Talking Points

Allowing Chinese insurers to use Stock Connect: Structurally positive

September 2016

The event...
The China Insurance Regulatory Commission (CIRC) recently announced that China's insurance funds are allowed to invest into Hong Kong via Shanghai-Hong Kong Stock Connect. In late September, industry players were also advised by CIRC, at a private meeting, that the investments made via the Stock Connect would be categorized as domestic equities (i.e. not included in the overseas allocation capped at 15% of total AUM).

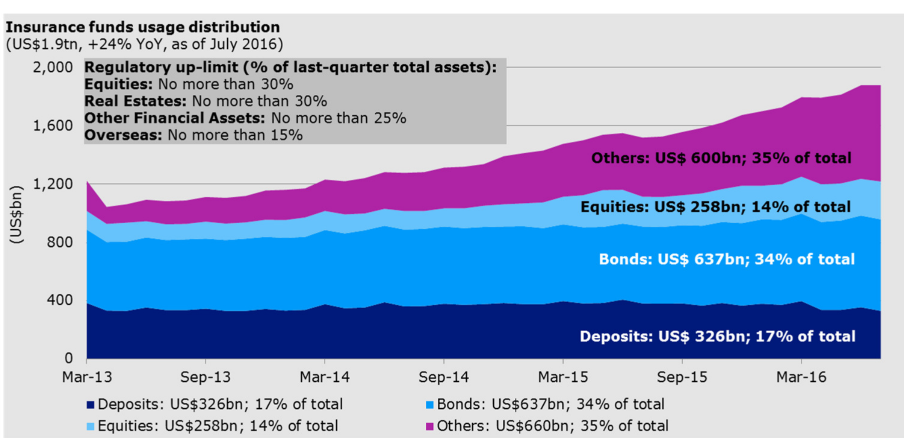
What we think...
We are encouraged by the ongoing positive developments in China's financial reform. In our view, the relaxation by the CIRC is structurally positive from the standpoint of Chinese insurers, as well as Hong Kong listed Chinese equities and the stock market.

Insurers: Greater access to offshore Chinese equities and flexibility in asset allocation
Prior to the relaxation, Chinese insurers mainly utilized the Qualified Domestic Institutional Investors (QDII) quota to invest in Hong Kong-listed stocks. Given that insurance companies' QDII quota was almost exhausted, the relaxation that allows insurers to use Stock Connect opens up an important avenue to access the offshore Chinese equity market.

Currently, Chinese insurers' investments are comprised of predominately onshore bonds and equity assets. Opening up a new investment channel via Stock Connect, and not considering the investments as part of the overseas allocation, will allow greater flexibility for insurers to achieve more optimally diversified portfolios. This should enhance the risk-reward profile for the portfolios as onshore equities have historically been more volatile than offshore equities.

Hong Kong listed Chinese equities & the stock market: Benefiting from structural flows and improving liquidity
The Hong Kong stock market is the prime beneficiary for the inflow potential coming from an increased allocation by insurers in Hong Kong listed equities. The increase in Southbound flows from the Stock Connect will enhance market liquidity, with a boost to the daily turnover of the HK stock market as the mainland investor base expands. Furthermore, China's insurance industry has seen total premium income grow 24% year-on-year (as at July 2016). This points to a huge potential source of fund inflows into Hong Kong listed equities.

The size for China's insurance funds totaled US$1.9 trillion, with US$258 billion invested in equities which accounts for 14% of the total. With the deregulation, there is much more room for Chinese insurers to increase their equity exposure, which is a long way from reaching the regulatory limit of 30% (refer to the graph below).



Source: CEIC and Citi Research.
Note: Insurance funds, per CIRC, can invest into five kinds of assets:
1. Liquid assets like cash/deposits; 2. Bonds; 3. Kinds of equities including non-listed parts; 4. Real estates; 5. Other financial assets.

Also, Hong Kong listed Chinese equities will benefit as domestic investors will spark interest in unique companies that are not available in the domestic A-shares market. Examples include Hong Kong telecom and utility names, which offer stable dividend yields in the midst of a low interest rate environment. Despite recent developments, H-shares are still not expensive relative to A-shares (A-shares are currently trading at a 28% premium to H-shares).

Conclusion

The deregulation of Chinese insurers confirms the government's continued efforts to pursue structural reform. Even with the earlier debut of Stock Connect (also with Shenzhen-Hong Kong Connect rolling out by the end of the year), relaxation of the hurdles associated with the QFII/ RQFII schemes, together with other positive developments in the asset management industry, we are only in the beginning of a long reform journey where we expect the 'opening up' trend to continue.

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