled their efforts. In 1998, the CPF Authority announced that it would earmark S$35 billion (US$21 billion) as seed money to promote the development of the sector. A further round of policy recommendations were made in a report published in September 2002 (see below). These efforts appear to have met with some success, as many international fund management firms have set up offices in Singapore and do business there.

Hong Kong

In contrast with Singapore, the development of the fund management industry in Hong Kong may be characterised as largely market-driven. The Hong Kong Government has generally left the growth of the industry to market forces, and although it has subjected the industry to regulation, the government has not sought to deliberately promote the industry through its policy framework. The industry is dominated by international firms.

The fund management industry in Hong Kong began developing in the late 1960s to early 1970s when British merchant banks set up operations in the territory. They managed retirement funds for their own groups but offered unit trusts to the public as well. Initially, the main customers were expatriates, since local Chinese preferred to invest directly on their own account. In the 1970s US asset management companies entered the market, and in the 1980s the Japanese. Rising wealth levels led to demand for retirement funds in the 1980s, and in the 1990s, unit trust investing gradually became more popular among the general public. A Code on Unit Trusts was first introduced in 1978 under government administration. This was replaced by a Code on Unit Trusts and Mutual Funds in 1991 administered by the SFC, and was followed by further codes and regulations on various kinds of investment-linked products. Fund managers are licensed under the securities legislation as investment advisers. A Mandatory Provident Fund (MPF) scheme was introduced in 2000, obliging employers to establish provident funds for their staff.

The bulk of the fund management business in Hong Kong is done by international firms that have established offices in the territory. Locally-based fund managers have only a

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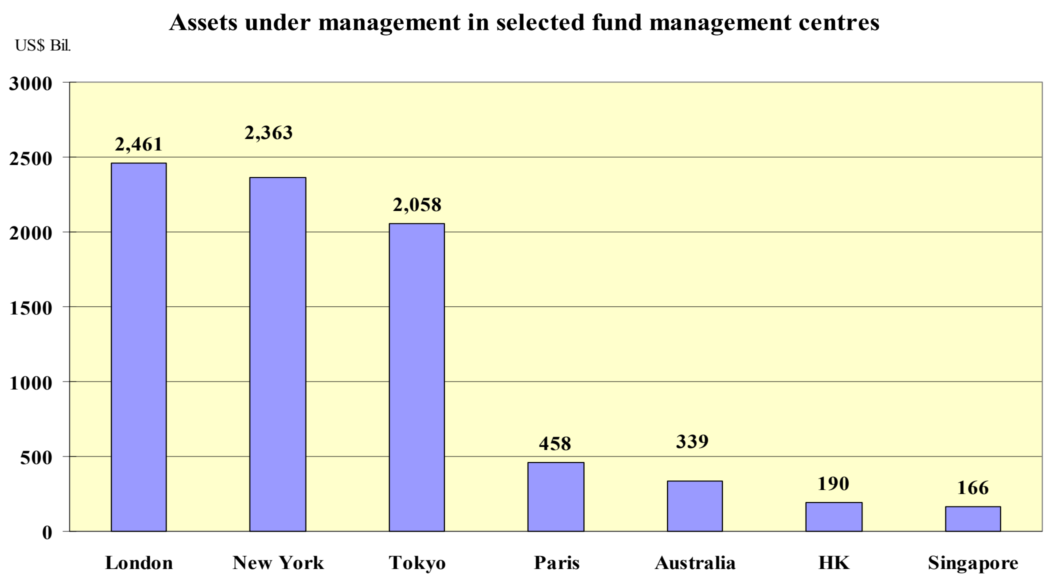
[2] September 2002, monetary values converted at HK$4.387=S$1, S$1.779 =US$1.

minor role. The Hong Kong Investment Funds Association, established in 1986, represents the interests of the sector. It now has close to 50 member firms.

QUANTITATIVE COMPARISON – SECTOR SIZE AND DEPTH

Before comparing the performance of the two fund management centres directly, it is useful to set both in the global context. Hong Kong and Singapore are international financial centres, but although rich (ie with high GDP per capita), they have small populations - of 7 and 4 million respectively - and a large part of their role is to manage offshore money on behalf of investors based overseas. They are perhaps to be regarded as subsidiary centres within the global fund management value chain. Nonetheless, the growth within the Asia-Pacific region, especially in Hong Kong's neighbour Mainland China, offers prospects to the industry located here.

