

COVID-19 AND FINANCIAL SERVICES IN CHINA

Challenges and Opportunities for the Chinese Financial Services Sector

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SUMMARY OF WHERE WE ARE IN CHINA

Painful Q1 with uncertainty going forward



China is returning to work

- Unprecedented government action restricted cases largely to Hubei, and now has shut off China from the world
- 80%-90% of production has been resumed; supply shock now becoming a demand shock

Q1 GDP growth will be dampened, but it has always been a slow quarter; Q2 and beyond will partly depend on government action...

- Short term economic contraction in Q1 inevitable; bank NPL rises
- Government has introduced a series of policies to support employment and SMEs
- We expect China GDP growth in 2020 of 4%-5%, based on further expected stimulus; our downside estimate is about 3.5%-4.2%

...and inevitably affected by the global spreading of COVID-19

- With a fast spreading global pandemic and a looming risk of global recession, we expect sluggish demand for Chinese export
- Further uncertainty due to populist and anti-globalization sentiment, which carries an impact in the much longer term

Layered impact on Hong Kong








COVID-19 has 'layered' additional stress on an already challenged Hong Kong economy

- Geopolitical tension since mid-2019 has a strong negative impact on HK's economy, already leading it into a recession
- With the recent increase in the case count due to importation, HK imposed a stronger and wider border control while highlighting the importance of social distancing
- HK SMEs and retailers, and food & beverage outlets are now facing a far greater liquidity pressure than ever

Path forward more uncertain for HK

- Curbing down case counts quickly will be critical, but interconnectivity of economy remains a challenge
- Creative & targeted government support will be essential for HK's speedy recovery, however there is limited scope given currency peg for monetary policy
- Transmission from real economy to financial sector only now starting to happen, with NPLs starting to rise

EXECUTIVE SUMMARY – OUTBREAK IMPACT ON THE FINANCIAL SERVICES INDUSTRY

	Banks	Securities Firms	Insurance Companies	Asset Managers	Wealth Managers
Industry trend before COVID-19 outbreak	 <ul style="list-style-type: none"> • Growth in asset and profitability began to decelerate, but still above 5% • Proactively address regulatory guidance on de-leveraging and orderly resolution of the perceived asset quality issue 	 <ul style="list-style-type: none"> • Fundamental shifts from ‘shadow banking’ to ‘capital market’ bring tremendous opportunities • Expect market consolidation and pressure for small players 	 <ul style="list-style-type: none"> • Double digit growth with government’s promotion of commercial insurance, esp. in the health lines • Shift in product mix from investment to protection coping with regulatory direction 	 <ul style="list-style-type: none"> • New regulations launched to promote active portfolio management while curb on shadow banking • Systematic shift from “quasi” investment managers to “professional” ones 	 <ul style="list-style-type: none"> • Slowing economy and downturn of credit cycle resulted in multiple product “bursts” and put extensive pressure on the WM industry, esp. for third party WM companies
COVID-19 outbreak impact on market trend	<ul style="list-style-type: none"> • Increasing penetration of online business • Highlights of capabilities in deal with business continuity planning & management <ul style="list-style-type: none"> – New NPL accumulating that challenges NPL management capabilities – Loosing in trade finance as global supply chain further diversifying production lines out of China 	<ul style="list-style-type: none"> – Indirect pressure from negative sentiment in capital market in short-term, but expected to normalize in the long-run 	<ul style="list-style-type: none"> – Short-term pressure on new premium and claims pay-out + Deepening risk education and increasing insurance awareness accelerate long-term growths 	<ul style="list-style-type: none"> – Discounted valuation in secondary and primary market during outbreak, but expected to normalize in the long-run 	<ul style="list-style-type: none"> – Unstable sales team due to sharp declining in new business and commission – Increasing reputational risk with more “blow ups” as economy further slow down – Accelerate Industry reshuffle

7 KEY AGENDAS FOR FS EXECUTIVES TO CAPTURE NEW GROWTH OPPORTUNITIES WHILE DEFENDING EXISTING POSITION

	Key Agenda	Rationale
Offensive Agenda	1 Digital acceleration	The outbreak future boosts online usage of financial services; traditional FS players should consider where to compete in the value chain as tech players further flourishing
	2 Health insurance growth strategy	With the promotion of insurance awareness by the outbreak, opportunities for health insurers are unprecedented and can be captured with well developed growth strategy
	3 Healthcare sector holistic solution	Develop sector specific solutions to ride with the potential healthcare boom after the outbreak will help banks generate substantial growth
	4 Supply chain migration opportunities	As the outbreak accelerates global supply chain to diversify production and sourcing lines out of China, Chinese banks' role along the shift should be redefined for new business opportunities
Defensive Agenda	5 NPL Management	NPL management will be essential for Chinese banks to deal with increasing bad loans after the outbreak and retain long-term creditworthiness
	6 Business continuity management	The outbreak put extensive pressure on business continuity management (BCM), which should have been developed and tested during normal time
	7 Recession readiness	As the risk of global pandemic is rising, financial institutions and regulators should be prepared for a potential global recession

01

MACRO IMPACT

PANDEMIC SITUATION (AS OF APRIL 1)

While the outbreak has been effectively contained in China, epicenters of the pandemic have shifted to Europe and North America; the increase of total confirmed cases globally continues to accelerate

Characteristics of COVID-19



Highly infectious through droplet and airborne transmission



Lower death rate compared to SARS



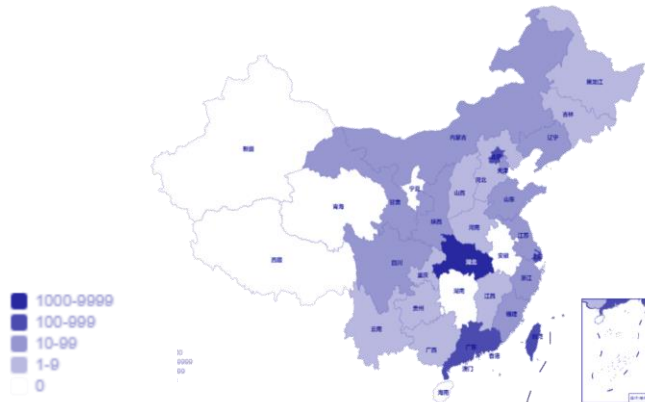
Senior citizen and people with pre-existing conditions are more vulnerable



Varying incubation period ranging from 1-14 days



While the situation has stabilized in China thanks to strict measures by the state ...



