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2019

CHINA (RE)ENTRY FOR GLOBALS
STARTING THE NEW CHAPTER

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MARSH & McLENNAN COMPANIES

Contents

Prologue and Summary

We have witnessed surging interest by global financial institutions to enter or re-enter China over the last two years. To promote and support the development of the financial sectors, China has been opening up the market by relaxing shareholding limits to foreign players in the financial sector. In July 2019, the PBOC announced that the 51% shareholding cap for foreign ownership of joint-venture brokers, fund management companies (FMCs), and futures companies would be cancelled by 2020, one year earlier than originally planned.

Since the publication in early 2018 of our last thought-piece on China entry, "Global Asset Managers in China: Riding the Waves of Reform", the wave of entries into China has continued with great momentum. For example, 22 global asset managers have set up private fund management (PFM) companies in China[1]. Meanwhile, many firms have been actively converting their FMC JVs into majority ownerships. Some firms have even been considering Bank Wealth Management Subsidiaries (WMSs) as another plausible structure.

Moreover, things have not been confined to the asset management space. The fundamental changes happening in capital markets are providing additional opportunities for global players to compete in the wealth management and securities spaces. For instance, four global investment banks have already obtained majority-owned securities JVs, with many more such JV applications pending as of the time of writing. As such, in the future, global asset managers could increasingly be served by global brokers operating in China who would offer services that are more aligned with global practices.

1 As of September 30, 2019

Exhibit 1: Summary of China entry movement by global players (not exhaustive)

Category	Player (not exhaustive)	Banking	Securities Company	Asset management			Others
		Onshore wholly-owned entity		Fund mgmt. company	Private securities fund	QDLP	
Universal banks	HSBC	WFOB	51%	49%			
	SCB	WFOB					
	Citi	WFOB	33%→(New 100%)				
Wholesale banks	GS		33% (→) 51%				Futures[1]
	MS	WFOB	49% (→) 51%	37%			
	JPM	WFOB	New 51%	49% → 51%			Futures (49%)
	UBS	WFOB	49% → 51%	49%			Futures[2]
	CS	Branch	33% (→) 51%	20%			
	DB	WFOB	33%	30%			
	BNPP	WFOB		49%			
	SG	WFOB					
	Nomura		New 51%				
Asset managers	Blackrock			17%			
	Vanguard						Inv't advisory JV
	Fidelity						
	Allianz			49%			Insurance
Hedge funds	Bridgewater						
	Man Group						

→ Recently increased shareholding

(→) Attempting to increase shareholding

Full management control

Partnership / JV

1. 100% owned by Beijing Gaohua Securities
2. 100% owned by UBS' Securities JV

Source: Asset Management Association of China, China Securities Regulatory Commission, State Administration of Foreign Exchange, Press release, Oliver Wyman analysis

We have also observed that the restrictive control applied to the business scope of foreign players has been easing. For example, foreign brokers are now able to attain a fuller set of qualifications. Whereas many had suffered from a lack of brokerage qualifications in the past, foreign banks are now allowed to apply for Class-A underwriting licenses for the interbank bond market, and to set up or invest in currency brokers. Additionally, in May 2019, the China Banking and Insurance Regulatory Commission announced plans to remove the approval process for foreign banks to operate RMB-denominated businesses in onshore China, levelling the historical disadvantage for banks that are unable to take RMB deposits.

Given the voluminous amount of readily accessible research on the China market, we aim to neither replicate such studies nor compile a simple fact pack. Rather, this paper aims to achieve two purposes. Firstly, we want to collate all the material developments in the last few years to provide global players with a big picture of the changing dynamics in the China market, thereby explaining why the current period is much better for global players to compete in China than it was a decade ago. Secondly, we hope to convert our first-hand experience into practical advice for global players at different stages of their China journey to help shape their priorities and decisions.

Section 1 summarises the key trends shaping a more favourable environment for global players. Local Chinese investors have begun to look for more sophisticated financial services as they mature, and global investors are increasingly allocating more resources towards China. The introduction and development of cross-border investment schemes are now providing global investors with easier access to the China market. The fundamental shift in China's financial system from banking and shadow banking towards capital markets is challenging legacy 'gold standards' for wealth and asset management and calling for innovation for which global players are well positioned. We expect this to translate into revenue pools of approximately USD 15 billion for global players by 2023.

Section 2 discusses five critical agenda topics for global players aspiring to enter or double down on China. Firstly, global players should calibrate an appropriate level of ambition for their China franchise in order to determine the most suitable type of active versus passive play. Secondly, global players should be aware of the complicated licensing requirements in China, and therefore consider their business proposition and licence application hand-in-hand at an early stage. Thirdly, we can then compare the various suitable options for global players to set up their 'base' operational entity. Fourthly, it is important that global players develop a deep understanding of the dynamics of prospective local partners to develop truly meaningful partnerships. Lastly, we recommend that global players take green-field opportunities to build their infrastructure in a modular way.

We remain excited about the prospects of the China market for global players, and hope that this paper is a useful tool for all global players to shape their ambitions.

1 China becoming increasingly relevant for global players

China is an exciting market for foreign financial services firms, given its vast size and strong growth compared to other leading global economies. Today, China has already become the second largest economy in the world, with the second largest stock market[2] globally with a market capitalization of RMB 43.5 trillion (USD 6.3 trillion) as of year-end 2018. In its broadest definition (i.e. including shadow banking investments), China's asset management market was equivalent to RMB 111 trillion (USD 16.2 trillion) in 2019 H1.[3]

To further support its economic development, China is speeding up the development of its capital markets by various forward-looking initiatives and by opening up the market for foreign participation.

In this section, we will discuss how the changing environment in China is offering a more level playing field for foreign players, and then identify potential opportunities for foreign players.

2 Combing market capitalization of Shanghai and Shenzhen stock exchanges

3 In our previous publications, we have sometimes adopted a narrower definition of the asset management market in China, contributing to differences in the size of the market

1.1 More favourable market environment

The environment in China has become more favourable for global players in recent years. (See Exhibit 2)

While global investors are increasingly attracted by investment opportunities in China, local investors are searching for more advanced and sophisticated investment solutions, which domestic financial institutions are no longer able to fully satisfy. More fundamentally, China's local capital markets are rapidly developing on the back of favourable policies, coupled with the continued effort to develop the offshore RMB market.