In terms of assets under management, the two centres are of course very much smaller than the global leaders London and New York.

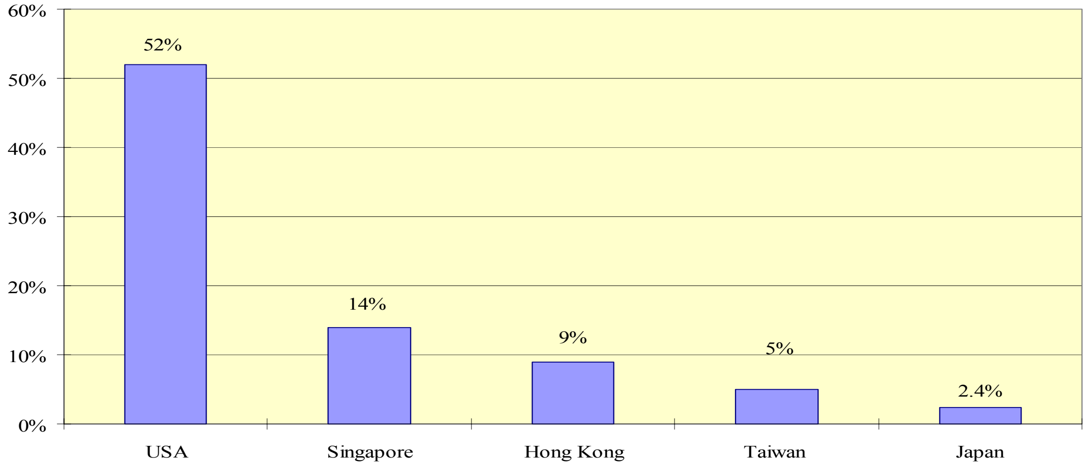


Note: Due to definition differences, the above figures are not strictly comparable.
Source: Hong Kong - Fund Management Activities Survey 2001, SFC;
Singapore – 2001 Survey of the Singapore Asset Management Industry;
Australia – Australian Bureau of Statistics;
London, New York, Tokyo, Paris – LSE website
(www.londonstockexchange.com/international/sld003.asp)

Although Tokyo and Australia are larger than either Hong Kong or Singapore they are generally not considered to be as significant in the international dimension. Tokyo is a very large centre for domestic fund management, but is not well-adapted as a centre for global management of funds. Therefore Hong Kong may be regarded as the leading international fund management centre in Asia, with Singapore a close second.

In terms of mutual fund penetration, Singapore is ahead of Hong Kong, although both are considerably lower than the US.

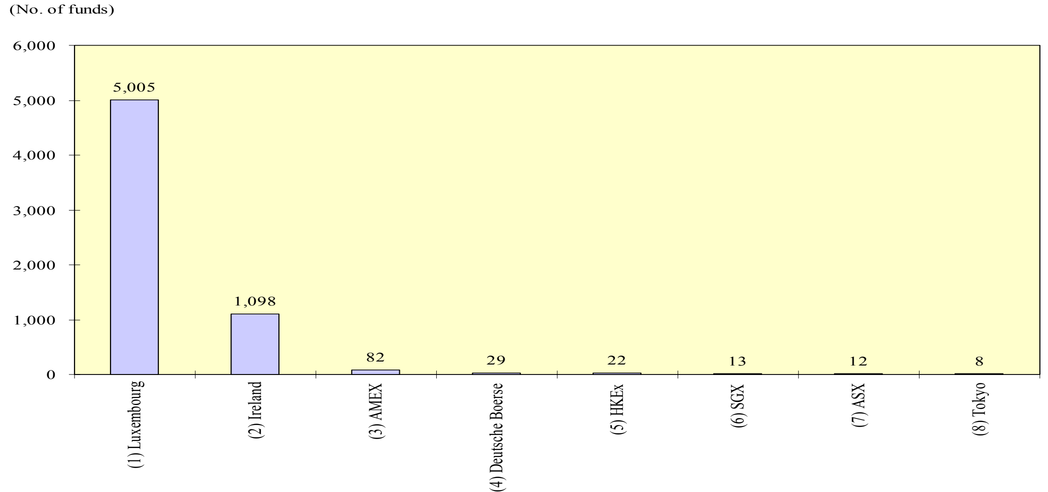
Penetration of mutual fund ownership in selected countries