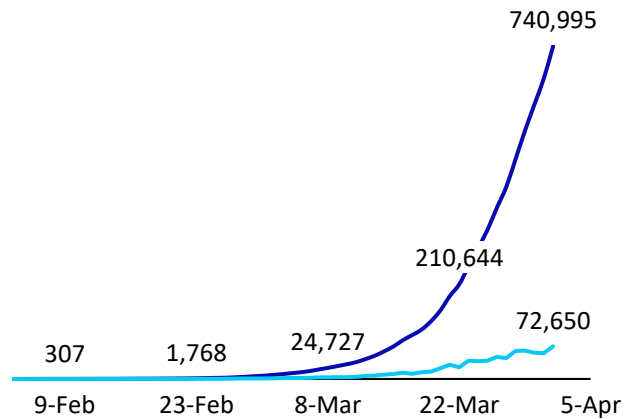
- 7 provinces are reporting 0 active cases
- Majority of new confirmed cases are imported from abroad, prompting tightened border control and reduced international air traffic
- Domestic focus has shifted to restarting economic activity and tracking asymptomatic patients



... COVID-19's global spread has continued to accelerate

Total / New confirmed cases outside of China

- Total confirmed cases
- New confirmed cases



Countries with highest number of cases

U.S.A.	163,199
Italy	105,792
Spain	94,417
Germany	67,366
France	51,477
Iran	44,606
U.K.	25,154
Switzerland	16,108
Turkey	13,531

Source: WHO, National Health Commission of the People's Republic of China, Oliver Wyman analysis

MACRO IMPACT: MAINLAND CHINA

The Chinese government put the economy on hold to control the outbreak, translating into severe short-term downturn

COVID-19 led to stricter response compared to SARS

Shorter time to implement nationwide epidemic response

~5 months for SARS

vs.

~2 months for COVID-19

Stricter control on population movement

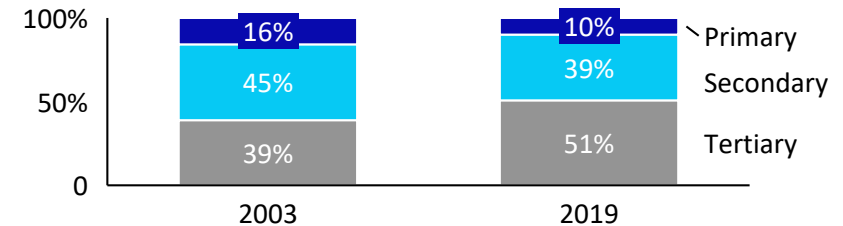
Designated Hospitals
sealed off during SARS

vs.

Entire Hubei Province
sealed off during SARS

More severe economic impact by COVID-19

China GDP contribution by sector in 03 vs. 19 (%)



Domestic production

- Due to travel restrictions and home quarantine rules
 - Massive disruption of labor supply resulting in a severe drop in economic activities
 - Double-digit YoY decline (Jan-Feb) across industrial output (-13.5%), retail consumption (-20.5%), and property investment (-16.3%)
 - Sharp drop of PMI to 35.7 for manufacturing and 29.6 for non-manufacturing in February
- As the pandemic is more under control in China today, economic activities in the domestic market has started to quickly recover

Sluggish foreign demand

- Continued decline in foreign demand due to the spread of COVID-19 globally, slowing down the recovery as factories running out of orders

Source: WIND, National Bureau of Statistics, The Economist, Reuters, Oliver Wyman analysis

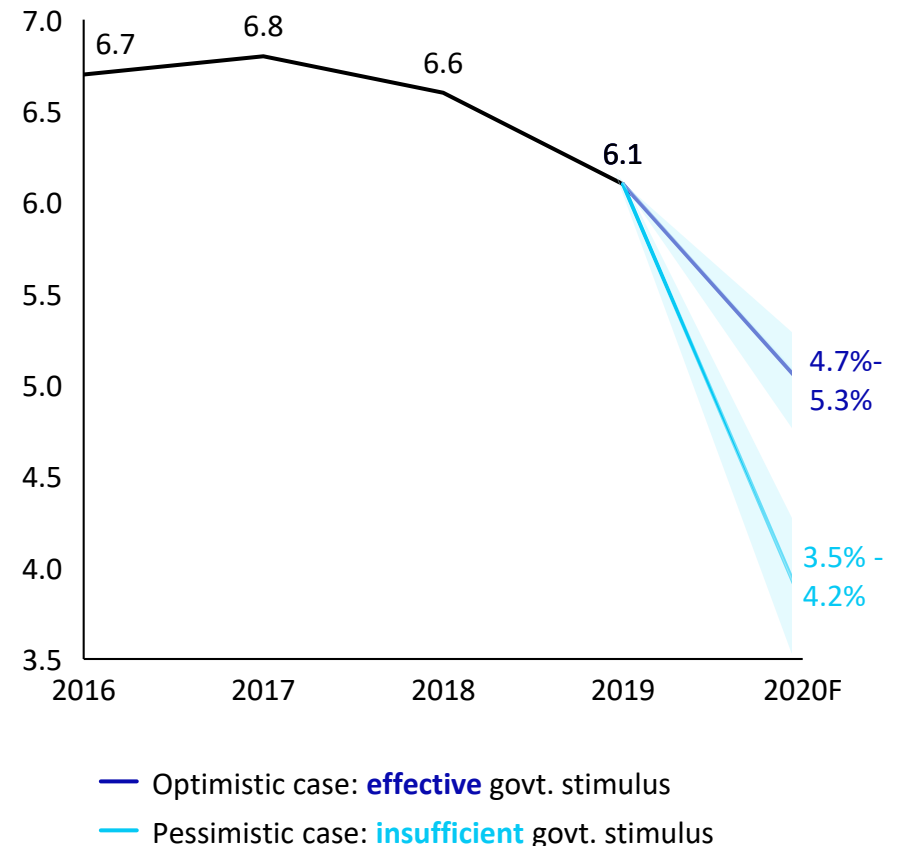
ECONOMIC IMPACT: MAINLAND CHINA

As more companies resume operations, the government has announced multiple stimulus packages for the economy; however, with increasing global uncertainties in sight, the effect of these measure is still to be observed

Stimulus from the government are expected, but their effectiveness remains unclear, with risks of overheat

- As of the end of March, over 76% of SMEs and 98.6% of national industrial companies have resumed production
- Chinese government have introduced a series of policies to reboot the economy, with further measures believed to be implemented, incl. industrial, fiscal and monetary policies
- Unlike the case for 08-09 when stimulus programs were designed to be funneled through the financial system, government support has been more targeted
 - Job creation: relief in social security payment, etc.
 - Small business targeted: national wide extension of maturity and interest forbearance
- However, even if the support/stimulus proves to be effective, uncertainties still exist
 - The rapidly developing global pandemic threatens to lead to a global recession and quite likely depression
 - Populist/anti-globalization sentiment may hit a stride in Western countries post the pandemic
 - A potential longer term damage in public image for China if not dealt with carefully

Possible economic performance for China in 2020 (%)