While this does not necessarily put global players immediately into winning positions, they now have a much better chance to compete against local competitors both in terms of attracting clients and managing investments. Furthermore, global players are naturally better positioned to serve global investors for their China investments by leveraging their global relationships.

Exhibit 2: Key trends on China's financial system and opportunities for global players

	Funding side	Asset side
Onshore	**Trends -** Expanding institutional balance sheet and wealth amid outbound capital control, while investors becoming more sophisticated (e.g. need for inheritance) **Opportunities -** Global FIs can finally compete with global expertise as advantages for local FIs diminish (e.g. access to high yield products)	**Trends -** Legacy shadow banking investments no longer sustainable, while capital markets rapidly developing (e.g. multi-layered market, more derivatives, etc.) **Opportunities -** Global FIs can bring in global capital market expertise (e.g. structuring) and drive market innovation
Offshore / global	**Trends -** Increasing demand (e.g. indices inclusion) and ease (e.g. quota expansion & harmonization) to participate in onshore assets **Opportunities -** Global FIs best positioned to serve global funding leveraging captive relationship	**Trends -** RMB internationalization still progressing (e.g. offshore RMB bonds and derivatives) amid setbacks from tension in global trades **Opportunities -** Global FIs well positioned to line up global capital with RMB denominated assets

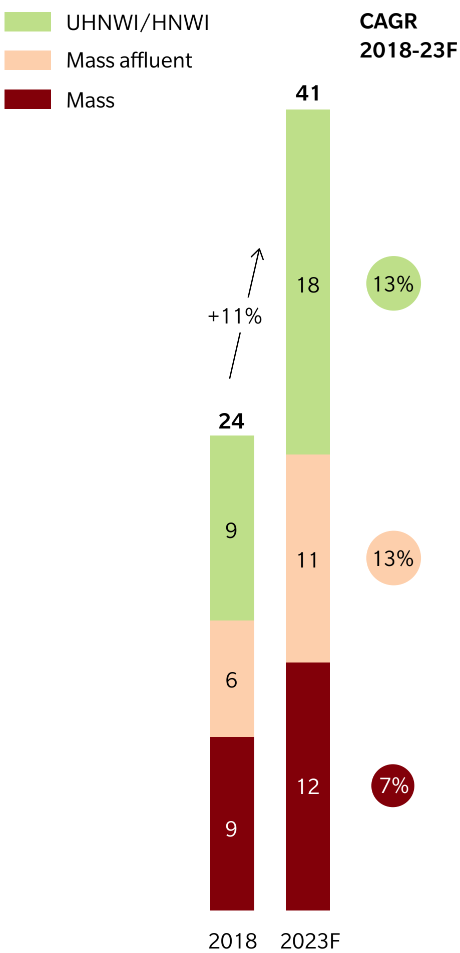
Source: Oliver Wyman analysis

Rising and more sophisticated demand by domestic investors

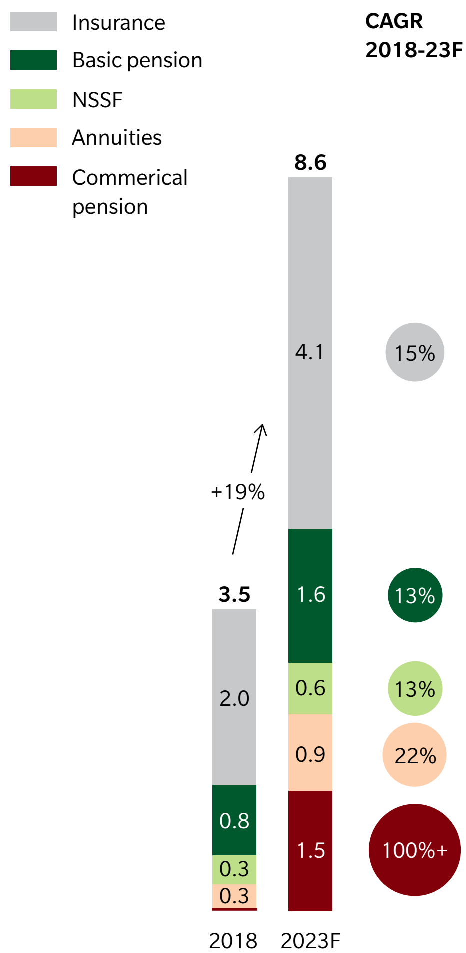
The demand from domestic investors is huge and is expected to continue to grow. The investable wealth of retail clients is forecasted to grow from RMB 167 trillion (USD 24.3 trillion) today to RMB 280 trillion (USD 40.7 trillion) by 2023. Meanwhile, the balance sheet of institutional clients (including only insurance, basic pension, NSSF, corporate annuities and commercial pension products) is expected to more than double from RMB 24 trillion (USD 3.5 trillion) to RMB 59 trillion (USD 8.6 trillion) over the same period.

Exhibit 3: Size of retail investable wealth and institutional balance sheet

Growing investable wealth of retail clients
2018–2023F, USD TN



Growing balance sheet of institutional clients
2018–2023F, USD TN



Note Numbers may not add up due to rounding errors.

Source: National Bureau of Statistics, China Banking and Insurance Regulatory Commission, National Council for Social Security Fund, Ministry of Human Resources and Social Security, Oliver Wyman analysis

Onshore wealth management is becoming more and more important for high-net-worth individuals (HNWIs) amid more stringent outbound capital control and rumoured estate taxes, and as more families begin to approach the transition of wealth from the first generation to the next.

The continued growth of pension and insurance markets is expected to translate into a huge demand for outsourced investment management, as pension providers and insurers seek to improve investment performances amid declining yields. These players have yet to fully exploit their thresholds for equity investments, but would require help from external managers due to their lack of equity investment capabilities.

Increasing participation by foreign investors in China

Over the last decade, some global investors have already recognized China as an important market for investments, given the enormous market size and strong macroeconomic growth, thereby actively overweighting China in their global asset allocation portfolios. The demand is now amplified as global indices have started to include onshore Chinese assets into the benchmark, triggering further investment demand from passive investors. It is expected that this will translate into an estimated inflow of close to USD 100 billion into the China market in 2019.