Note: Due to definition differences, the above figures are not strictly comparable.
Source:
USA: ICI website - 2001 Profile of Mutual Fund Shareholders, Investment Company Institute http://www.ici.org/pdf/rpt_profile01.pdf
Singapore : CMG First State Investments website http://www.cmgfirststate.com.sg/news/2001112100.html
HK : HKEx Retail Investor Survey 2001
Taiwan : Fiance Asia website - http://www.financeasia.com/articles/BDAF788A-740C-11D4-8C110008C72B383C.cfm
Japan : JapanInc website http://www.japaninc.net/mag/comp/2001/08/aug01_invest_sawakami.html

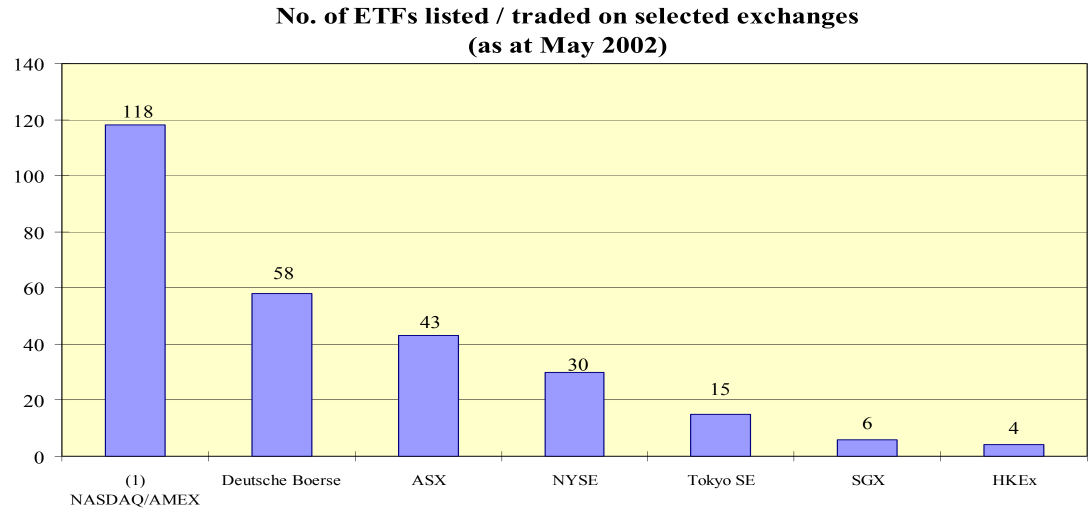
In terms of funds listed on global exchanges, neither Singapore nor Hong Kong are significant players.

No. of funds listed on selected global exchanges (2001)



(1) No. of undertakings for collective investment as at June 2001
(2) As at 9 October 2001, figures included 984 investment companies funds, 112 unit trusts & 2 limited partnership funds.
(3) Included 30 broad-based index ETFs, 29 sector index ETFs & 23 international index ETFs.
(4) Included 18 index funds and 11 actively managed funds currently traded in the XTF segment of Deutsche Boerse.
(5) Included 2 ETFs (excluding 2 iShares) (Dec 2001).
(6) Included 5 ETFs and iShares but excluded investment limted companies (Dec 2001).
(7) Included 2 classical ETFs, 6 hybrid ETFs and 4 world link ETFs currently traded in the ETF segment of ASX (2001).
(8) Included 2 Real Estate Investment Trusts & 6 ETFs. (2001)
Note: Due to different definitions, the figures may not be strictly comparable.
Source: Exchanges' respective website & email enquiry.

In terms of numbers of exchange-traded funds (ETFs) listed, Singapore is ahead, thanks to its alliance with the American Stock Exchange, although trading volumes in HKEx's Tracker Fund have been greater.