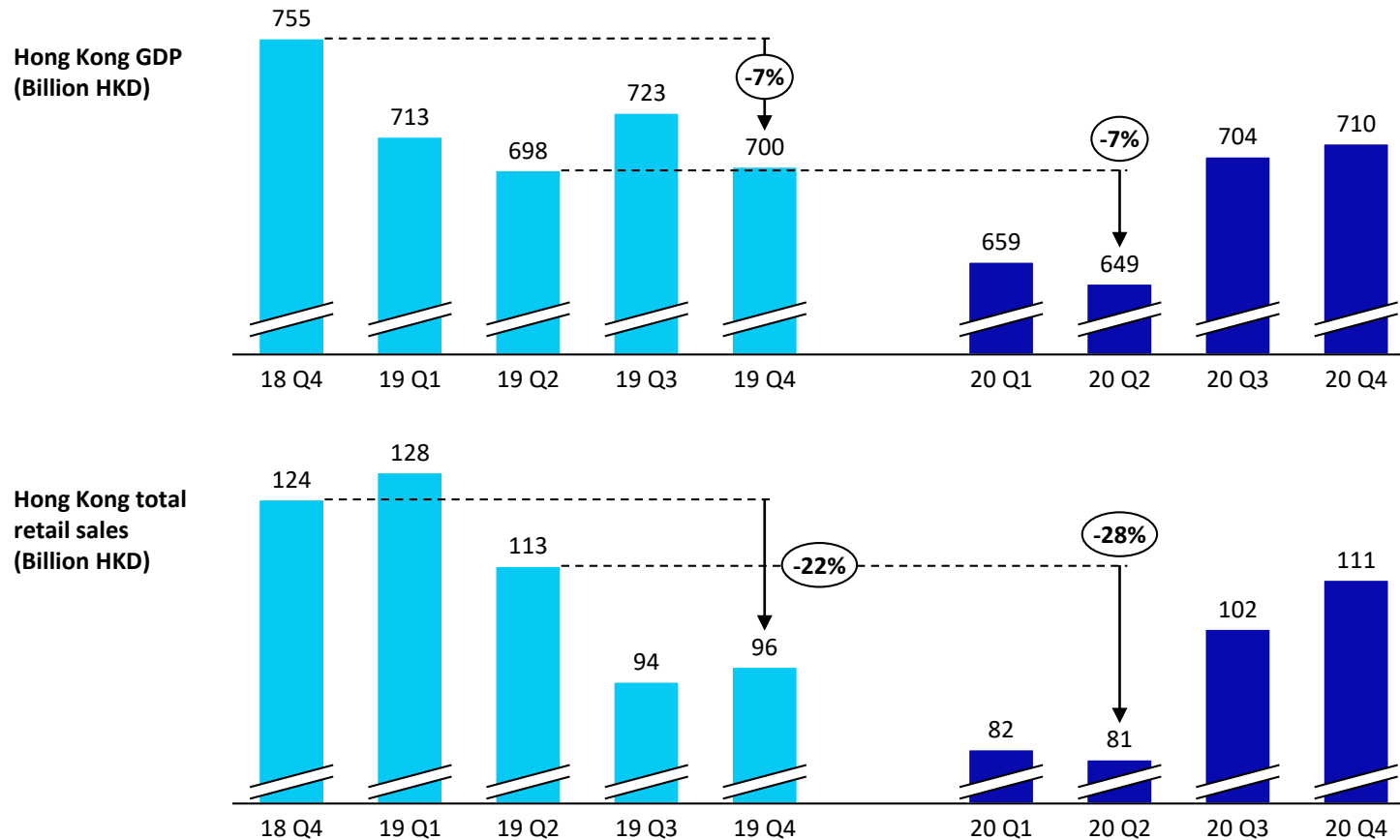


ECONOMIC IMPACT: HONG KONG

Piling on the declining trend caused by social unrests in Hong Kong in 2019, COVID-19 is expected to worsen the local economy – targeted government support will be essential for a speedy recovery

Economic decline in '19 due to social unrests

Virus outbreak will worsen the situation



Creative & targeted government support and stimulus will be essential for HK's recovery

Source: Census and Statistics Department of HKSAR, Oliver Wyman analysis

02

KEY AGENDA FOR FINANCIAL SERVICES EXECUTIVES

IMPACT ON FINANCIAL SERVICE: RISK AND WARNING

Failures in SMEs and a slower income growth may pose a deeper impact on the economy; at the same time, it is often difficult to target precisely with stimulus – defaults from those 2 sectors may have poses further risks

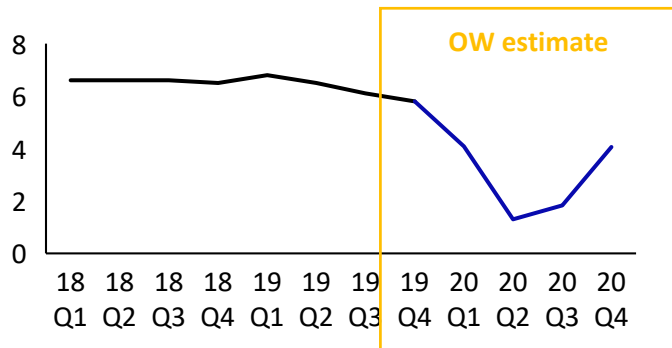
SMEs facing survival crisis in the outbreak

- SMEs are forced to shut down during the outbreak, and are hard to survive for more than 3 months due to cash flow constraints
 - >90% postponed their business re-open date
 - >50% delayed for 2+ weeks and have no clear re-open till now
- According to PBOC, MSMEs contribute
 - >60% GDP and >50% tax
 - >80% employment in China now



Higher unemployment (6.2% in Feb) and lower personal disposable income due to corporate layoff and SME failure

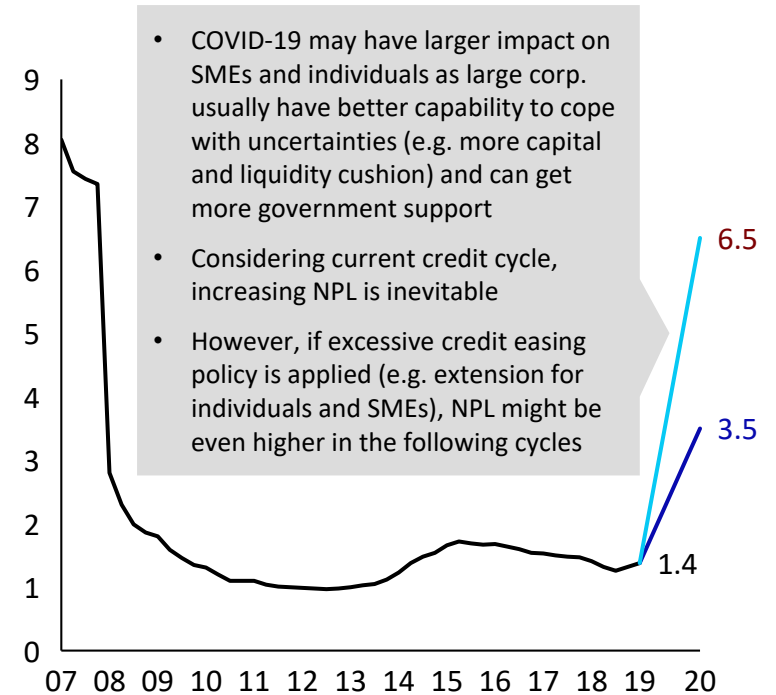
Disposable income growth rate (%)



SME loan default



China commercial bank NPL Ratio (%)



- Basic case (Defaults naturally caused by epidemic and the credit cycle)
- Pessimistic case (Credit cycle overly suppressed caused by excessive counter-cyclical easing policy)



Personal loan default














Source: WIND, National Statistical Bureau, PBOC, Economy Daily and Postal Savings Bank of China, Oliver Wyman analysis

IMPACT ON FINANCIAL SERVICE: OPPORTUNITIES AND CHALLENGES

While offline economy is hit hard by the outbreak, an opportunity window has opened for online businesses and various financial institutions

