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A Watershed Moment for Wealth Management in China

As the world emerges from the fog of the Covid-19 pandemic, KPMG has published its Hong Kong Banking Report for 2020, exploring the ways in which the industry has begun to shift on the back of the pandemic, and what further evolution is to come. Edmond Tan, Partner, and Ricardo Wenzel, Director, Wealth & Asset Management at KPMG China contributed their invaluable insights to the report, discussing the shifting reality that is China's wealth management market, as the economic giant's growing mass affluent and high-net-worth ranks, rapid digital evolution and increasingly globalised landscape all come to the forefront, making China's appeal to international players all the more enticing.

BY:
EDMOND TAN, PARTNER,
& RICARDO WENZEL, DIRECTOR, WEALTH & ASSET MANAGEMENT
KPMG CHINA

China's strong historical economic growth, rapid technological development and its fast-growing middle class represent key growth opportunities for financial institutions worldwide. Coupled with the dropping of foreign ownership restrictions in the country's financial services sector, 2020 marks a watershed moment for international banks seeking to enter or expand their presence in mainland China.

The case for going onshore

The case for going onshore in mainland China is clear. Between 2013 and 2018, China had an average annual economic growth rate of 7%, significantly higher than the world average of 2.9% . Despite the global economic slowdown caused by the Covid-19 pandemic, China remains among the largest and most attractive markets for wealth and asset management worldwide.

This is largely due to the innovation and rapid growth of the digital economy in the last few years, which both foreign and domestic wealth managers can capitalise on by focusing less on developing extensive physical branch networks with large headcounts, and more on digital infrastructure and distribution channels to speed up market penetration with continuous coverage. Another opportunity for wealth managers is the large and growing population of mass affluent and high net worth individuals, many of whom are seeking greater product diversity and new investment opportunities while increasingly demanding more diversified, portfolio-based solutions for wealth protection purposes. This emerging trend is not only driven by a shifting investor attitude towards risk, but also by the wealth transfer to the next (mostly second) generation and very likely accelerated by the market turbulence caused by Covid-19.

From a regulatory perspective, the phasing in of wealth management product regulations issued by the People's Bank of China, China Securities Regulatory Commission and China Banking and Insurance Regulatory Commission in 2019 is expected to be completed by the end of 2020, which should help to level the playing field for foreign entrants with regards to investment product requirements, suitability checks, disclosure and asset value calculation, as well as curbing shadow banking. The new regulation also provides an opportunity for foreign entrants to leverage their overseas wealth management expertise and experience.

Mainland China also continues to open up its economy to foreign investment in its financial services sector. From a shareholding perspective, in the past foreign banks could only hold a minority share in their mainland China operations. However, there has been a continued loosening of foreign investment restrictions. In 2018, shareholding limitations were dropped for foreign institutions investing in local Chinese banks, with the latest development involving the scrapping of foreign ownership limits for public fund management and securities firms from April 1st, 2020. Under the new US-China trade rules the management of pension funds is also opening up to foreign financial institutions.

Key considerations and challenges for an onshore operation

A number of international financial institutions have taken steps to take a majority or wholly-owned stake in their mainland China operations, and we expect to see an increasing interest in market entry or further expansion onshore. When devising their onshore strategy, foreign financial institutions should be mindful of the competitive landscape in China and take into account the strength of the existing players in the market, which includes the larger domestic banks, the wealth management arms of rural and commercial banks, and the tech giants.

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In addition, it is crucial that new entrants ensure that they adapt to the PRC regulatory framework and effectively manage regulatory risk. The regulatory landscape in mainland China can be challenging, with certain restrictions hindering the full implementation of business services, and varying interpretations of regulations. Foreign banks should therefore invest in building up a robust compliance department to appropriately monitor regulatory risk with respect to

[1] http://www.samacn.org.cn/files/frame/202003311204511204.pdf

capital requirements, services and products they are allowed to provide, and disclosure practices.

Foreign banks also need to assess their existing digital capabilities and consider how this can be expanded or tailored for the digitally savvy clientele in mainland China. The average Chinese customer is highly digital and plugged into the latest technologies, turning to their smartphones for payments, investments and all other key aspects of their daily lives. They therefore have very specific and high expectations when it comes to banking and wealth management, particularly around the ease and accessibility of banking and wealth management services.

This requires a shift in foreign banks' approach to access and service their clients in mainland China. Building digital infrastructure and distribution channels from scratch is a very challenging option, and may only bring limited benefits as the large tech incumbents already command powerful distribution capabilities and sticky client relationships. The same goes for physical branch networks, which will be virtually impossible for international banks to build from scratch to span the entire country and to compete with regional institutions. We believe that banks will therefore seek to forge alliances and partnerships to create new channels and drive growth and innovation onshore. A successful partnership could result in win-win outcomes for both parties through access to new revenue pools, product manufacturing expertise, risk management, advisory capabilities and an enhancement of the investment product shelf.

Data management and IT infrastructure are also key considerations for foreign banks' onshore operations. Banks should build localised and sustainable IT architecture in compliance with regulatory requirements, and ensure robust controls around data security and the management of cross-border data transfers. Local IT vendors will play a key role with regards to software procurement and assisting foreign banks during the implementation stage. It is crucial for foreign banks to select a partner that can provide market-leading solutions with long-term maintenance support and upgrade opportunities.

What does success look like?

Given the potentially challenging market environment for foreign entrants, what will define the long-term success of international financial institutions? We believe the key is to unlock access to a large breadth of new clients and revenue pools onshore. While creating a comprehensive digital strategy and finding the right partner are crucial, we believe that in order to set themselves up for success, foreign banks should focus not only on a niche of UHNW clients (who often hold assets offshore and also bank offshore) for their wealth management business, but also on the rapidly growing mid-tier high-net-worth client base. Indeed, in 2018, China had 1.97 million high-net-worth individuals, with entrepreneurs being a crucial segment, whose personal investable assets exceed RMB 10 million, totalling about RMB 190 trillion of personal investable assets nationwide . This is a sizeable sum, and with wealth management penetration remaining relatively low in mainland China, this indicates a largely untapped opportunity for growth.

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While foreign banks are getting their digital offerings up to scratch in order to target this broader client segment, they also need to ensure that they get their operating model and product mix right for the onshore market. Hiring the right talent is also crucial. There is clearly an abundance of new talent and innovation in mainland China, but at the same time there is also fierce competition between traditional banks, tech companies and start-ups for this talent. Foreign entrants will need to ensure that they focus on remuneration, career development and company culture as key differentiators in order to attract top talent.

Another success factor is the ability to project the bank's offshore brand recognition and the ability to leverage their product, operational and risk management expertise. However, while brand recognition is important, foreign entrants should also recognise that localisation is key to success in the mainland China

[2] http://www.samacn.org.cn/files/frame/202003311204511204.pdf

market. A common pitfall of multinational banks entering China is to manage their operations from outside of China – in some cases, even from outside of Asia. We believe that in order for foreign banks to truly succeed, strategic senior management decision-making needs to come from within mainland China, and from experienced people who fully understand and are immersed in the local market.

Winning in China for foreign private banking and wealth management entrants will certainly be challenging yet rewarding, and will require long-term commitment.

Furthermore, as the effects of Covid-19 continue to change ways of working and weigh on business and economic growth, the long-term opportunities and strategic importance of China remains. While there is no single formula for success, the relaxed foreign ownership rules give foreign entrants more leeway than ever before to operate as they see fit within regulatory boundaries. Ultimately, we believe that succeeding in mainland China can only be achieved by being on the ground, close to prospects, clients and regulators, with the right capabilities and expertise, digital channels and product suite. ■