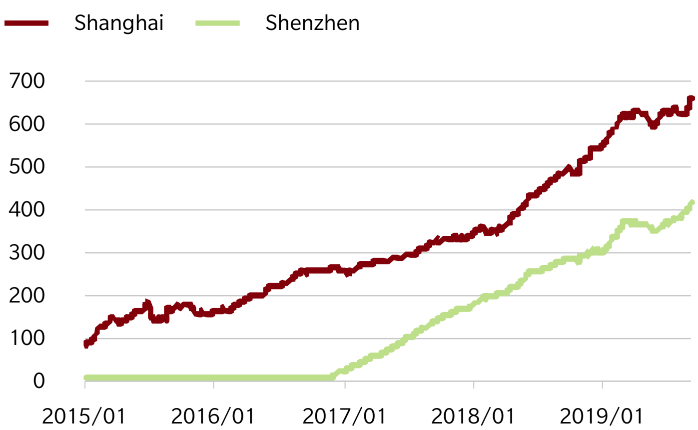
Looking forward, many asset managers have even begun to publicly discuss the potential for China to be carved out as a standalone asset class (like Japan) by major index providers. This would translate into significant further inbound capital, as global institutional investors (e.g. pension and insurance providers), following the benchmarks' leads, increase their allocations into China.

The growing inbound investment demand is matched by the continued introduction of cross-border schemes, such as Qualified Foreign Institutional Investor (QFII), RMB Qualified Foreign Institutional Investor (RQFII), Stock Connect and Bond Connect, which make onshore China investments accessible to foreign investors. The regulators had been increasing the cross-border quotas over the last few years, until a complete removal of quota restrictions on QFII and RQFII schemes was recently announced in September 2019.

Exhibit 4: Size of inbound quotas and expected inflow due to indices inclusion

Broadening and expansion of the cross-border investment channels

Aggregate quota used - northbound stock connect [1]
2015–2019, RMB BN



Approved Investment Fund – QFII
USD BN

2002	2007	2012	2015	2019 - Jan	2019 - Sep
10	**30**	**80**	**150**	**300**	**Quota restriction removed**

Increasing inflow demand from indices inclusion

Estimated capital inflow by HKEX
2019, USD BN

	Q2	Q3	Q4
Bloomberg	+18	+18	+12
MSCI	+13	+13	+13
FTSE	+2	+4	-2
S & P Dow Jone Indices	-	+1.2	-
Total	**33**	**36.2**	**25**

1. Northbound trading refers to foreign investors trading in Shanghai Stock Exchange and Shenzhen Stock Exchange through stock connect scheme with Hong Kong Stock Exchange

Source: Hong Kong Exchanges and Clearing Limited, State Administration of Foreign Exchange, Oliver Wyman analysis

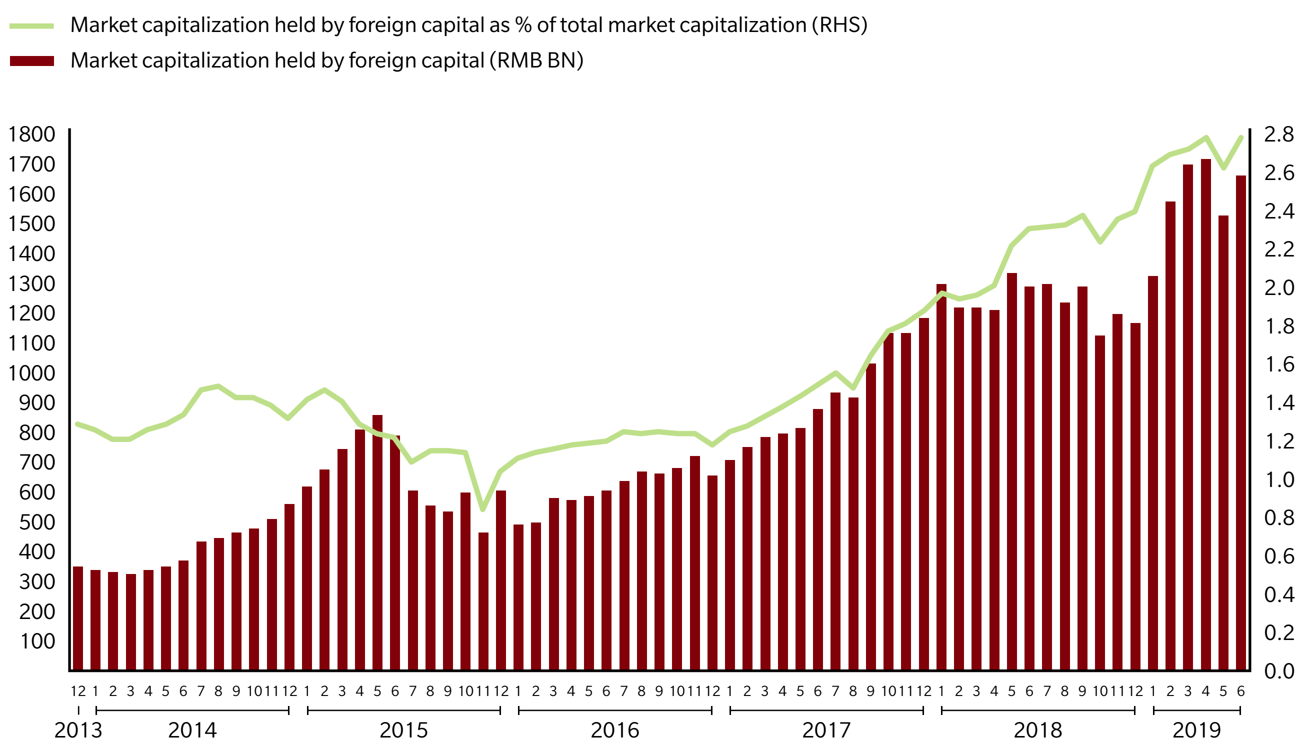
Although the short-term impact of the removal of QFII quota restrictions may be insignificant as the quota utilization is still low at 30-40% today, it will provide more flexibility as inbound demand continues to pile up and as regulators ease legacy barriers that discouraged the use of QFII/RQFII channels. For example, the scope of tradeable instruments under the QFII scheme has expanded[4] since early 2019. Furthermore, policymakers are now moving towards harmonizing quota schemes by announcing plans to merge QFII and RQFII, which would help reduce administrative burdens for foreign players.