(1) Includes AMEX ETFs
Source: Websites of respective exchanges

On a stand-alone basis, the two centres can be compared on an indicative basis as in the table below. It should be noted that the bases for the statistics presented below differ. For example, Singapore's figure for assets under management (AUM) includes the assets of private banks, whereas Hong Kong's may not. Singapore calculates discretionary AUM, while Hong Kong does not; Hong Kong distinguishes between AUM managed in the territory and managed outside, whereas Singapore does not.

Statistics on fund management in Singapore and Hong Kong (2001)

	Hong Kong [(1)]	**Singapore**[(2)]
	US$bn	US$bn
Assets under management (AUM)	190	166
Change in AUM from 2000	-1.2%	11%
Managed in territory	86	n.a.
Discretionary AUM	n.a.	97
AUM attributable to overseas investors (% of total)	131 (69%)	n.a.
Discretionary AUM attributable to overseas investors (% of total discretionary)	n.a.	69 (71%)
AUM invested overseas (% of total)	152 (80%)	n.a.
Discretionary AUM invested overseas (% of total discretionary)	n.a.	79 (81%)
Assets under advice	18	n.a.
Number of regional headquarters	34	n.a.
Number of authorised funds	1,870 [(3)]	319 [(4)]
Number of companies providing fund management or advisory services	172	159

n.a. Not availaible
(1) Fund Management Activities Survey 2001, SFC (monetary values converted at HK$7.8 = US$1)
(2) 2001 Survey of the Singapore Asset Management Industry, MAS (monetary values converted at S$1.847=US$1)
(3) SFC website *31 March 2001*
(4) MAS website *31 December 2001*

The statistics show that Hong Kong is somewhat the bigger centre in terms of AUM, with US$190 billion in 2001 (probably stated on a more conservative basis), 14% more than Singapore's US$166 billion. However, the trend has been one of steady growth in Singapore – from AUM of S$37 billion in 1992 to S$307 billion in 2001. Although statistics are available for Hong Kong only since 1999, and may not be wholly comparable between years because of refinements in the classification process, there appears to have been a sharp decline in AUM from HK$3,492 billion in 1999 to HK$1,468 billion in 2001. It appears that the decline relates mainly to the restructuring of one very large firm and to general falls in asset prices; nonetheless it is a concern.

In terms of managing funds from overseas investors, and investing funds overseas, both centres appear to have comparable performances. Both can claim to be international fund management centres. As regards the source countries (ie location of investors), no information is available for Hong Kong, but for Singapore in 2001 more than half of the 71 percentage points coming from overseas is from Europe (25 percentage points) and North America (14 percentage points); rest of Asia contributes 12 percentage points and other countries 20 percentage points. As regards the destination of overseas investment, again no information is available for Hong Kong, but for Singapore the bulk of the 81 percentage points of AUM invested overseas is in Asia: 9 percentage points in Japan and 48 percentage points in rest of Asia; Europe and North America attract 9 percentage points each and others 6 percentage points. Thus, although the Singapore fund management industry is well-diversified, its major theme is acting as a conduit for investment flows from Europe and North America to Asia.

QUALITATIVE COMPARISON – DEVELOPMENT STRATEGIES

Singapore

As stated above, the two centres have different strategies. In Singapore, the authorities have deliberately targeted the development of the fund management industry, and have tried to stimulate its growth with a range of incentives. The Singaporean approach is a structured one; plans are developed and policies revised in the light of experience. Another characteristic of the Singaporean approach has been to deliberately foster offshore activity while restricting foreign firms from access to the domestic market. Thus, for many years, the Singapore International Monetary Exchange (SIMEX, now part of Singapore Exchange) traded only overseas derivatives contracts and foreign brokers were not permitted general access to domestic market. However, following the Asian Financial Crisis, the authorities reviewed this policy and have opened the domestic financial sector to foreign firms.

Current incentives for fund managers in Singapore include the following:

- Concessionary profits tax rate of 10% on earnings from offshore fund management;
- Tax holiday, say for two years from establishment of the firm in Singapore;
- Development grants for establishment of an office in Singapore;
- 50% subsidy for staff salaries;

- 70% subsidy for overseas training of staff;
- Mandates to manage the very large investment pools controlled by Government-related bodies such as the Central Provident Fund.

