



INVESTMENT MANAGEMENT & FUNDS

China's fund management joint ventures: The growing flow of wealth

FINANCIAL SERVICES



Introduction

Fund management has been one of the most accessible sectors for foreign financial institutions since the first Sino-foreign joint ventures were approved in 2002. The market has developed considerably in recent years and continues to show encouraging prospects.

China's regulators have shown they are open to innovative ideas and new products. This is especially welcome news for foreign players and potential new entrants.

There are inevitably challenges involved in doing business in China. For fund management joint ventures these include setting the right terms, improving the efficiency of distribution channels and providing better education for retail investors.

This joint KPMG/Reuters report considers all of these challenges and also provides analysis of the comparative size and performance of the different segments of the fund management industry.

I would like to offer my thanks to Reuters for their work in researching and drafting this excellent paper. This is our sixth collaborative report on Financial Services in China and Hong Kong SAR since late 2005 and our second of 2007.

Bonn Liu

Partner, Financial Services
KPMG in China and Hong Kong SAR



China's long-term political, economic, social, even environmental need is to free the world's fastest growing, major savings pool from a limited set of choices. The choices create uncompetitive behaviour in internal capital markets and force speculative walls of money into narrow investment targets. Releasing China's savings will almost certainly create new paradigms of investment behaviour and direction outside its borders, as well as within.

This historically important process has started. But there are immediate dangers for the unwary and new pitfalls will emerge. Reuters Senior Asia Funds Correspondent Jeffrey Hodgson and Bonn Liu, Financial Services partner for KPMG in China and Hong Kong SAR, have interviewed 15 fund management executives to give us in this professional report the important insights which can mean the difference between success and failure for those companies entering the sector, as well as those already in it.

I am also very pleased to thank our Shanghai-based colleague Zhou Liang, from Reuters global fund information company Lipper, for key data to illustrate the trends and possibilities.

Once more, I am pleased and confident to recommend this study to you.

Eric Hall

Editor for North Asia
Reuters

A market of extremes



This report from KPMG and Reuters surveys the lessons learnt by the foreign fund management joint ventures that have set up in China over the past four years.

Authorities granted approvals for the first batch of joint ventures in late 2002. Since then, approximately 30 joint ventures and foreign-invested companies have been established or are in progress, with at least 20 of these having launched two or more retail products.

China's fund industry has seen explosive change over this time, with assets under management rising more than sevenfold. In 2006 alone, assets rose by more than 80 percent, driven by impressive product launches and a 130 percent rise in the Shanghai Composite index.¹

The foreign-invested fund managers have gained a rapid presence in the China market. By late 2006 these companies had captured 39 percent of the market in an industry with some RMB 856 billion (USD 111 billion) in assets under management.²

More importantly, many of these ventures, even in the mid-sized tier, are profitable, according to executives interviewed by Reuters and KPMG. Fee margins are healthy by global standards, with many companies earning more than 100 basis points on their assets under management.

Success for foreign-linked fund managers in China has, however, been uneven. Executives describe the market as one of numerous challenges, including fierce competition from domestic managers, lack of investor education, limited distribution channels and a shortage of fund industry talent.

In addition, markets are volatile. After rising more than 130 percent over the course of 2006, Shanghai stocks hit a record high on 27 February 2007, then fell nearly 9 percent. That one-day sell off – the biggest in a decade – triggered sharp falls in other equity markets around the world.

Topping the list of challenges is the question of control in a structure where foreign partners are limited to a 49 percent holding. Many industry veterans consider the relationship between controlling parties the single most important factor in the success or failure of a joint venture.

In preparing this report, KPMG and Reuters spoke to 15 fund management executives based in Hong Kong, Singapore and mainland China. These interviews have been supplemented by extensive desktop research. The report does not disclose information specific to any company gained during the interview process, unless approval has been granted.

¹ China Investment Management Market Update, Z-Ben Advisors Ltd. February 5, 2007

² *ibid*

A market of massive potential



Prior to the approval of the first joint ventures in 2002, there had been no foreign participation in China's fund management industry. The country's first investment fund was launched in 1991, but national rules governing funds were not introduced until 1997. The first authorised fund managers were established the following year.³

Foreign ownership of a joint venture was initially capped at 33 percent and this was later relaxed to 49 percent. In 2006 it went a step further. Ventures where the foreign partner was the largest single shareholder were approved, giving international fund management companies their greatest control yet.

For early entrants, these conditions seemed like a worthwhile trade-off. For a small investment relative to their global operations, the joint venture structure gave them the opportunity to achieve first mover advantage and gain industry knowledge in a market with vast potential.

Already the world's fourth-largest economy, China's growth rate topped 10 percent last year and is forecast to remain strong. Its 1.3 billion people have stored away more than USD 2 trillion of personal savings into low-yielding bank accounts that the fund industry hopes can be put to better use in professionally managed investment products.

China is likely to become the fastest growing fund market in the world, with assets under management estimated to reach USD 1.4 trillion by 2016, according to a McKinsey study.⁴ The firm forecasts a compound annual growth rate of 25 percent, leading to up to USD 3 billion in annual profits for the industry by 2016.

The country's National Social Security Fund (NSSF), which was valued at USD 42 billion at the end of 2006, is also expected to be a significant long-term source of assets, helping reduce the reliance on retail investors.

³ Fund management in China, Dr. Tiger Tong, China Knowledge Press (2005)