Similar trends are being observed for the Connect schemes, where capital flow limits have been raised (e.g. in 2018, daily northbound capital inflow caps for Shanghai

4 In January 2019, the CSRC expanded the investment scope of QFII to cover more diverse types of onshore financial instruments, e.g. National Equities Exchange and Quotations (NEEQ) stocks, bond repo, private funds, financial futures, commodity futures, options, etc.

and Shenzhen Stock Connect were quadrupled to RMB 52 billion (USD 7.6 billion) and the coverage of financial instruments have been expanded (e.g. the introduction of Bond Connect in 2017). It is expected that a broader variety of connect schemes will continue to be introduced, including ETF Connect, Commodity Connect, IPO Connect and eventually Warrant Connect, although these will take place gradually as regulators and exchanges align interests and iron out operational procedures. These moves will only encourage broader and deeper participation in the China market by foreign investors, where foreign capital currently only accounts for 2.7% of the total A-share market capitalization.

Exhibit 5: A-Share market capitalization held by foreign capital



Source: People's Bank of China, WIND, Oliver Wyman analysis

Advancement of the local capital market

In the past, the real economy in China raised funding mainly through indirect sources such as bank deposit or shadow banking[5] channels. However, these avenues have been posing enormous hidden credit risks to the financial system and have so become increasingly unsustainable amid slower economic growth. Hence, policymakers have been proactively driving the development of local capital markets. For example, the Science and Technology Innovation Board (STAR)[6] was established to allow different types of companies to raise funds, and to create trading opportunities for investors of varying risk appetites.

At the same time, it is expected that the capital market trading environment will improve and converge towards global standards, as Chinese policymakers recently proposed various policies and reforms to increase the width, depth and transparency of local capital markets. These policies include the introduction of more new derivative products for onshore markets, a stricter set of share suspension criteria, and measures to vitalize stock trading activities.

5 Shadow banking refers to the off-balance-sheet indirect credit given to borrowers, usually in the form of bank wealth management products (WMPs) and trust products. Banks would sell the WMPs to investors, and the funds collected would in turn be invested into 'channel vehicles' such as trust products (different from the trusts in developed markets), which then in turn would be invested into fund-raising project financing. See our recent report "Global Asset Managers in China: Riding the Waves of Reform (2018)" for more details

6 The STAR market started trading in July 2019, with 25 debutants and currently around 150 companies in the registration pipeline. It allows currently unprofitable technology companies, including pre-revenue biotechnology start-ups, to list in Shanghai, providing investors wider choices of investment assets. Also, the STAR market has adopted a new, registration-based IPO mechanism, in which companies are required to fully disclose their earnings and operations in their IPO applications. The Shanghai exchange will assess their documents before green-lighting their IPOs. Most significantly, the regulators will let the market decide the worth of the companies. This is different from the approval-based mechanism applied for main boards today

Exhibit 6: Summary of policy details on the capital market trading environment

Direction	Policy details	Impact
Introduction of new derivative products onshore	Introduced first equity index options in 2015 Continuous development of commodity options since 2018 More new types of derivatives to be introduced in the future (e.g. OTC options, interest rate options, synthetic equity options, cross-border derivatives, etc.)	**Provides investors a wider range of instruments for trading and hedging**
Stricter set of A-share suspension/ resumption trading criteria	Clarified the specific criteria for stock trading suspension/resumption in Nov 2018 Allowed exchanges to reject unreasonable suspension applications Proposed more demanding disclosure requirements for stock trading suspension/resumption, etc.	**Reduces inappropriate stock suspensions and increases market transparency**
More measures to vitalize stock trading activities	Eliminated the 130% maintenance margin requirement in Jan 2019, leaving the maintenance margin to be decided by the securities companies based on their own risk assessment Loosened the risk capital requirement for securities companies to invest in equity securities	**Facilitates a more liquid, active and price-efficient market**

Source: China Securities Regulatory Commission, Oliver Wyman analysis

We also anticipate that the proven data analytics and technological know-how of domestic tech giants could be translated into insightful and tradeable solutions for capital market participants. For example, leading players such as Alibaba and Baidu have been leveraging their proprietary alternative data (e.g. their e-commerce analytics and search engine results) to produce innovative stock market indices that are already being tracked by several passive funds today.

All of these factors are expected to facilitate the creation of a greater variety of and better quality onshore Chinese investable assets, which will eventually support a wide range of investment strategies.

Continued development of offshore RMB assets

With the blueprint of RMB internationalization from trade settlement currency to investment currency to a final goal as reserve currency, the RMB has become a more international currency compared to a decade ago.

While there have been setbacks on advancing the RMB as a settlement currency given the association with the trade war and the slow relaxation of controls with regard to foreign exchange, substantial progress for the RMB as an investment currency has been observed. For example, various RMB financial products have begun to prosper in Hong Kong, not only RMB bonds, but also various types of RMB securities (i.e. securities traded in RMB) listed on the Hong Kong Stock Exchange including ETFs, REITs and equities. Policy relaxations are also driving the development of offshore RMB risk management instruments. For instance, the HKEX first introduced bond derivatives in 2017, serving as an interest-rate-hedging tool given the demand for RMB bond investments from channels such as the Bond Connect schemes.

Coupled with the progress of various global development strategies advocated by China, including the Greater Bay Area (GBA) plan and the broader Belt and Road Initiative (BRI), the RMB products ecosystem is expected to flourish, providing opportunities for investment managers, financial intermediaries and market infrastructure providers[7].