It should also be understood that the Singapore strategy is a proactive one. Foreign fund managers, ie those based overseas, are actively solicited to set up offices in Singapore. The authorities also recognize the value of innovation and are keen to get the leading edge firms to set up in Singapore. In accordance with this policy, Singapore has been welcoming to hedge funds, and has granted them mandates of government money to encourage them to set up in Singapore. At the recent Hedge Funds World Singapore 2002 conference, the keynote address was given by a representative of the Monetary Authority of Singapore (MAS)[3].

In September 2002, the Financial Services Working Group of the Economic Review Committee established by the Singapore Government the previous year published a paper of recommendations for policy improvement: *Positioning Singapore as a Pre-eminent Financial Centre in Asia*. The participants of the working group included representatives of the financial sector, including fund management firms; and various focus groups were established under its umbrella. The report identified four strategic thrusts for Singapore's financial sector: developing Singapore as (1) a regional leader in wealth management, (2) a regional/global processing centre, (3) the Asia-Pacific risk management centre, (4) an attractive business environment. The recommendations were perhaps not especially penetrating or original, and it seems that this is partly because it was felt that the financial sector had recently undergone a major policy change (including the opening of the domestic market to foreign competition as mentioned above). Nonetheless, the key measures relating to fund management were quite comprehensive.

1. **Expanding the government's role in developing the asset management industry**, by action steps (1) developing start ups and small and medium sized fund management firms; (2) extending fund management mandates granted by the Government of Singapore Investment Corporation (GIC) and the MAS; (3) providing funds to attract private equity players.
2. **Boosting competitiveness as pre-eminent asset management centre**, by (1) improving tax treatment, (2) reviewing CPF structure; (3) improving investor education; (4) improving professional training.
3. **Increasing focus on developing alternative assets** (ie hedge funds) cluster, by (1) raising developmental focus and regulatory responsiveness; (2) establishing the limited partnership structure (ie for an investment vehicle, as in the US) in Singapore; (3) reforming the Trustees Act; (4) streamlining tax incentives for private equity into a single package; (5) increasing tax certainty for private equity; (6) establishing a favourable tax environment for alternative investments; (7) upgrading professional skills in private equity; (8) using private equity as an option to help Government-Linked Companies (GLCs) to spin-off non-core assets.

[3] *A Decade of Controversy and Growth*, Yeo Lian Sim, MAS, 19 September 2002.

4. **Developing ancillary services** by (1) developing trustee and custody services; (2) developing specialized legal, custody and other ancillary services.

It may be said that the above constitutes a national development strategy for the fund management sector, building on existing strengths, addressing weaknesses, prioritizing likely market niches, taking account of related (cluster) activities and supporting factors and leading edge global developments.

Hong Kong

Hong Kong adopts a more laissez-faire approach, hence its strategy tends to be implicit rather than articulated in government planning documents. The success of the sector generally relies upon the efforts of the firms rather than on government sponsorship. In Hong Kong, the contribution of government is generally to maintain investor confidence through regulation of the sector and its products, and generally to provide an environment friendly to fund management business, including a sound legal system, low tax regime, good physical and telecommunications infrastructure and a skilled workforce.

Nonetheless, the role of government and the regulator has become more significant for the Hong Kong fund management industry in recent years.

- One example is the launch of **Hong Kong's MPF** on 1st December 2000, which had as one of its expressed aims the support of the fund management sector. Previously it was left to companies to decide whether to establish retirement funds or not; now retirement funds are mandatory. However, in Hong Kong the funds are managed by the private sector whereas in Singapore the CPF is largely managed by the Government.
- Another example is in the **attitude of the authorities to hedge fund**s. This was quite negative following the Asian Financial Crisis, with allegations that hedge funds engaged in a "double play" involving the stock and futures markets; restrictions were imposed on short selling and derivatives trading as part of the Thirty Measures introduced in September 1998. However, hedge funds continued to operate in the territory, and in November 2002 hedge funds began to be authorized for sale to retail investors.
- A third example is the growing importance of the Hong Kong Monetary Authority **(HKMA) as a source of mandates for fund management**. The HKMA allocates some 30% of its assets, or around US$37 billion, to 37 professional fund management firms based in ten major financial centres[4]. It appears that most of this money is managed outside the territory. However, recently the HKMA has acknowledged its role in fostering the local fund management industry[5].