Boom in online retail

 <p>Online healthcare</p>	<ul style="list-style-type: none"> Ping'An Doctor's new user registration saw 10x growth, number of consultations scheduled in Feb is 9x of pre-outbreak monthly average, total visits topped 1.1BN 30% of consultation on DingXiangYuan is about COVID-19; its bilingual real-time report received 3.5TN views by end of March 	 
 <p>O2O E-commerce</p>	<ul style="list-style-type: none"> For major players (incl. Miss Fresh, JDDJ, Hema, Dingdong, Yonghui), transactions during the outbreak increased by 200%-500% Customers are expected to be better educated for online grocery purchase 	 
 <p>Online education</p>	<ul style="list-style-type: none"> DAU increased by 1100%-1500% for major online education apps after school cancelation during the outbreak 	
 <p>Remote office software</p>	<ul style="list-style-type: none"> New user increase growth rate¹ for remote office APP / software reaches 580%+ during the outbreak New user increase growth rate¹ of Dingding, Zoom and corporate WeChat hit 703%, 662%, and 299% respectively 	 

Increasing online financial services usage

Online financial services to fulfil everyday demand

- Online banking & wealth management**
 - Alipay daily mutual fund purchase **increased by 400%** in the first 2 weeks in Feb
 - China Merchants Bank online WM customer interaction totaled **240K times** in Feb
- Online insurance brokerage:**
 - New China Life launched new products via WeChat and achieved **1392% YoY growth** in Feb
 - Zhong'An scored **55% premium growth** during the first two months of outbreak and expects **health insurance to grow by 70% in 2020**



Payment/instalment service support for increasing online service transaction








To-B financial services

- 2B SaaS platform**
 - A 2B turn key asset management platform signed a **dozen new service contracts** with FIs, including third party wealth management firms, insurance firms, and trust companies
- ERP system and cash flow management to support business continuity**

1. New user increase growth rate = (new user increase during 2020 COVID-19 outbreak / Spring Festival – new user increase in 2019 Spring Festival) / new user increase during 2020 COVID-19 / Spring Festival
Source: Questmobile, expert interview, internet data, Oliver Wyman analysis

BASED ON THE LONG-TERM TREND OF THE INDUSTRY, WE FURTHER ASSESSED THE SHORT-TERM IMPLICATION OF THE COVID-19 OUTBREAK

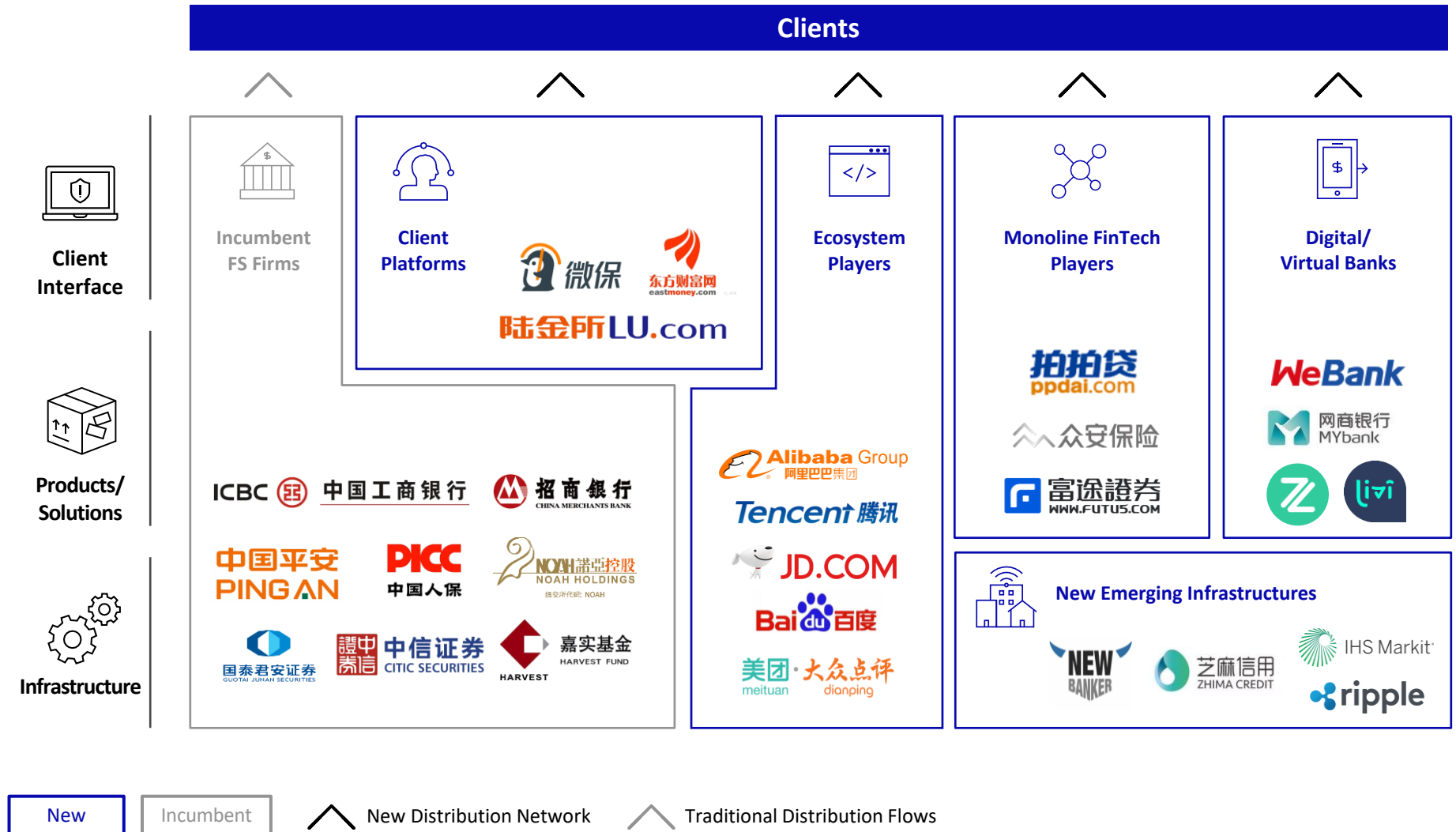
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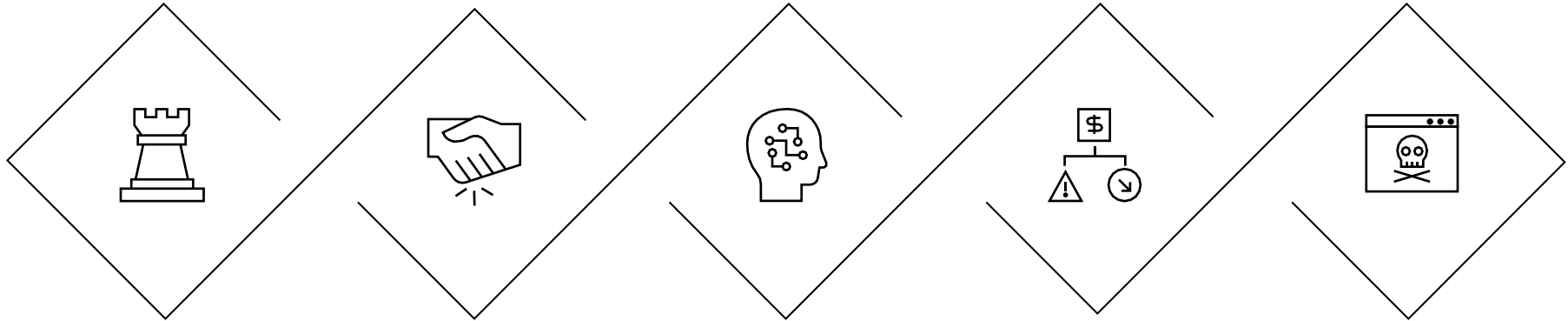
1 DIGITAL ACCELERATION