7 See Celent's recent report "RMB Internationalization: Integrating the Great Wall with Global Capital Markets (2017)" for more details

1.2 Emerging business opportunities

The shift of China's financial system from shadow banking to capital markets will promote tremendous onshore China opportunities for global players, especially when considering the following points with historical structural disadvantages now being eased:

- The asset management space was dominated by banks and their "channel" partners who were manufacturing 'quasi-fixed income' investment products on the back of the shadow banking system, leaving professional fund management with limited room to compete
- Similarly, the wealth management space was occupied by third party wealth management companies and local banks with higher risk appetites to distribute these principal-guaranteed 'quasi-fixed income' investment products
- Given the prevalence of shadow banking financing and an underdeveloped institutional market, the capital markets currently remain relatively vanilla, resulting in a largely undifferentiated market dominated by players with larger branch networks and better relationship access

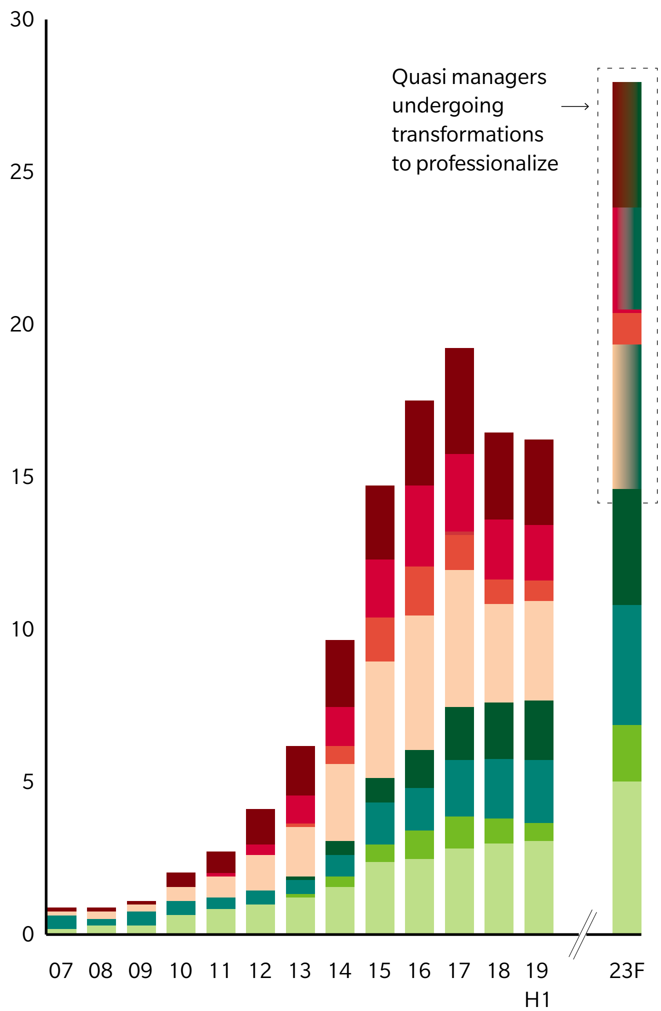
Asset management: In search of 'quasi-fixed income' substitutes

In our 2018 "Global asset managers in China" report, we predicted the shift in AUM from "quasi" managers to "professional" managers. We believe this trend will continue, as the recent default scandals with quasi-fixed income products means consumers are becoming increasingly dubious of such legacy products.

More importantly, many of the legacy "quasi" managers will begin to transform themselves into "professional" managers. Banks are actively setting up Bank Wealth Management Subsidiaries (WMSs) to replace legacy bank WMPs, with WMSs focusing on standard assets, such as equities, rather than shadow banking assets. Meanwhile, securities asset managers (Sec AMs) are actively building up their actively managed Collective Asset Management Plans. Trust companies that were historically "channel vehicles" for shadow banking-based investment products are transforming into Family Trusts. Cumulatively, the overall AUM of the market is projected to reach RMB 170-205 trillion (USD 25-30 trillion) by 2023.

Exhibit 7: Total AUM of China's asset management industry

2007 to 2023F, USD TN (LHS), % (RHS)



	'17-'18[3] CAGR	Industry outlook	Perspectives
"Quasi" investment managers[1]			
Trust	-14%	↗	Shift to family trusts
Securities AM	-21%	↗	Refocus on active mgmt. (e.g. collective AM plans)
Futures AM	-48%	↗	
FMC subsidiary	-28%	→	Diminishing value
Bank WMP	-25%	↗	Shift to bank WMS
"Professional" investment managers[1]			
Private funds[2]	14%	↑	Continue to develop and form symbiotic relationships with 'transforming' quasi managers (e.g. manage equity portfolios for bank WMSs)
Mutual funds	12%	↑	
FMC segregated account	-6%	↑	
Insurance AM	8%	↑	
Overall	**-10%**	**~10–12% CAGR**	

18–23 CAGR ↑ 10%+ ↗ 5–10% → <5%

1. "Quasi" asset managers include bank WMP (largely delegated), FMC subsidiary, Futures AM, Securities AM, Trust (all mainly "channel" business). "Professional" asset managers include private funds, mutual funds (including segregated accounts) and insurance AM (all mainly "active investment")

2. Including private securities funds (mainly secondary market investment); private equity / venture capital funds (mainly primary market investment) and others (e.g. investment in art, wine, etc.)

3. Using CAGR in original RMB figures to isolate the effect of FX fluctuations.

Source: AMAC, CIRC, CSRC, CTA, CBRC, WIND, Oliver Wyman analysis

Therefore, the differences between the asset management licenses are reducing, and we will see three critical implications going forward as a result:

1. Asset managers, both global and local ones, will place a reduced emphasis on “choosing the license based on its scope of business”. On the contrary, asset managers will need to actively determine what types of business they want to offer (e.g. discretionary portfolio management, fund-of-funds, funds, advisory, etc.) in order to differentiate themselves from their peers.

2. This may lead to stronger direct competition, as most licensed providers would then be competing within the sphere of actively managed public funds based on listed securities. The biggest opportunities lie within the realm of providing suitable replacement solutions in place of the traditional quasi-fixed income products. In this regard, we have already witnessed tremendous growth in the mutual fund space over the last two years, particularly with passive funds and ETFs[8]. As these types of trading instruments continue to prosper, we also anticipate an opportunity for quant funds to develop low-risk arbitrage products as decent alternatives, and this area is just one example of where global managers may be able to import their global know-how.

3. A lack of equity-related or alternative investment capabilities by Bank WMSs and other evolving “quasi” managers may lead to the outsourcing of “professional” managers for sub-advising capabilities. This could be an interesting symbiotic play, with Bank WMSs benefiting from maintaining a strong local brand and distribution network, and global players meeting such qualitative needs by cooperating with suitable Bank WMSs.

Wealth management: Elevating from product distribution to broader advisory

Correspondingly, global players should focus on building product platforms comprising of offerings that could serve as substitutes for ‘quasi-fixed income’ products.