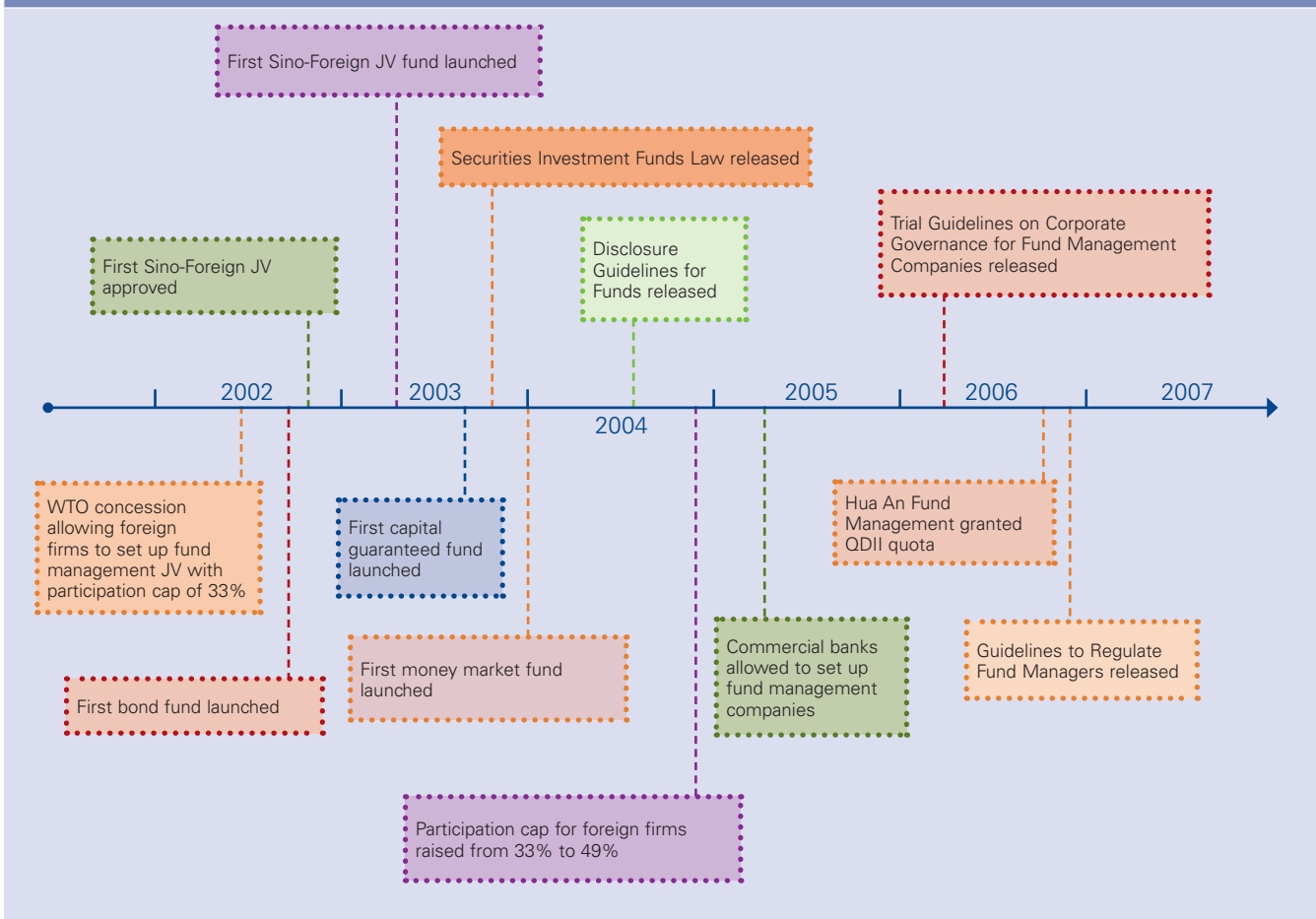
⁴ McKinsey China Asset Management Study, March 2007.

Fund executives advise that a very positive development on the diversification front could happen as early as 2007. Chinese regulators are said to be working on changes that would allow for segregated account management for institutional investors.

Currently, assets from institutional and retail investors are pooled into the same products, for the same fees. New rules would allow institutional investors to negotiate individual, specially tailored mandates, likely for much lower fees.

While some executives are wary about the impact this could have on their bottom line, others believe it is a positive development that would bring China in line with other major markets. Lower fees for mandates could be offset by the higher inflow of institutional assets, assets that are likely to be invested for years, rather than months, as often happens with retail funds.

Timeline, 2002-2007



A market of challenges



Executives with the joint ventures and foreign-invested fund companies are naturally excited about the huge potential of the Chinese market. But their early experiences have also taught them some hard lessons about the reality of the marketplace. Some of these challenges are faced by fund houses globally, but many are unique to China's still young industry.

Local competition and investment performance

With decades of experience and access to the finest research tools and information technology, foreign-invested fund companies should have a strategic advantage when facing local players. However, this is not necessarily the case.

Seven of the country's eight largest fund managers are domestic players, the exception being China's largest fund house, Harvest Fund Management (see page 8: Industry market share). It was already China's fifth-largest mutual fund manager when Deutsche Bank bought a 19.5 percent stake in 2005.

Executives say this dominance is partly due to the several years' head start the domestic managers have had. But there is another factor at play. China is a market where short-term performance is a key driver of flows. Domestic players have frequently demonstrated an ability to turn their knowledge of local markets into high returns.

One executive with a domestic fund company commented that, "when it comes to investment, it's always a local game". This may be true around the world, but it is especially so in China's developing market.

This is confirmed by data from Lipper, which showed that over a two-year period to 31 July 2006, managers of funds, both international and domestic, achieved what every stock picker dreams of – consistently beating the average returns of the markets they invest in.⁵

⁵ "ANALYSIS-Fledgling China QFII funds beat market," Reuters News, 7 September 2006

Analysts say the results are not surprising in a market where retail investors are inexperienced and the quality of stocks, and accompanying corporate information, is mixed.

Skilled fund managers thrive in markets with such inefficiencies, producing "alpha", or returns above those of the underlying market. Beating the broader market is critical for active managers, because investors would otherwise be better off investing passively through low-cost indices or tracker funds.

In addition, Chinese sell-side stock coverage "is less extensive than that in the developed markets," according to a Goldman Sachs report released last year.⁶ The investment bank concluded that this created more opportunities to out-perform the market. Indeed, some fund managers questioned the value and credibility of brokerage research, indicating that they preferred to do this themselves.

This may be partly due to the fact that Chinese fund houses have traditionally had in-house analyst teams and poached top analysts from the sell side, a model that foreign fund managers moving into China are now mimicking.⁷

Given all this, international players have sometimes found themselves at a disadvantage compared to local players when it comes to having an in-depth and detailed knowledge of Chinese stocks.

Executives from both local and foreign-invested companies say joint ventures have sometimes stumbled by importing investment strategies which may have succeeded elsewhere, but are unsuccessful in China.

But joint venture executives are quick to point out another important aspect – the approach to risk. Foreign-invested fund companies say they are trying to implement best international practices when it comes to risk management, using modern portfolio theory to build optimal portfolios by measuring the relationship between risk and return, as well as avoiding more basic risks like portfolio concentration.

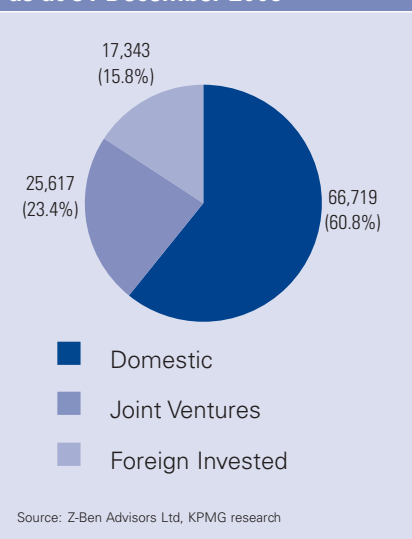
Most Chinese retail investors remain unfamiliar with the notion of risk-adjusted returns. The concept has not necessarily been eagerly embraced by many of the domestic fund managers. This means some are more willing than foreign-invested counterparts to take on liquidity, concentration and other risks in their portfolios to achieve these gains. Executives with the foreign-invested fund companies believe that as China's fund industry matures, investors will develop a greater appreciation for their more risk-focused approach, which they believe will produce superior returns over the long-term.