Incumbent FIs are at risk of losing client ownership as 'new challengers' emerge across the FS value chain, while the outbreak has made the situation more urgent for traditional FIs



1 DIGITAL ACCELERATION

Accelerated digital transformation could be achieved through the following 5 critical topics



Digital Strategy

- Develop digitalization transformation plan that manage threats and channel disruptive forces for growth
- Tailor strategy with digitization and industry expertise

Digital Partnership

- Identify use cases for effective partnership
- Prospect partners and support partnership proposition development
- Develop tangential plan and operating model for the partnership

Digital Analytics

- Prioritize objectives and define business requirements
- Develop and deploy customized analytical tools to accelerate time-to-value

Digital Cost Allocation

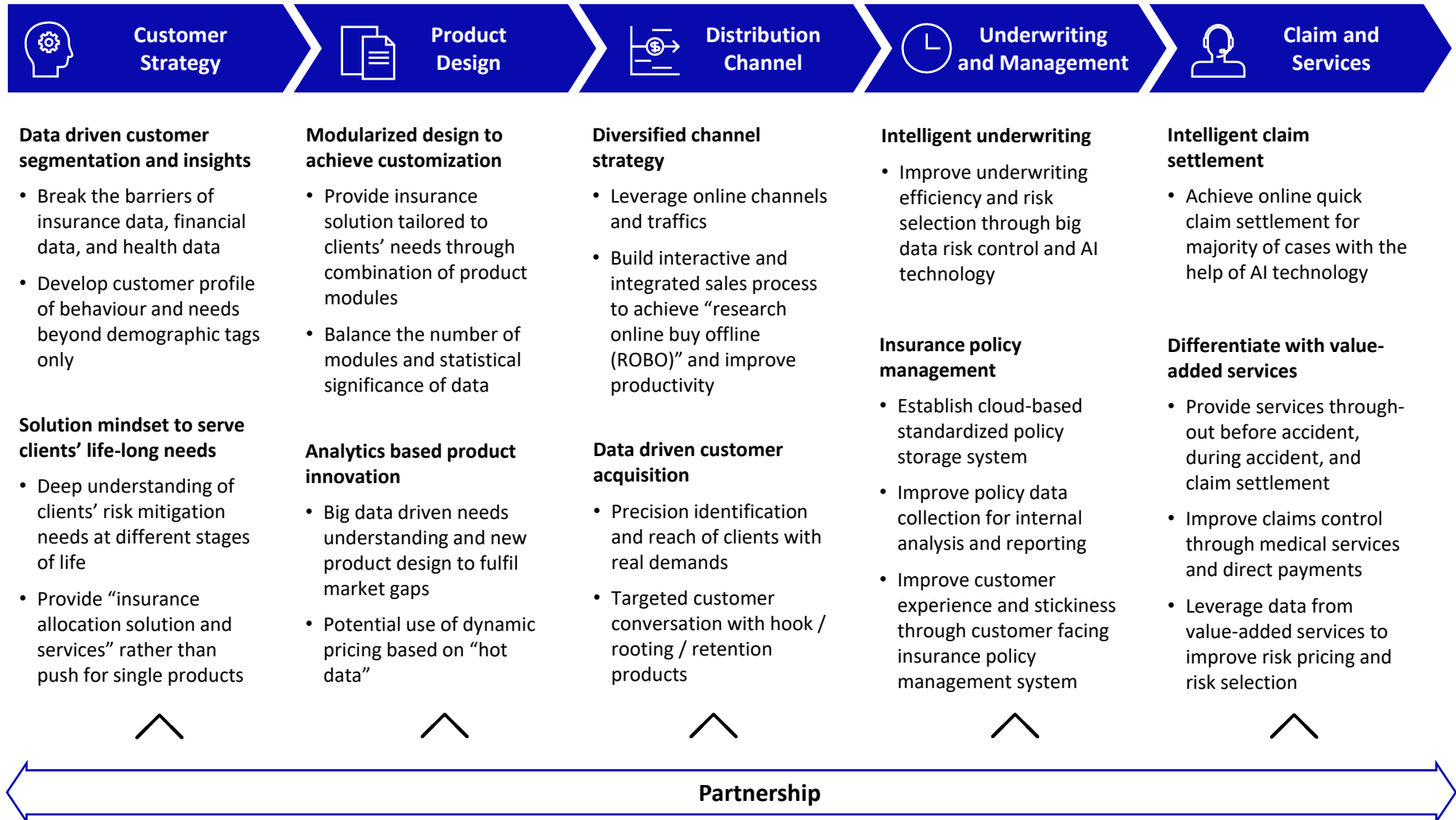
- Create cost transparency and change cross-BU engagement model
- Enable better decisions based on data
- Provide an equity story on digital investments

Digital Risk Management

- Identity new risks emerging from digitalization
- Redefine risk functions to become risk and digital centres of excellence to both support business and mitigate risks

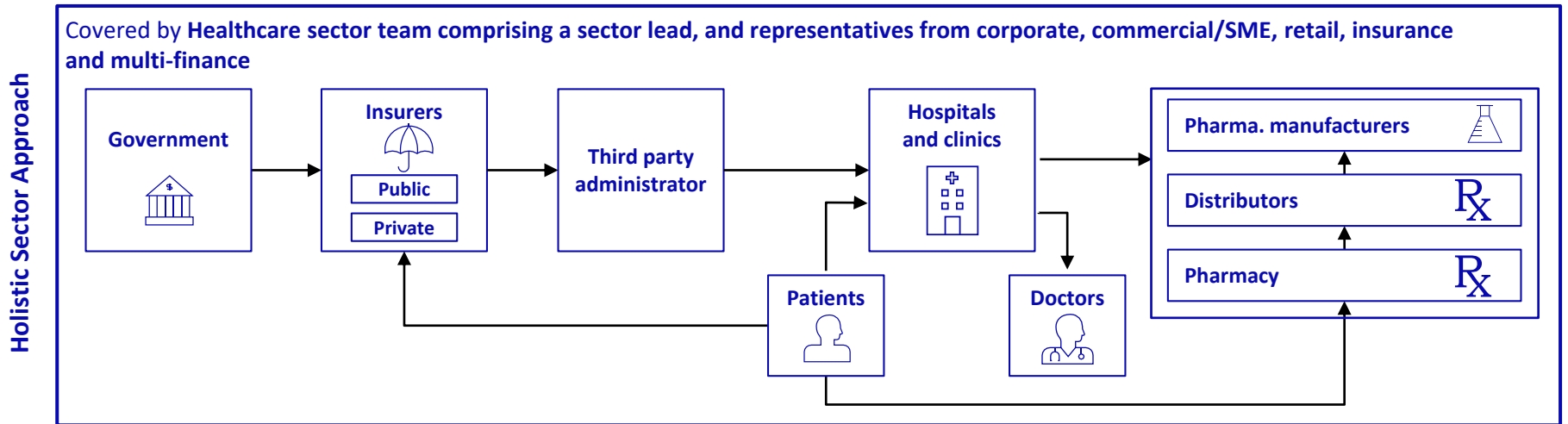
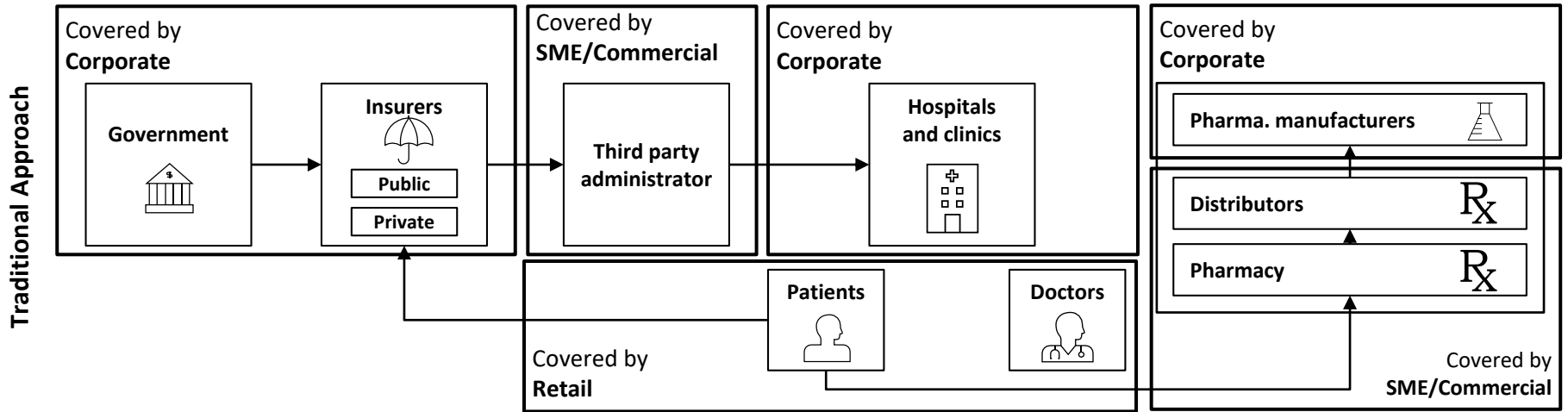
2 HEALTH INSURANCE GROWTH STRATEGY