Foreign wealth managers may also be able to create opportunities that entice clients with more professionally managed investment solutions, while local players busy themselves with fixing the legacy product issues. For example, according to our recent survey, the “Second Generation” of target families tend to seek discretionary wealth management solutions so that they can free themselves from managing inherited wealth and so pursue their personal interests.

Foreign wealth managers can also leverage on their global expertise to bring in higher-end private banking solutions, such as wealth and inheritance planning.

8 See our recent report “China Asset Management: ETF as Next Wave of Growth (2019)” for more details

Securities: Derivative innovation and global-standard securities services

Global investment banks can then compete in the sales and trading space by focusing on more innovative derivative products and various structured solutions. We believe that the influx of global asset managers will lead to the demand for more complicated financial products.

Equally, we anticipate that the market will have a strong need for custody and security services alternatives that are more aligned to global standards, as foreign player participation increases and the local institutional customer segment grows.

Exhibit 8: China market revenue opportunity for global players

Note Numbers may not add up due to rounding errors.

1. Including revenue from all AM licenses (e.g. bank WMS); which has a diluting effect on foreign players' share of revenue given their lower participation in other licenses.

2. Including revenue generated from banking, securities and 3rd party management industries.

3. Including brokerage (institutional), investment banking and investment return (i.e. proprietary trading and/or market making) only

Source: Securities Association of China, Asset Management Association of China, WIND, Oliver Wyman proprietary data and analysis

2 Critical strategic agenda for global players in China

While the market environment in China has become a lot more reasonable for global players than a decade ago, the heavy local competition and different market structure (e.g. separate entities and licensing for securities versus banking) still presents enormous challenges for global players aspiring to deepen their presence in China.

For players with vastly different backgrounds and stages of development in China, we believe it is imperative to do the following: calibrate an appropriate overall China ambition; design business propositions in conjunction with keeping licence application considerations in the mind; consider a series of organic, inorganic and partnership avenues for growth; and lastly, develop future-proved infrastructure that is most suited for China's unique but evolving market structure.

2.1 Determining an appropriate overall China ambition

It is tempting for all players to cite China as a growth driver and to get a share of the pie that is the China market, but global players need to thoroughly consider their 'rights to win' and 'appetite to invest'. In this endeavour, they need to determine what is the right level of ambition with regard to their China onshore ventures.

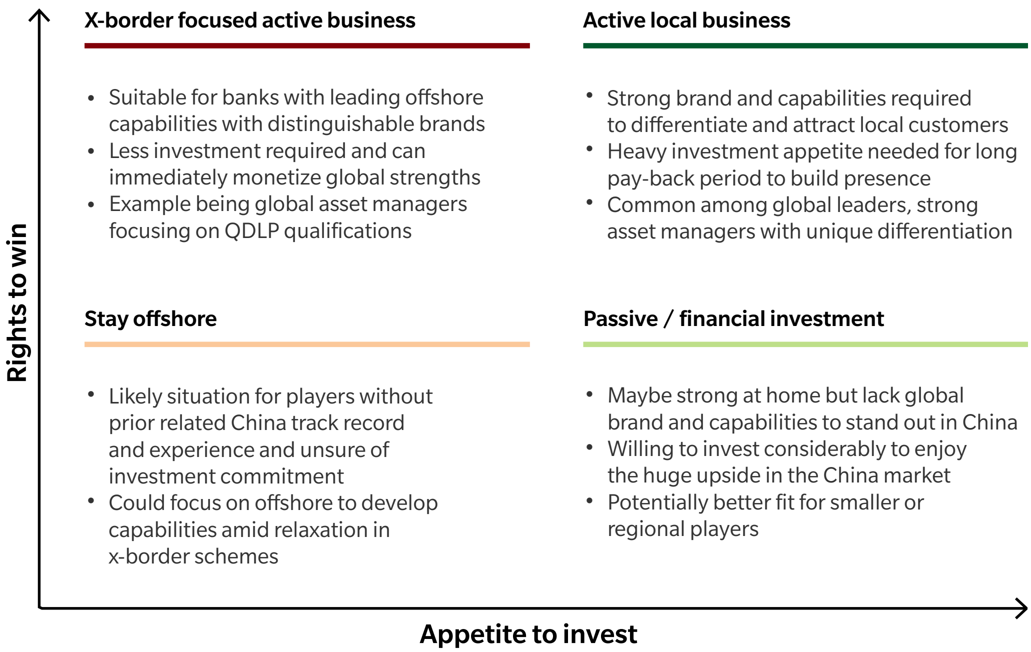
While leading global banks may go gung-ho with their China entries, we have seen some other players struggling with how to balance China with their broader global business portfolios. The long pay-back period needed for the local venture's reputation to grow and its customer relationships to deepen appropriately (we have seen cases where operational headquarters have had to prepare for close to 10 years to put themselves in a position to succeed) has often created a dilemma for executives, who usually have competing priorities or imminent challenges with their regional and/or offshore businesses.

Therefore, in-depth discussions are required at the Board and Senior Management level to thoroughly consider the benefits and trade-offs involved. While it may seem difficult today, global players should begin to explore properly the potential synergies between their prospective onshore business and existing global business.

Players with smaller appetites, for instance, may consider focusing on certain niche areas. For example, several global asset managers have chosen to focus on outbound-plays by prioritizing the QDLP business in China, in order to take advantage of their global product strengths while recognizing their lack of onshore China investment experience.

On the other hand, we believe smaller or less differentiated players could still passively participate in the China market to get a share of the lion-sized opportunities, albeit the irony being that foreign firms are now allowed to enjoy majority stakes. Thus, they could consider making majority-stake investments into local financial institutions that offer promising upside. Although this may require a larger initial investment, it should also provide global players with stable and growing returns. The key is to identify the right targets for investment. If managed correctly, global players may also be able to then 'export' their newly acquired Chinese expertise (e.g. investment know-how) back home or to other global markets where such expertise is heavily sought.

Exhibit 9: Different potential levels of China ambition for global players



Source: Oliver Wyman analysis

2.2 Planning overall business proposition and licence application simultaneously

Global banks often want to replicate their global business models in China, only to then find that such business models tend to be less plausible due to the Chinese market's entity and license structure. In China, global banks need to set up several entities and acquire multiple licences in order to provide a full range of offerings across all lines of business.