Lack of investor education

According to fund executives, the beloved Western notion of "buy and hold" has made limited inroads in China, as retail investors often make less distinction between their approach to fund products and individual stocks.

It has been widely reported that many large mutual fund launches have been followed by significant redemptions just months later. Some executives recalled cases where distributors had drawn on their relationships with

Market segmentation, assets under management (USD million), as at 31 December 2006



⁶ "China A-Share Strategy: A new paradigm," 1 November, 2006

⁷ "ANALYSIS-Funds roll up sleeves for China stock research," Reuters News, 14 December, 2006

investors to solicit subscriptions. Some investors would do so to maintain the relationship, but then remove their money shortly thereafter.

In many cases, however, local investors have redeemed well-performing funds because they believed it was time to lock in their profit, just as many traders do with a stock.

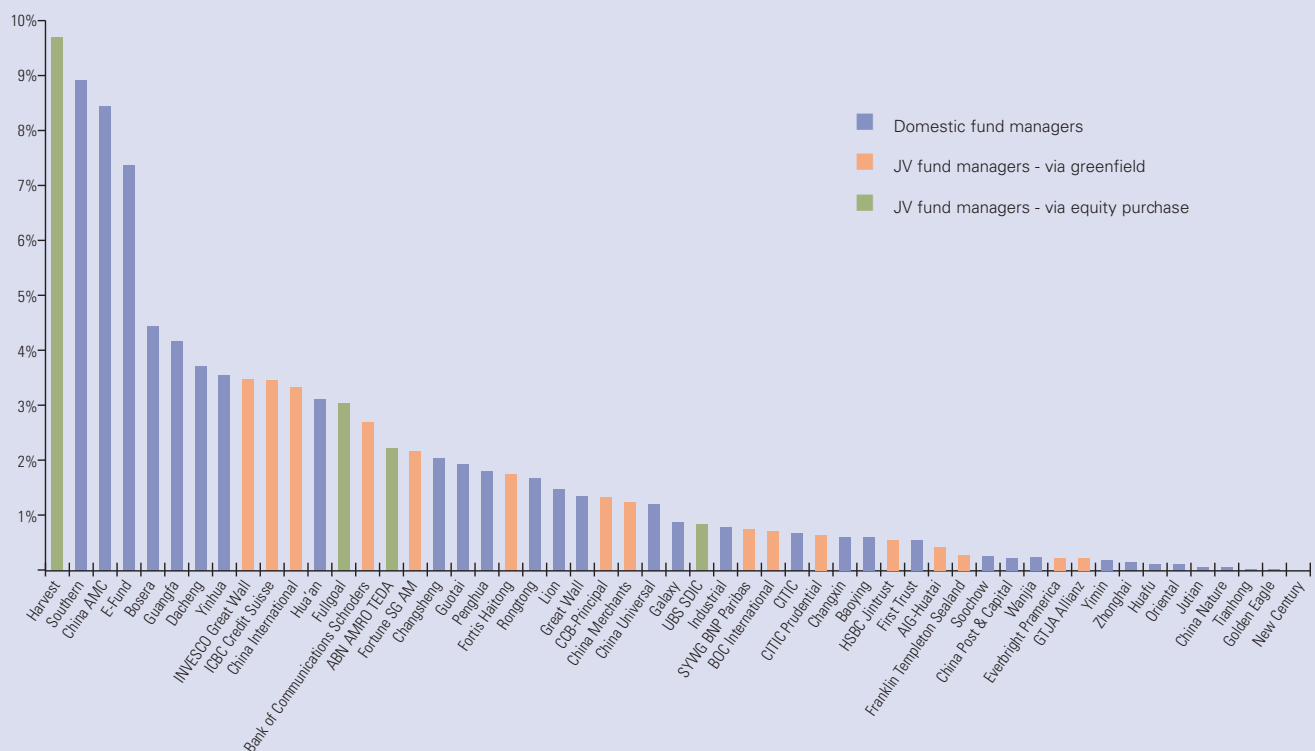
Perhaps most frustrating or surprising to international fund executives has been the belief among many retail investors that as the net asset value of a fund rises from its initial price of one yuan it becomes expensive. Investors then sell these successful funds to buy funds with a lower net asset value, which they view as cheaper.

This disregards the fundamental valuation of the fund's investments, the skills of its manager, the outlook for the sector it invests in, or losses due to transaction costs.

Some domestic and foreign-invested fund companies have responded to this market reality by paying out dividends, that represent much of the fund's capital appreciation, in the hope that investors will continue to view them as "cheap" and reinvest the money. This process is costly and increases the difficulty for the investment team managing the portfolio. Other fund managers have chosen to do the equivalent of a stock split with their fund units, again to increase the perception they still represent good value.

The phenomenon of paying out sizable dividends has actually helped fuel the "IPO mentality", in that investors often used their dividends to invest in new products rather than reinvesting into existing funds. Several joint venture executives said it would be cheaper, easier and more logical to put greater onus on secondary offerings of

Industry market share as at 31 December 2006



Source: Z-Ben Advisors Ltd.

existing funds, but that they are under pressure from both distributors and the investing public to continually deliver new products.

Distribution

Distribution is a challenge in the sense that there is significant reliance on China's largest banks, including Industrial & Commercial Bank of China, Bank of China, China Construction Bank, Agricultural Bank of China and Bank of Communications. Together they have tens of thousands of branches across the country.

With a strong hold on the distribution network, the big banks have formidable negotiating power. Some fund executives described situations where banks, rather than the fund managers,

seemed to hold the most sway over deciding which products get to market.

Typically, the bank named as the fund's custodian will lead the distribution. Custodian fees on funds stand at an average 25 basis points, a high figure by global standards. Banks are also the largest distributors, with the bank branch channel accounting for 54 percent of assets raised through fund launches last year, compared with 22 percent raised through securities branches and 24 percent through direct sales.⁸

Fund executives say the complexity of the logistics involved in selling funds through tens of thousands of bank branches is daunting.