A well developed growth strategy with In-depth market understanding and customer insights can help health insurers seize the next wave of market growth after the outbreak



3 HEALTHCARE SECTOR HOLISTIC SOLUTION

To ride the expected healthcare boom after the outbreak, banks should transform from serving distinct clients to serving the whole value chain



3 HEALTHCARE SECTOR HOLISTIC SOLUTION

Case study: One bank's strategy involved the design of tailor made products to address payments pain-points across healthcare sector's ecosystem

Exploring broader industry processes and financial interlinkages highlighted pain points



Significant delays and reconciliation issues in claims processing (e.g. insurance claims)



High administrative costs incurred in chasing and reconciling outstanding receivables (e. g. supplier pharmaceuticals)

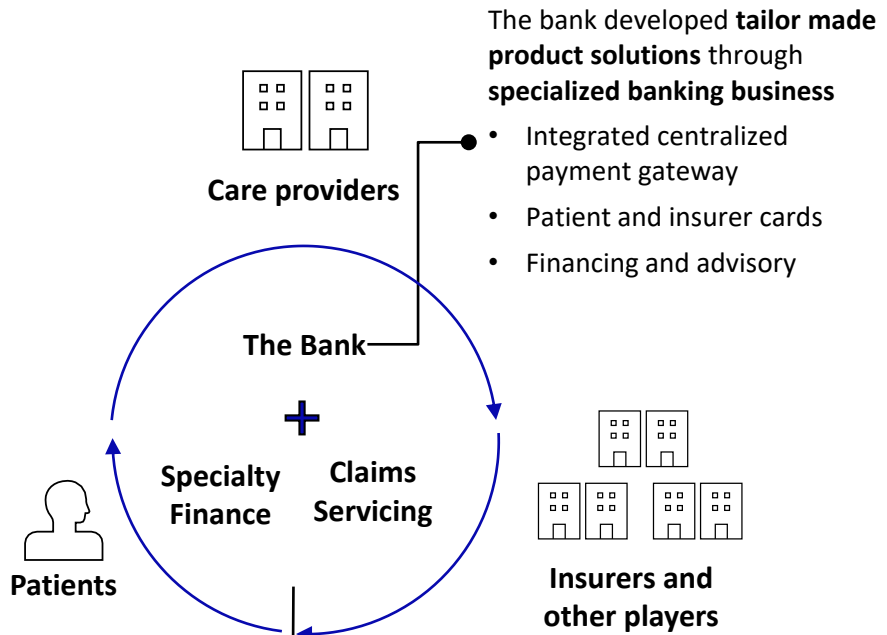


Mostly manual payment processing with no unified platform



Higher working capital requirements, poor service delivery, and duplication and billing issues

enabling the bank to tailor product solutions and become integral part of healthcare ecosystem



Wider range of tailored products/ services for healthcare professionals through subsidiaries .

- Equipment financing .
- Health claims and payment solutions .
- Practice Purchase & Improvement .
- Insurance, etc.

Source: Oliver Wyman Analysis

3 HEALTHCARE SECTOR HOLISTIC SOLUTION

Banks which implemented sector strategy solution have enjoyed substantial growth across wide range of business metrics

Sector solution strategy impact

Based on past project experience for sectors after implementing sector solutions

15–20%

RoRWA uplift



- Driven by a combination of factors:
 - Higher client share of wallet
 - Increased fee income
 - Lower customer acquisition and servicing costs

30–40%

Growth in CASA balance



- Achieve transaction bank status to attract deposit-rich sub-segment of the prioritized sectors
- Develop solution that address current pain-points in meeting their banking needs

20–30%

Lower customer acquisition costs



- Leverage anchor relationships in a sector to reach attractive customer sub-segments
- Set up value chain solutions and programs to allow rapid customer acquisition

Source: Oliver Wyman project experience

4 SUPPLY CHAIN MIGRATION OPPORTUNITIES

Supply chain migrating out of china will be a gradual process, while preamp the business opportunities along the shift will lead to first mover advantage



Challenges for corporates

Complicated Planning

- Multiple target countries to fill up the full production capacity of China
- Partial migration vs. end-to-end pending on suppliers of parts and components
- Long ramp up time required leads to reshoring risk

Multiple-border complexity

- With upstream manufacturing, downstream installation, and end customers potentially all in different countries, it creates complexity for supply chain management

Treasury capability upgrade

- Increasing multi-country exposures and funding needs increase corporate's vulnerability
- Offshore treasury management as new territory for some Chinese corporates

Industry upgrade challenge

- Capital originally deployed in China production lines need to be redeployed after migration ...
- ... which will likely flow into new economy sectors (such as smart automobiles, gig economy, etc.) that are in need of banking solutions



Opportunities for banks

- **Advisor services** on cross-broader trade and customs processes to help clients make well-informed decisions
- **Provide financing** for suppliers in target country to help build capacity

- **Advisor services** on supply chain management (i.e., procure to pay solutions) and working capital (i.e., funding strategy)
- **FX and rates solution** across various countries to improve production margin