This is made more difficult under the 'separate license regime' in China, where entities are required to operate separately from one another, a situation which of course lends itself to inefficiencies. As such, global banks need to elevate their entity and license planning to a bank-wide level and design the target business portfolio bearing in mind the entity and licensing constraints. Based on our experience, the Asset Management and Wealth Management businesses are impacted the most.

The Asset Management business in China, in particular, is broken down into various licenses under multiple entities. Global players could set up an independent entity in the form of an IMWFOE / PFM or an FMC JV. Alternatively, they could tag onto an existing banking or securities entity to apply for a Bank Wealth Management Subsidiary (WMS), which is an asset management entity despite its name, or a Securities Asset Management qualification, which could then be spun off as a subsidiary.

Global players need to consider the trade-off between the ease of entity ownership and the license's fit for purpose. For example, while an IMWFOE / PFM provides long-only managers with a fully owned local business from day one, the nature of the license would force the managers to have to adapt to absolute return strategies, even though such strategies may not be their forte. Furthermore, global players should also take into account organization-wide considerations for any Asset Management business that they undertake. As an example, foreign players with a heavy banking focus may consider centring their Asset Management business around the Bank WMS, so that the Bank WMS could then potentially support bank-wide priorities (e.g. for Private Banking to leverage the Bank WMS to offer discretionary mandates, commercial pension products together with Retail Banking, etc.).

Exhibit 10: Relevance of entity/license for typical business lines

	Major entity / licence				
Typical business lines	**Securities JV**	**FMC JV**	**IMWFOE PFM**	**Bank WMS**	**Bank (WFOB)**
Asset Management	Products for qualified investors only[1]	Mass + qualified investors	Products for qualified investors only	Mass + qualified investors	Bank AM dept. not favoured under new reg.
Wealth Management	Trading + 3rd party products	Needed for manufacturing of proprietary products, discretionary offerings, etc.			Banking + 3rd party products
Sales & Trading	Both equity and fixed income				Fixed income only
Securities Services	Mostly private fund custodian				More common for mutual fund custodian
Investment Banking	Both ECM and DCM (not all types of debt)				DCM (some types of debt)

Highly relevant for the business line — Partially relevant for the business line

1. Unless attaining a mutual fund licence under Securities JV AM

Source: Oliver Wyman analysis

Similarly, the Wealth Management businesses of global players are typically built on an existing banking or securities entity, which results in very different propositions that can be offered to customers. For example, a bank-based wealth management business in China would be able to offer banking services such as taking in deposits, but at the same time it would not be allowed to provide securities trading services to its banking customers, and vice versa. Furthermore, in order to provide discretionary investment management solutions to customers, global players would need to possess asset management licenses and qualifications. This creates further complications, as the business would then span across multiple entities despite regulations demanding arms-length arrangements (as will be explained in the coming paragraphs).

It is important for global players to determine the 'house entity' upon which their wealth management business would be set up, taking into account their target customers and the propositions suitable for them. For example, a proposition targeting entrepreneur segments may require significant linkage with capital market solutions, thus justifying a securities-centric model. Global players would also need to consider the 'accessibility' of asset management licenses within the organization. Any private banking and/or wealth management business, if set up on the banking entity as the house entity, may be able to tap into the Bank WMS more easily. The house entity decision also hinges on the existing availability of licenses and business (and hence license application) priorities of other lines of business and the broader China franchise as a whole.

Similar issues have also been observed within the securities business, where some activities, such as mutual fund custodian services and some aspects of the debt-trading and underwriting business, are more prevalent within the banking entity than securities entity.

Lastly, the sometimes-competing interests across business lines may mean that more bank-wide coordination for qualification planning is required. For example, a newly established securities JV can only apply for four major qualifications at the time of application, and further qualifications can only be added in batches of two, which may pose constraints to the type of business the entity can initially support.

2.3 Setting up the 'base' operational entity

Depending on their current status, there are various routes for global players to choose in terms of putting their China strategy into operation. For global players who are already in China, they need to balance the benefits of converting an existing JV into a majority ownership against that of setting up a new JV. First of all, global players need to evaluate the strength and future prospects of the current JV and, hence, whether it will be worth it for them to double down, while at the same time navigating more practical considerations such as the likelihood for existing partners to sell their stake. In addition, they would need to consider the operational implications after turning an existing JV into a majority ownership. For example, a global firm may want to align the operational processes of its current JV with the global standards it has in place. However, such a move may face significant pushback from the existing JV's current management.

For those who do not have an existing entity, it is almost a natural decision for them to build a greenfield entity. However, global banks who go down this road would need to think through the partnership dynamics – for example, whether the management's philosophy is properly aligned (especially given multiple precedents of failed JVs), whether the partner with whom they choose to work would be willing to wind down their stakes in the future for the global firm to eventually achieve full ownership, whether the partner would be able to bring strategic value such as exclusive client access to the table, etc.

Exhibit 11: Options for global players to set up the initial operational entity

	Already have an existing JV		Do not have an existing JV	
	Raising shareholding	**Quitting then setting up new JV / entity**	**Participating in an existing JV / entity**	**Setting up new JV / entity**
Securities	UBS acquired from China Guodian Capital Holdings and COFCO to increase stake to 51%	JPM sold its 33% owned JV (with First Capital Securities); and re-entered with 51%-owned new JV	Possible option, but no example as of today	Nomura set up new 51%-owned JV with trading group Orient International
FMC	JPM won an auction for 2% stake to take majority stake in China International Fund Mgmt.	Possible option Multiple firms exited their China JV (e.g. SSGA, BNY, Lyxor, etc.); plans to re-enter unclear	Possible option, but no example as of today	Possible option, but no example as of today
IMWFOE PFM	Not relevant, typically 100% owned from Day 1	Multiple firms set up an IMWFOE PFM even with existing FMC JV; with a view to convert into FMC then quit existing one	Possible option, but no example as of today	Fidelity as first global firm to set up IMWFOE PFM, with a view to convert to FMC

Source: Press release, Oliver Wyman analysis

Linked to the earlier discussion on ambition, smaller regional players should also rigorously question whether they have the capabilities and patience required to build the business from scratch. In light of this, some players are considering to potentially take up shares from existing players in the market. Global players could look at targets such as local aspiring players seeking strategic investors, as well as players with investment companies as shareholders who are planning to cash out from existing JVs.