That said, they also note the benefits they can derive from the incredible



Summary of custodian banks as at 31 December 2006

Custodian Bank	Number of funds	Assets under management (AUM) RMB billion	Market Share (%)
Industrial & Commercial Bank of China	73	268.4	31.34
China Construction Bank	57	192.4	22.46
Bank of China	51	158.7	18.53
Agricultural Bank of China	51	128.4	15.00
Bank of Communications	39	59.8	6.98
China Merchants Bank	14	21.0	2.45
China Everbright Bank	10	9.9	1.15
Industrial Bank	6	6.4	0.75
Shanghai Pudong Development Bank	7	3.9	0.45
Huaxia Bank	5	3.1	0.36
China CITIC Bank	2	2.5	0.29
China Minsheng Banking Corp.	6	2.0	0.24
Total	321	856.5	100

Source: China Securities Journal, 8 Jan 2007

⁸ McKinsey China Asset Management Study, March 2007

reach of the banks. This was highlighted in December 2006, when Harvest Fund Management raised a record RMB 40 billion (USD 5.11 billion) in just one day.⁹

Industry watchers also note that despite only having launched in late 2005, ICBC Credit Suisse Asset Management quickly became the third largest foreign-invested fund management entity after selling its products through ICBC's branch network, the largest in China.

Executives comment that as the market matures, alternative channels are likely to develop, similar to how they have in many Western markets. These could include independent financial advisors, direct sales through in-house agents and even the internet.

However they stress that this change will take many years, and until then, foreign-linked and domestic companies alike will have to accept and adapt to the reality of bank-led distribution.

Regulation

For both domestic and foreign-invested fund houses, most of the challenges in dealing with the regulator centre on the approval of new products.

Executives say approvals are getting longer due to the backlog created by the growing number of fund companies looking to launch products. This is of the greatest concern to start up joint ventures, which have yet to launch a product.

This suggests there has been some "first mover" advantage for the

Overview of fund products in China as at 31 December 2006

	Number of funds	Assets under management (AUM) RMB billion	Market Share (%)
Open-end funds			
Equity fund – Stock	100	335.8	39.2
Equity fund – Index	16	27.9	3.3
Hybrid fund – Equity focus	41	130.3	15.2
Hybrid fund – Balanced	20	79.0	9.2
Hybrid fund – Bond focus	8	5.4	0.6
Bond fund – Bond	18	12.1	1.4
Bond fund – Short to medium term	8	5.9	0.7
Other fund – Capital guaranteed	6	13.0	1.5
Other fund – Special strategy	2	5.1	0.6
Money market fund – Grade A	40	73.4	8.6
Money market fund – Grade B	9	6.1	0.7
Close-end funds	53	162.5	19.0
Total	321	856.5	100

Source: China Securities Journal, 8 January 2007

⁹ "China fund raises \$5 bln in one day on stock boom," Reuters News, 8 December 2006



existing Sino-foreign fund management joint ventures, who can support and even expand operations with revenue from existing funds as the regulator works through the backlog. For late entrants yet to receive their first product approvals, revenues are non-existent and they can find themselves eating into start-up capital to cover costs.

Fund executives noted the China Securities Regulatory Commission was openly interested in diversifying the range of fund products beyond straight equity funds, creating opportunities for companies looking to expand into other asset classes, such as fixed income and balanced products.

A tough fight for talent

One of the biggest operational challenges for fund houses in China is a shortage of talent. A Chinese fund manager, on average, will run a fund for approximately one year, with more than 30 percent of funds managed by one manager for less than half a

year, according to a 2006 study by the official *Securities Times*.¹⁰

But the problem doesn't stop there. Fund executives say hiring and retaining skilled workers in roles ranging from compliance officers to research analysts is one of their biggest challenges.

The root of the problem is the surge both in the amount of assets under management and the number of fund managers. At the end of 2006 there were 53 operational fund managers, which had both a license and at least one product launched. Additional fund companies have also been licensed and are in the process of launching their maiden product, with several joint ventures still in the works.

To address this issue, the regulators issued a guideline towards the end of 2006 making it more difficult for fund houses to hire senior executives and managers who have frequently moved from one employer to another.

Wages are rising as a result. Fund executives say they are faced with

¹⁰ "ANALYSIS-Job hopping plagues China fund industry," Reuters News, 5 September 2006

the dilemma of whether to pay up, raising their cost base and fueling the problem, or holding the line at the risk of higher turnover. Several executives at the smaller joint ventures say they would favour the latter course, but offset it with a strong performance-based bonus scheme.

Such schemes can be difficult to accept for the Chinese partners in the joint ventures. One foreign fund executive noted that remuneration levels for top money managers came as a particular shock to some senior officials of big state entities. While aware of the market realities, he noted some of these officials were trained and rose up within a system that saw comparatively low pay, even for people running large enterprises.

Executives with the foreign joint ventures say the fight for talent is an area where they have an advantage. In addition to decades of experience in designing compensation practices, they believe many talented Chinese employees favour working for a joint venture over a similar-sized local company. Foreign-linked companies can typically provide well-developed training and career development, which may include the prospect of work experience in another major investment centre such as London or New York.

Spreading the message of sound investing

Fund companies are taking some interesting initiatives to counter the lack of understanding of financial principles among Chinese investors.

One such effort has been a booklet produced by HSBC Jintrust, entitled "The Ten Golden Rules." It features ten creative, day-to-day life stories about basic investing with cartoon characters explaining financial concepts such as inflation, diversification, regular investing, compound interest, risk versus return and portfolio rebalancing.

The booklet proved popular with investors and client managers. It has been reprinted three times with nearly a million copies distributed to existing clients and participants at HSBC Jintrust's investor education seminars. In addition, Bank of Communications ordered 600,000 copies, to be included as an investor education component in its client welcome package.

Picking your partner: The keystone to success



Among the executives and industry experts interviewed for this report, there was almost unanimous agreement about one point. The biggest factor in the success or failure of the Sino-foreign fund management joint ventures so far has been the quality of the relationship between the controlling partners.

As logical as this might seem, executives say several of the Sino-foreign joint ventures had suffered from communication problems and disagreements over fundamental issues, bringing to mind the Chinese proverb: "Same bed, different dreams".

By contrast, they say the most successful joint ventures are those that have shared a common vision for the organisation, particularly in relation to:

- The ability to put the long-term prospects for the joint venture ahead of the short-term profit considerations. For the Chinese partner, this means accepting they may not see a return on their investment for some time, and must be prepared to bear this cost.

- An agreement on the standards of the firm. This typically means the joint venture will implement best international practices followed elsewhere by their foreign partner, even if it is not yet required or common practice in China. It means the joint venture might pass up on certain opportunities.

Executives say the dynamic of the successful partnerships has to be one of balance. This means the foreign company must be respectful about the Chinese partner's knowledge of local markets and practices, just as the Chinese partner should be respectful of the international company's experience.

Several executives speak of a situation where an investment strategy which has been successful abroad was introduced to a joint venture. This was done despite the assertion of the Chinese partner that the country's financial markets lacked the level of information flow needed to make the strategy work. The resulting products had poor performance and were deemed a failure.

Likewise, the joint ventures perceived as the most successful have been those where the partners have agreed on strategy and jointly selected top management appointments. Executives say this typically resulted in a unified corporate culture, improving morale, operations and giving the firm a greater likelihood of delivering strong investment and operational returns.