The Financial Secretary launched a Financial Market Development Task Force in late 2001, which established a Working Group on fund management. It appears that the Working

4 HKMA Annual Report 2001, page 69.

5 *Exchange Fund roles revealed*, SCMP 8 November 2002.

Group has been looking at various issues including a review of Hong Kong company law in relation to estate planning, a "passport" system for Hong Kong-registered funds to be distributed within the region, ways to develop Hong Kong into a fund administration and servicing centre for the region, and taxation issues. At time of writing no report has been issued.

Based on interviews with Hong Kong-based fund managers and related professionals, potential improvements in the Hong Kong policy framework for fund management include the following.

- **Taxation of offshore funds**. Funds authorized by the SFC are exempt from profits tax, however the position of unauthorized funds is uncertain. Recently the Hong Kong Inland Revenue Department has been issuing enquiry letters and tax demand notes to managers of unauthorized funds. The industry practitioners expect a clarification of the position, ideally by granting unauthorized funds exemption from tax. Otherwise, there might be significant negative impact on the industry.
- **An enhanced fund listing regime**. The number of funds listed on HKEx has declined from 60 in 1990 to 11 as at the end of November 2002, notwithstanding the concurrent expansion of the fund industry in Hong Kong. Many funds originated in Hong Kong are listed overseas, eg in Dublin. A review is needed of how to attract more funds to list in Hong Kong.
- **Relaxation of the restrictions on short selling and derivatives trading** (some relaxation is in progress currently).
- **Further streamlining of regulation.** At present there are four regulators involved in the MPF segment alone – the MPF Authority, the SFC, the Insurance Commission, and the HKMA. Streamlining would help the industry.
- **Development of a Hong Kong domicile for mutual funds**. Only 5% of the funds authorized by the SFC at the end of 2001, holding 2.1% of the assets, were incorporated in Hong Kong; thus a part of the fund management value chain goes to offshore jurisdictions such as Luxembourg. Consideration could be given to creating a special section of the Companies Ordinance for mutual funds, perhaps along the lines of Part XIII of Dublin's Companies Act 1990, which envisages variable capital investment companies.

In addition, more effort could be directed at promotion of Hong Kong as a base for fund management and the solicitation of fund managers.

CONCLUSION

The comparison of Singapore and Hong Kong, based on available data, shows that by most measures Hong Kong is the larger fund management centre. Current developments such as the MPF scheme and the opening of the China market hold out the prospect of further growth for Hong Kong. However, the statistics, although imperfect, indicate that while the industry in Singapore has been growing steadily over the years, the industry in Hong Kong has actually been shrinking. Although overall Hong Kong remains an attractive business environment for fund managers, more could be done in areas such as taxation. More attention may need to be given to these issues to assure a prosperous future for the Hong Kong fund management industry.

APPENDIX

Summary comparison of the fund management industry in Hong Kong and Singapore

	Hong Kong	Singapore
1. Assets under management (AUM)	US$190 bn (2001)	US$166 bn (2001)
2. Mutual fund penetration	9% (2001)	14% (2001)
3. No. of listed funds	21 (2001)	13 (2001)
4. No. of listed ETFs (including iShares)	4 (May 2002)	6 (May 2002)
5. Major source of investors (Discretionary AUM)	n.a.	29% Domestic 25% Europe 14% North America 12% Rest of Asia (2001)
6. Major investment (Discretionary AUM)	n.a.	19% Domestic 48% Rest of Asia (excl. Japan) 9% Japan 9% Europe 9% North America (2001)
7. Government attitude	Laissez-faire, recently with an increasing government role	Pro-active
8. Policy approach	Basic infrastructural support — low tax regime, sound legal system and other infrastructure	• Structural plans • Initial emphasis on offshore activity, domestic market more open recently
9. Attitude towards hedge funds	Cautious but more open recently	Welcoming and encouraging
10. Incentives	No direct incentives	• Tax concessions and holidays • Development grants • Subsidies for staff salary and training • Mandates in CPF and other government funds
11. Government development strategies	• Mandatory Provident Funds • Relax restrictions on hedge funds	• Expand government's role in fund management firm set up and government mandates • More incentives and encouragement measures • Develop hedge funds and ancillary services