2.4 Developing partnerships to enable a thriving business

While global players tend to be able to differentiate between product expertise and service quality, it is typically a challenge for them to compete on client acquisition. We believe global players can explore different forms of partnerships to tackle this problem.

On the asset management side, the most imminent challenge for new managers is about securing seed funding for their first product to build a proven track record, followed by product distribution. Some players develop win-win deals with local securities brokers by offering them fund custodian and administrative mandates in exchange for support in distribution. Others, meanwhile, are attempting to scale up by adopting an 'advisory' approach, where they sub-advise prominent investment managers with strong local brand names in front of end customers. In this regard, six IMWFOEs[9] have acquired 'advisory' qualifications after operating under their PFM qualifications for a year.

Similarly, private banks and wealth managers can consider a range of financial institutions, fintech companies and lifestyle ecosystems as potential partners for customer acquisition. Many leading fintech and consumer tech companies have amassed huge customer bases on their platforms, where global players could work closely with these partners to single out the most valuable customers using analytics and offer wealth management solutions to them.

Global players would need to develop a deep understanding of their prospective partners' strengths, and any key trends affecting their partners and their partners' operating industry. For example, digital ecosystems and traditional financial institutions have very different customer bases and capabilities, implying potentially very different partnership propositions. Such a context requires global players to think from the local player's perspective (i.e. why would a local player be interested in any propositions from a foreign partner). For example:

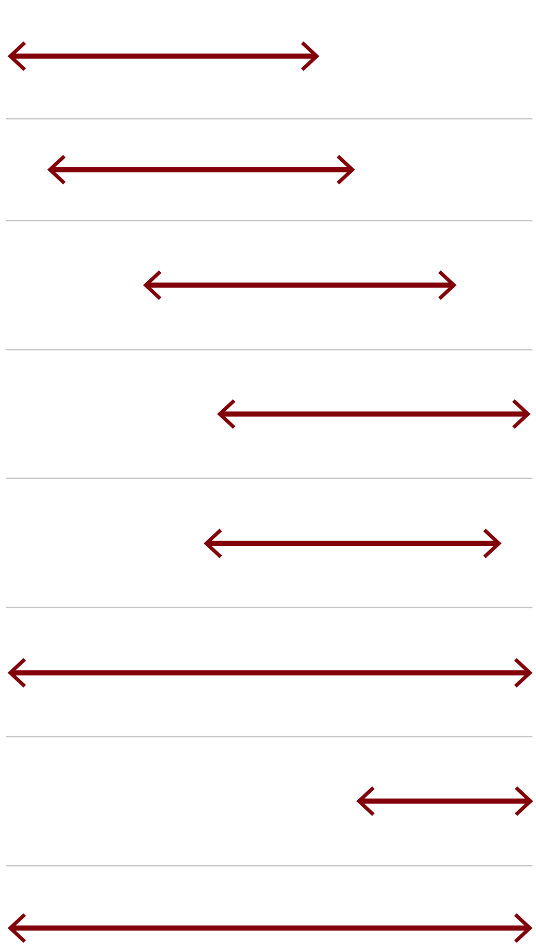
1. Local financial institutions are also dynamically re-calibrating their strategic and investment focus given regulatory reforms. For instance, banks may potentially anchor and build any future WAM business around their new WMS, as opposed to investing into multiple entities. This may undermine the future prospects of existing JVs.

2. Local players are exploring strategic synergies onshore (e.g. local 3rd party wealth managers are trying to tap into foreign players' onshore CIB qualifications), so they would be keen to evaluate the foreign players' actual organic growth onshore as opposed to just their offshore edges.

3. Local players may prefer to focus any partnership opportunity on testing out existing non-core or under-performing businesses, as a lowest-risk approach to beginning a foreign partnership. This means global players may need to be prepared to start cooperating with an unequal footing and seeing the cooperation as a longer-term journey as opposed to a short-term transaction of complementary capabilities. Foreign players may also need to adopt non-traditional and flexible approaches in any initial collaborative format (e.g. Vanguard's first minority JV with Ant Financial).

9 As of August 31, 2019

Exhibit 12: Focused segments and dynamics of prospective partners



Category	Customer Focus (Mass / Mass affluent / Emerging affluent / HNWI)	Dynamics
Tech giants		• Scaled user base with frequent touch point • Abundant data to identify high value users and understand behavior and needs
Online personal finance mgmt.		• In-depth access to financial data for customer understanding and prospect identification
Online info aggregator		• High concentration of 'investor base' • Major players shown interests in expanding into securities and wealth management space
Online product platform		• Strong investor base from P2P boom ... • ... but need transformation amid quasi-FI products downturn
Online securities broker		• Unique customer (Chinese with offshore asset) • Limited onshore business means minimal conflicting interests on onshore partnership
Core traditional FIs (banks, securities)		• Typically huge customer base due to large branch network and perception on 'security' • Actively driving wealth mgmt. transformation
3rd party WM		• High concentration of HNW customer base • Headwind in quasi-FI products may lead to need for business model transformation
Asset managers (FMC, PFM, PE)		• Some built D2C relationship on digital platform • Limited offerings (i.e. funds) may open room for broader collaboration

Source: Oliver Wyman analysis

2.5 Developing future-proved infrastructure

Given that many foreign players will be entering China with a minimal existing presence or legacy, they actually have an opportunity to build their infrastructure in a way that is most efficient for their future expansion. We recommend that global players build their infrastructure in a 'connectable' and 'modular' way.

Due to the aforementioned 'separate license regime', operations across entities and across borders are largely walled-off from one another. While there have been discussions about the potential convergence of regulatory regimes and the harmonization of cross-border information flow, no one can as yet predict how quickly this convergence might progress. As such, we recommend global players to design technology architecture in a flexible way so that systems across different entities are compatible with one another. Doing so would allow information flow across entities to be made possible simply by altering permission rights once regulation changes actually occur in the future.

Global banks entering the China market also need to make a design choice – whether to set up their core technology platform to be locally run with global connectivity, or globally run with local connectivity. Increasingly Chinese regulators have been advocating locally run platforms, but this also means that global banks would need to be able to cope with the challenges of needing to report locally and the difficulty associated with finding sufficient local language support function employees, as well as sufficiently meeting the reporting requirements in their home jurisdictions.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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