Industry players say in several cases disagreement among the controlling partners has cascaded through the organisation, hurting morale, investment performance and ultimately profitability. Evidence of this has been found in some companies where the controlling shareholders had divided up hiring decisions for specific roles, for example, the Chinese partner hiring the CEO, while the foreign partner appoints compliance and risk management officials.

Fund industry executives say the role of a joint venture's general manager has increased in importance in the wake of new guidelines issued in 2006. The guidelines stressed that day-to-day decisions should be taken at the management and not the board level. Executives believe one upside of this change will be that controlling shareholders are now less likely to clash over day-to-day operations.

Another lesson learnt by the Sino-foreign joint ventures is the importance of respecting and capitalising on local investment talent. Several executives point to one joint venture, where the Chief Investment Officer had been recruited from a local firm and went on to generate superior investment returns. They say the foreign partner did not make the mistake of imposing their investment practices and methodologies on this local manager.

That said, many international executives stress the importance of implementing best global practices in their joint venture operation, particularly in compliance and risk management. They note that at the end of the day, their global reputation and possibly their investments in other Chinese financial sectors would be jeopardised if something goes wrong.

This situation is not always easy. The head of Asian operations for one global fund house pointed to the example of a dispute with its local joint venture over a sales practice that did not conform to the foreign company's global standards, although acceptable locally. The local partner said it was concerned about the negative impact on sales if the foreign partner's standards were followed. In the end, the foreign partner was adamant its global reputation could be hurt, and the local partner agreed to the change.

Analyst view

"Stable performance is the target of all fund companies in China, but there are some differences in approach.

Domestic fund investors hold for a much shorter period compared to more developed markets.

Fund companies in China face greater short-term performance pressure and need to pay more attention to their customers' short-term demands. A recent study of 179 Chinese funds revealed a weighted average turnover rate of 219 percent. This is four times higher than the typical turnover rate for comparable investments in the US.

Fund companies in China have addressed these demands in different ways.

While domestic funds are more active, we see that the joint ventures often have a longer-term investment view.

Typically, domestic companies have more experience in stock selection and know the market well. There are many joint ventures among the top-performing funds. But many of these, such as Harvest, Fullgoal, and China International, have succeeded with a more local style in their approach to investment."

Zhou Liang, Head of Research,
Lipper, China

The road ahead



Looking forward, joint venture executives say they are largely optimistic about the prospects for their operations and China's fund management industry as a whole.

Most see evidence that the industry is maturing. Markets, while still opaque by international standards, are becoming more transparent. Fund managers across the industry are adopting increasingly sophisticated strategies and putting a greater emphasis on risk management. Some retail investors are learning to take a longer term perspective. Meanwhile the role of institutional investors, such as pension funds and insurance companies, is taking on a growing importance.

The leaders of the fund management joint ventures are also bullish about the potential for China's Qualified Foreign Institutional Investor (QFII) and Qualified Domestic Institutional Investor (QDII) programmes to boost assets under management.

China initiated the landmark QFII system in 2003, allowing selected foreign investors to invest in its main stock and debt markets for the first time. The USD 10 billion of existing QFII quotas have almost been fully allocated and there is speculation more quota will be offered later this year.

Its domestic counterpart, the QDII scheme, was launched in 2006, partly to encourage capital outflows and ease upward pressure on the yuan. To date just one fund manager, Huanan Fund Management Co., has been allowed to participate in the scheme with Wall Street investment bank Lehman Brothers working as its partners.

QDII has seen limited success to date. In sharp contrast with the QFII scheme, only a fraction of the USD 14.7 billion in QDII quota has been used. Analysts blamed the structure of the initial products sold by banks, which were largely restricted to low-yielding fixed-income investments. This meant returns were eroded by the appreciation of China's currency on foreign exchange markets.

Fund houses are hopeful that equity-oriented and less conservatively designed products will prove more successful.

With both schemes, their international connection gives foreign-linked companies a natural advantage over purely domestic players. That said, the Huanan/Lehman tie-up demonstrates that local firms, and international fund houses not involved in joint ventures, can also participate.

Several of the Sino-foreign joint ventures are already sub-advising on QFII mandates, and others including Bank of Communications Schroder and Fortune SGAM Fund Management have publicly said they will sub-advise upcoming QFII funds.

Executives with Schrodgers, KBC-Goldstate, Harvest, Guotai Junan Allianz, JPMorgan's China International, Fortis Haitong and HSBC Jintrust have all publicly stated their desire to help launch QDII products into China, in some cases as early as this year.

Hard fought success and lessons learnt



In just four years, international fund managers have made serious inroads into China's fund industry, carving out market share, accumulating billions of dollars in assets and generating enough revenue in many cases to emerge profitable.

This raises the questions of whether there has proved to be a first mover advantage; and whether it's too late for those international fund management houses sitting outside the mainland market to participate.

On the first question, the answer is probably that there was a first mover advantage, but only for firms that capitalised on the opportunity, avoided or learnt from mistakes and, as at least two veteran fund executives described, got lucky.

Those firms that got it right typically did so by finding the balance both in

dealing with their Chinese partner, and successfully combining elements of their global investment practices with the stock-picking acumen of local managers. This led to a virtuous circle of higher returns generating inflows to the point where at least one high profile manager stopped accepting new money.

But given the volatility of the market, luck did play a factor. One executive lamented his firm's early success in raising what was at that point China's largest equity fund ever, only to see much flow out again amid a serious market downturn. Another noted how his firm fell in the assets under management rankings as the popularity of its money market fund faded during a market upturn, even as it was waiting for approval to launch a new equity fund.

Executives with the money-losing joint ventures may be questioning the wisdom of their decision to dive in early, but other players have few regrets.

One senior regional executive with an international fund house noted that time and effort aside, its financial investment in the joint venture was "almost nothing" in comparison to its global operations. Now it has a self-funding and profitable operation in a high growth market with arguably the greatest potential in the world. With more than 50 fund companies now competing for business, more start-ups on the way and regulatory approval for new products slowing, it definitely feels like "first mover advantage" to these established joint ventures.