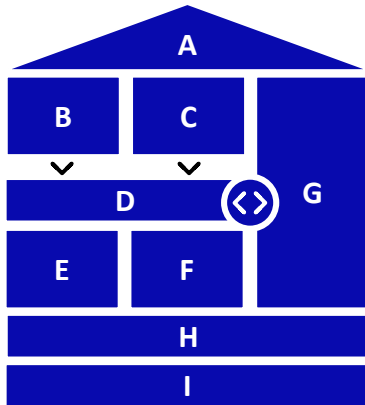
- **Risk management solutions** (such as forwards) to hedge new business risks
- **Treasury advisory** to help corporate setup and optimize offshore treasury management structure

- **Next generation banking proposition** for new economy sectors to help them grow, such as
 - Micropayment services in smart automobiles
 - Massive payment and reconciliation flows in gig economy

5 NPL MANAGEMENT

Oliver Wyman’s NPL management framework can help Chinese banks effectively deal with accumulating NPLs and improve credit positioning

Oliver Wyman’s NPL Management framework

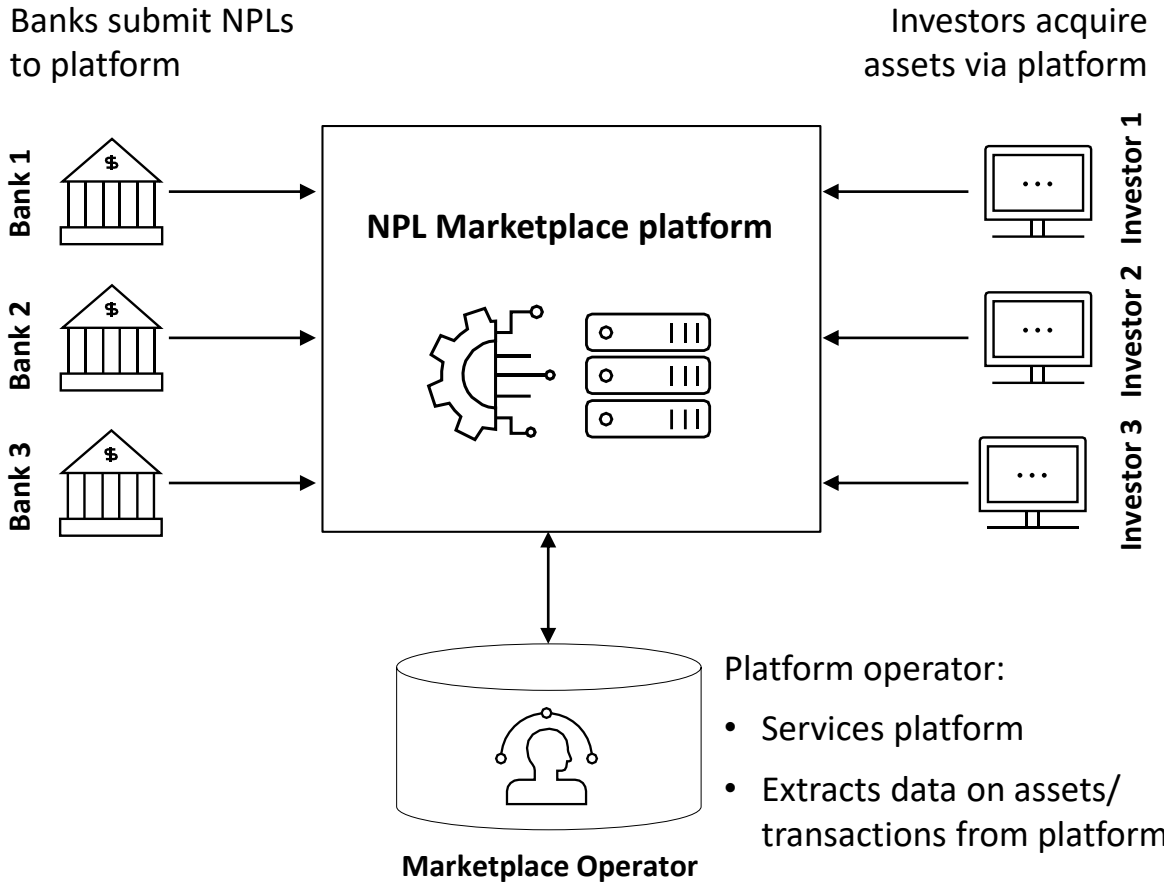


Core dimensions	Examples of typical components of each dimension
A Organization and Governance	<ul style="list-style-type: none"> Organizational structure, team and channel configuration, departments and committees Units responsibility perimeter
B Customer segmentation	<ul style="list-style-type: none"> Customers segmentation, as the foundation of tailored resolution strategies
C Analytics and tools	<ul style="list-style-type: none"> Suite of analytical tools (segmentation, solutions, valuation, impact assessment) Tools required to support processes
D Resolution strategies and processes	<ul style="list-style-type: none"> Differentiated resolution strategies and processes for each customer segment Level of industrialization required vs. case-by-case management Processes to enable identification and treatment of clients at risk Client handover processes
E Collateral Management	<ul style="list-style-type: none"> Collateral management and valuation Standardized and clear process
F Out-sourcing Management	<ul style="list-style-type: none"> Analytics based out-sourcing decision making Out-sourcing counterparties evaluation in batches Redistribution of cases among out-sourcing counterparties based on evaluation
G Monitoring and reporting	<ul style="list-style-type: none"> Resolution efficiency monitoring Resolution dashboard and reporting Operational and financial reporting
H Talent and personnel	<ul style="list-style-type: none"> Training and up-skilling Capacity management Performance management framework
I Technology and Infrastructure	<ul style="list-style-type: none"> Case manager tools to support decisioning and workflow management Data management infrastructure

5 NPL MANAGEMENT

Meanwhile, market leaders and/or regulatory could potentially build an NPL electronic trading platform to help improve NPL management efficiency for the whole market

Illustration of NPL marketplace



Benefits of NPL marketplace

- Information transparency
- Lower costs
- Increased liquidity

6 BUSINESS CONTINUITY MANAGEMENT

Business Continuity Management is a holistic management process that improves an organization's resilience to disruption of normal operations, such as the outbreak

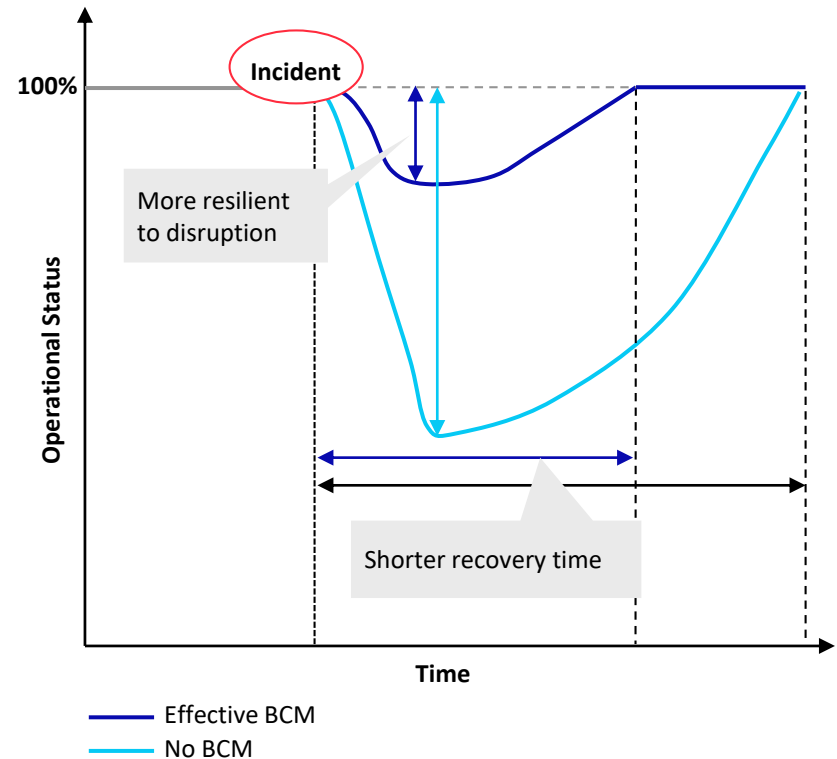
ISO's definition of BCM

Holistic management process that identifies potential threats to an organization and the impacts to business operations those threats, if realized, might cause, and which provides a framework for building organizational resilience with the capability of an effective response that safeguards the interests of its key stakeholders, reputation, brand and value-creating activities