That said, it's not necessarily too late for other international players to enter, but there may be a trade-off in terms of cost and control. With a much larger market and more competition, it is undoubtedly more expensive to now buy into an existing manager or start

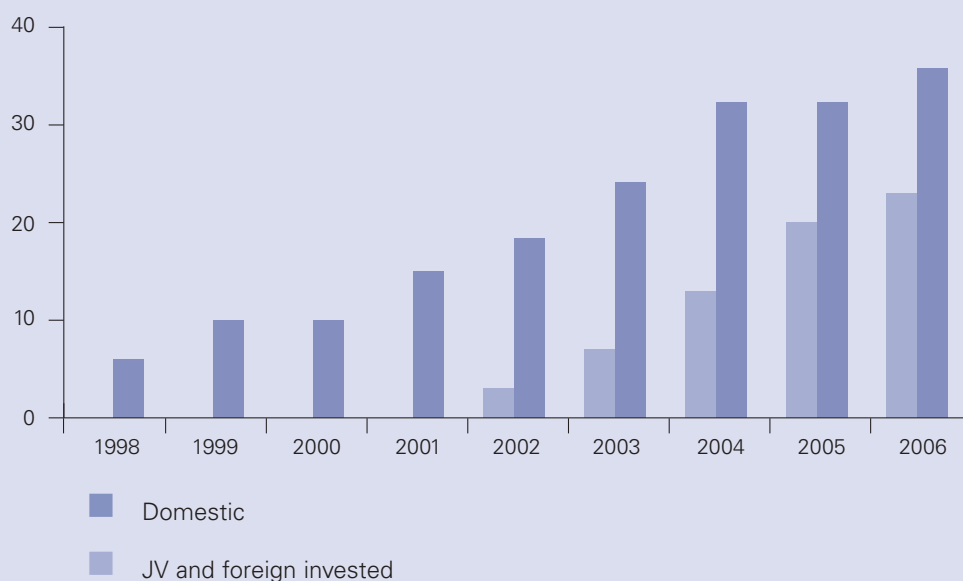
from scratch. Buying a stake in an existing firm has proven a successful strategy for some, as firms like Harvest and Fullgoal demonstrate. However, control in such ventures is clearly in the hands of the Chinese partners. With each passing year, these large local fund management companies are developing their skills and expertise, reducing their need to seek assistance from a foreign partner.

Limited control may be a price worth paying for an international house, given predictions that China will develop into one of the world's largest wealth management markets in coming decades.

However, international firms choosing to enter this market must be aware that China's massive potential alone will not carry them. Recent history has taught that financial success can be achieved, but only by overcoming major challenges, many of which are unique to China.

Appendices

Appendix I: Number of fund management companies, 1998-2006



Source: Lipper

Appendix II: 2006 year-end market segmentation

	AUM (RMB Million)	Share
Domestic	520,987.63	60.8%
Joint Ventures	200,036.77	23.4%
Foreign Invested	135,428.14	15.8%
TOTAL	856,452.54	100.0%

Appendix III: List of domestic fund managers				
	31 December 2006		31 December 2005	
	AUM (RMB Million)	Share	AUM (RMB Million)	Share
China Southern	76,302.89	8.91%	53,676.85	11.44%
China Asset Management	72,355.00	8.45%	40,166.18	8.56%
E Fund Management	63,123.93	7.37%	36,197.90	7.72%
Bosera	38,045.91	4.44%	37,311.33	7.95%
GF Fund Management	35,687.23	4.17%	8,999.89	1.92%
Dacheng	31,878.25	3.72%	13,474.47	2.87%
Yinghua	30,399.57	3.55%	11,258.25	2.40%
Hua'an	26,561.32	3.10%	44,850.44	9.56%
Changsheng	17,487.69	2.04%	11,372.29	2.42%
Guotai	16,634.69	1.94%	8,723.69	1.86%
Penghua	15,406.83	1.80%	11,353.76	2.42%
Rongtong	14,350.75	1.68%	6,634.33	1.41%
Lion	12,664.34	1.48%	4,760.26	1.01%
China Great Wall	11,605.18	1.36%	7,197.14	1.53%
China Universal	10,347.75	1.21%	868.68	0.19%
Galaxy	7,546.13	0.88%	9,130.35	1.95%
Industrial	6,819.55	0.80%	3,046.78	0.65%
CITIC	5,875.60	0.69%	10,210.99	2.18%
Chang Xin	5,148.48	0.60%	12,344.37	2.63%
Baoying	5,082.34	0.59%	2,858.77	0.61%
First-Trust	4,724.10	0.55%	7,363.38	1.57%
Soochow	2,314.45	0.27%	347.44	0.07%
China Post & Capital	2,148.35	0.25%	-	0.00%
Wanjia	2,050.77	0.24%	2,078.94	0.44%
Yimin	1,566.87	0.18%	-	0.00%
Zhonghai	1,398.99	0.16%	499.17	0.11%
Huafu	998.91	0.12%	365.40	0.08%
Orient	972.41	0.11%	316.34	0.07%
Jutian	499.18	0.06%	1,061.50	0.23%
China Nature	492.27	0.06%	392.28	0.08%
Tianhong	187.71	0.02%	255.36	0.05%
Golden Eagle	175.10	0.02%	588.91	0.13%
New Century	135.09	0.02%	446.51	0.10%
Huashang	-	0.00%	-	0.00%
TOTAL	520,987.63	60.8%	348,151.95	74.2%

Source: Z-Ben Advisors Ltd.

Appendix IV: List of joint venture fund managers

	31 December 2006		31 December 2005	
	AUM (RMB Million)	Share	AUM (RMB Million)	Share
INVESCO Great Wall	29,786.14	3.48%	4,299.12	0.92%
ICBC Credit Suisse	29,641.41	3.46%	3,946.50	0.84%
China International	28,612.18	3.34%	2,451.85	0.52%
Bank of Communications	23,122.49	2.70%	2,504.32	0.53%
Schroder				
Fortune SGAM	18,676.93	2.18%	12,451.84	2.65%
Fortis Haitong	14,958.75	1.75%	14,556.98	3.10%
CCB Principal	11,546.92	1.35%	6,236.81	1.33%
China Merchants	10,628.08	1.24%	15,458.25	3.30%
SYWG BNP Paribas	6,472.21	0.76%	5,440.08	1.16%
BOC International	6,199.58	0.72%	1,788.10	0.38%
CITIC Prudential	5,623.93	0.66%	-	0.00%
HSBC Jintrust	4,743.96	0.55%	-	0.00%
AIG-Huatai	3,616.87	0.42%	683.03	0.15%
Franklin Templeton Sealand	2,486.22	0.29%	527.09	0.11%
Everbright Pramerica	2,015.70	0.24%	3,053.05	0.65%
Guotai Junan Allianz	1,905.40	0.22%	7,632.16	1.63%
First State Cinda	-	-	-	0.00%
KBC-Goldstate	-	-	-	0.00%
Lombarda China	-	-	-	0.00%
Lord Abbett China	-	-	-	0.00%
TOTAL	200,036.77	23.4%	81,029.18	17.3%

Source: Z-Ben Advisors Ltd, KPMG research

Appendix V: List of foreign invested fund managers

	31 December 2006		31 December 2005	
	AUM (RMB Million)	Share	AUM (RMB Million)	Share
Harvest	83,090.10	9.70%	24,611.26	5.25%
Fullgoal	26,059.26	3.04%	8,062.30	1.72%
ABN AMRO TEDA	19,069.69	2.23%	4,935.49	1.05%
UBS SDIC	7,209.09	0.84%	2,326.05	0.50%
TOTAL	135,428.14	15.8%	39,935.10	8.5%

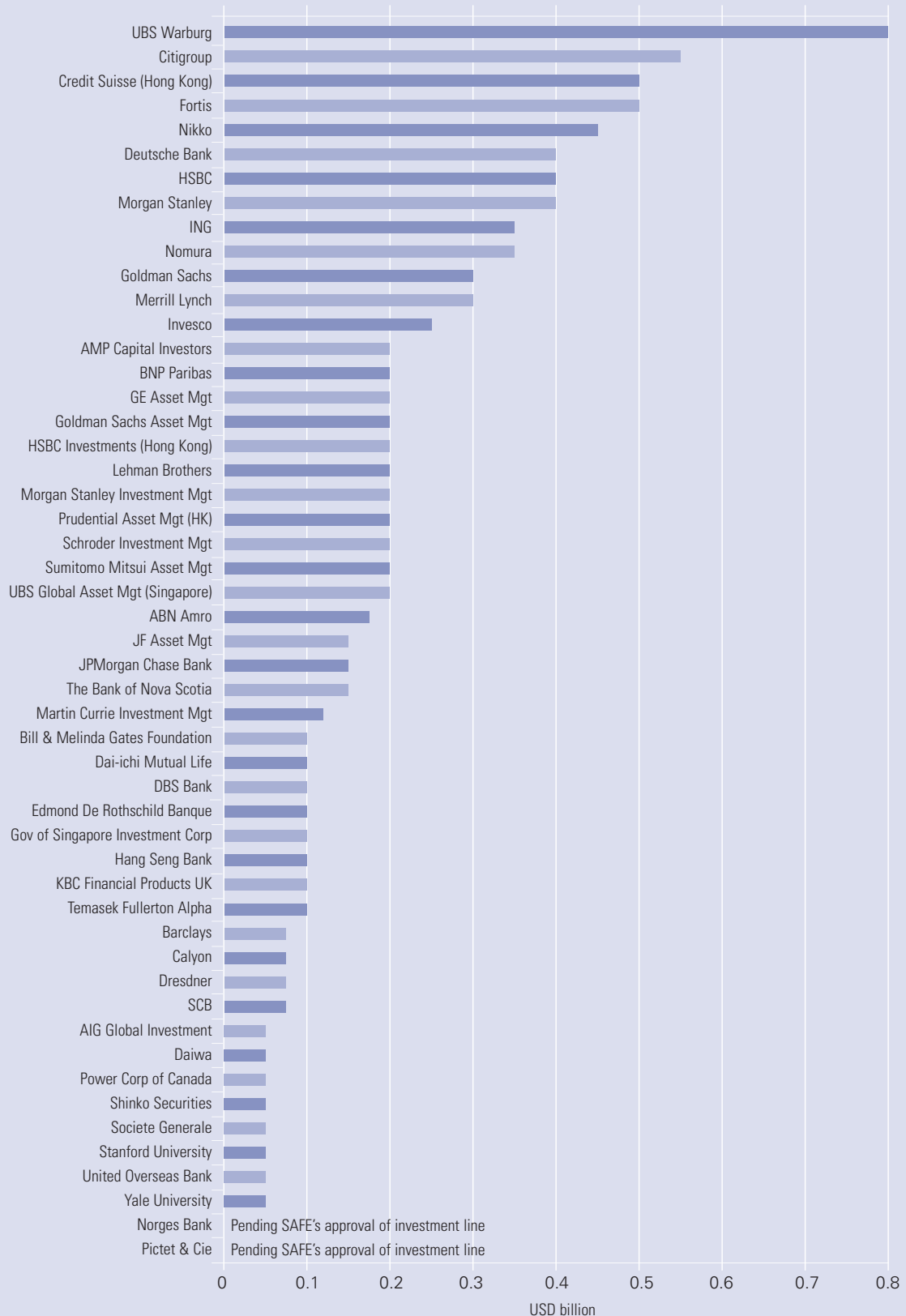
Source: Z-Ben Advisors Ltd, KPMG research

Appendix VI: Overview of management and custodian fees in China fund industry

	Management fee rate (%)	Custodian fee rate (%)
Open-end fund		
Equity fund – Stock	1.2 - 1.5	0.2 - 0.25
Equity fund – Index	0.5 - 1.3	0.1 - 0.25
Hybrid fund	1.2 - 1.5	0.2 - 0.25
Bond fund	0.41 - 0.8	0.14 - 0.2
Capital guaranteed	1 - 1.2	0.2
Money market fund	0.33	0.1
Close-end fund	1.25 - 1.5	0.25

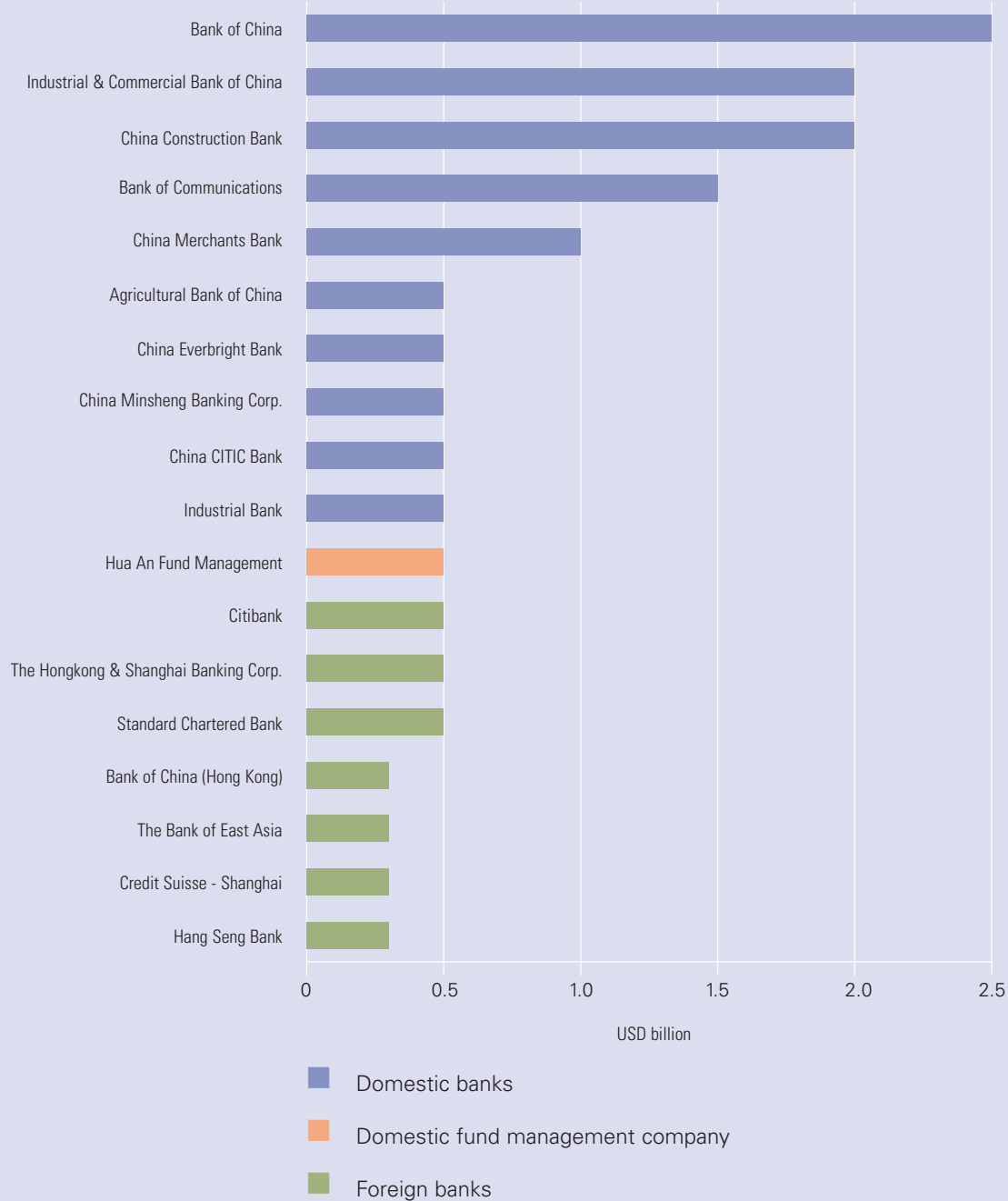
Source: China Securities Journal, 8 Jan 2007, www.huaan.com.cn, http://funds.money.hexun.com, KPMG research

Appendix VII: List of QFII approved by CSRC and investment quota granted by State Administration of Foreign Exchange (SAFE) as at 31 March 2007



Source: China Securities Regulatory Commission, State Administration of Foreign Exchange, KPMG research

Appendix VIII: QDII list and investment quota approved by SAFE as at 31 March 2007



Source: State Administration of Foreign Exchange, KPMG research

Appendix IX: Overview of Sino-foreign joint venture players as at March 2007			
JV set up date	Foreign Partner(s)	Chinese Partner(s)	Name of fund management JV
December 02	ING Investment Management (30%)	China Merchants Securities (40%) China Huaneng Finance (10%) China Power Financial Affairs (10%) China COSCO Finance (10%)	China Merchants Fund Management
February 03	Societe Generale Asset Management (33%)	Fortune Trust & Investment (67%)	Fortune SGAM Fund Management
March 03	Allianz Dresdner Asset Management (33%)	Guotai Junan Securities (67%)	Guotai Junan Allianz Fund Management
April 03	Fortis Investment Management (49%)	Haitong Securities (51%)	Fortis Haitong Investment Management
April 99 May 03 (foreign participation)	BMO Financial Group (27.78%)	Haitong Securities (27.78%) Shenyin & Wanguo Securities (27.78%) Shandong International Trust & Investment (16.68%)	Fullgoal Fund Management
June 03	INVESCO Asia (49%)	Great Wall Securities (49%) Dalian Shide Group (1%) Kailuan Group (1%)	INVESCO Great Wall Fund Management
July 02 Sep 03 (foreign participation)	ABN AMRO Asset Management (Asia) (49%)	Northern International Trust and Investment (51%)	ABN AMRO TEDA Fund Management (previously named ABN AMRO Xiangcai Fund Management)
December 03	BNP Paribas Asset Management (33%)	Shenyin & Wanguo Securities (67%)	SYWG BNP Paribas Asset Management
March 04	Pramerica Investment Management (33%)	Everbright Securities (67%)	Everbright Pramerica Fund Management
April 04	JPMorgan Asset Management (UK) (49%)	Shanghai International Trust & Investment (51%)	China International Fund Management
June 04	Merrill Lynch Investment Managers (16.5%) BOC International Holdings (16.5%)	BOC International (China) (67%)	BOC International Investment Managers
September 04	Franklin Templeton (49%)	Sealand Securities (51%)	Franklin Templeton Sealand Fund Management
November 04	AIG Global Investment (49%)	Huatai Securities (49%) Suzhou New District Hi-Tech Industrial Park (2%)	AIG-Huatai Fund Management
June 05	Credit Suisse (25%)	ICBC (55%) China Ocean Shipping (Group) Company (20%)	ICBC Credit Suisse Asset Management

Appendix IX (continued): Overview of Sino-foreign joint venture players as at March 2007			
JV set up date	Foreign Partner(s)	Chinese Partner(s)	Name of fund management JV
March 99 June 05 (foreign participation)	Deutsche Asset Management (Asia) (19.5%)	China Credit trust (48%) Lixin Investment (32.5%)	Harvest Fund Management
June 02 June 05 (foreign participation)	UBS (49%)	SDIC Hongtai Trust & Investment (51%)	UBS SDIC Fund Management
July 05	Schroder Investment Management (30%)	Bank of Communications (65%) China International Marine Containers (Group) (5%)	Bank of Communication Schroder Fund Management
August 05	Prudential (33%)	CITIC Group (33%) China-Singapore Suzhou Industrial Park Ventures (18%) Suzhou New District Hi-Tech Industrial Economic Development (16%)	CITIC Prudential Fund Management
September 05	Principal Financial Group (25%)	China Construction Bank (65%) China Huadian Corporation (10%)	CCB Principal Asset Management
October 05	HSBC Investments (UK) (49%)	Shanxi Trust & Investment (51%)	HSBC Jintrust Fund Management
April 06	First State Investments Management (46%)	Cinda Asset Management (54%)	First State Cinda Fund Management
May 06	Lord Abbett (49%)	Yangtze Securities (30%) Tsinghua Holdings (21%)	Lord Abbett China
May 06	Banca Lombarda e Piemontese (49%)	Guodu Securities (47%) Pingdingshan Coal (Group) (4%)	Lombarda China Fund Management
November 06	KBC Asset Management (49%)	Goldstate Securities (51%)	KBC-Goldstate Fund Management
Pending	Credit Agricole Asset Management (33.7%)	Agricultural Bank of China (51.3%) CHINALCO (15%)	
Pending	Royal Bank of Canada (30%)	China Minsheng Banking (60%) China Three Gorges Project (10%)	
Pending	AXA Investment Managers (39%)	Shanghai Pudong Development Bank (51%) Shanghai Dragon Investment (10%)	
May 01 Pending (foreign participation)	Nikko Asset Management (20% via acquisition)	Hebei Securities (40%) United Securities (20%) Chinalion Securities (20%)	Rongtong Fund Management

Source: China Securities Regulatory Commission, various newspaper, KPMG research

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