Objective of BCM

- To develop Business Continuity Plans (BCPs) to ensure continuation of critical functions in the event of a crisis
- To implement and practice these plans so they can be executed effectively, if and when a crisis actually occurs
- To improve efficiency and effectiveness of these plans over time, continually adapting to changing risks

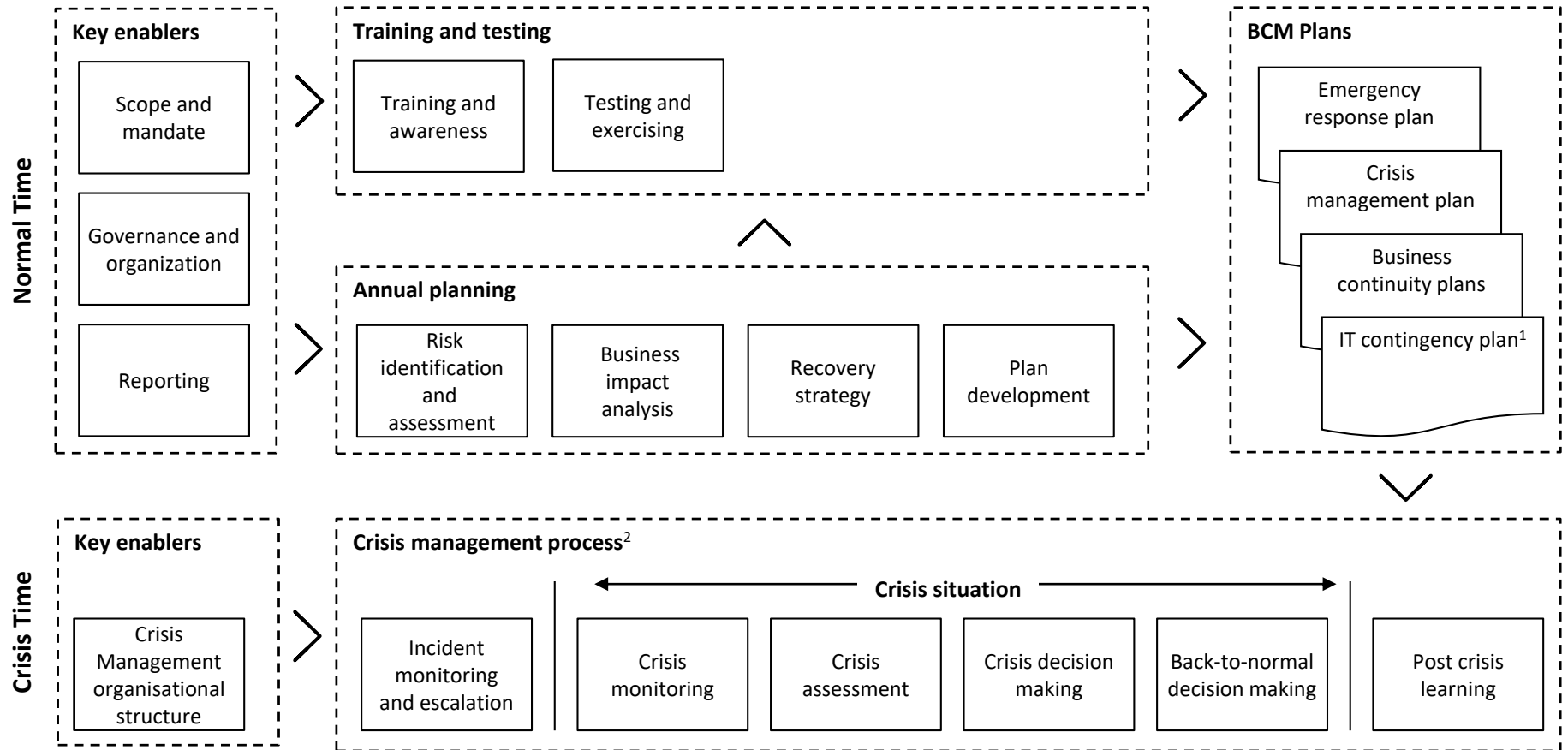
Illustration of effective BCM in action



6 BUSINESS CONTINUITY MANAGEMENT

Oliver Wyman has developed a comprehensive and clear target state framework, as well as a vision for BCM function to guide the transformation

Oliver Wyman's Business Continuity Management (BCM) framework






1. Designed and annually reviewed by IT department

2. Process guidelines will be documented in Crisis Management Plan (CMP)

7 RECESSION READINESS

Recovery and Resolution Planning (RRP) is designed to address financial institution failures, especially bank failures, and is key to systemic resilience in the potential recession scenario

Recovery Plan		Resolution Plan	
Question	“How does a FI react in an emergency situation?”		“How can a FI be resolved in a structured way?”
Goals	<ul style="list-style-type: none"> Recovery of the FI from a distressed situation by adopting appropriate measures Ensuring a sufficiently large and well-designed portfolio of recovery measures 	Degree of common elements	<ul style="list-style-type: none"> Proofing resolvability of the FI Ensuring the stability of the entire financial system in case of FI failure Minimizing burden to taxpayers
Components	<ul style="list-style-type: none"> Structure and business model Core business lines, critical functions Connectedness analysis 		<div style="background-color: #000080; color: white; padding: 5px; text-align: center;">Strategic Analysis</div> 
	<ul style="list-style-type: none"> Early warning triggers Recovery triggers Thresholds 	<div style="background-color: #000080; color: white; padding: 5px; text-align: center;">Indicators and Triggers</div>	<div style="background-color: #00BFFF; color: black; padding: 5px; text-align: center;">Resolution strategy</div> <ul style="list-style-type: none"> Resolution approach (SPE vs MPE) Resolution scenarios Implementation of resolution Recapitalization – Bail-in incl. analysis of liability cascades and loss absorption capacity Structural resolution measures (sales, bridge-institute, asset transfers)
	<ul style="list-style-type: none"> Definition of stress scenarios (qual. + quant.) Market-wide vs. specific Short- vs. long-term 	<div style="background-color: #000080; color: white; padding: 5px; text-align: center;">Scenarios</div> 	
	<ul style="list-style-type: none"> General recovery measure framework Specific recovery measures for scenarios 	<div style="background-color: #000080; color: white; padding: 5px; text-align: center;">Recovery measures</div>	
	<ul style="list-style-type: none"> General governance framework vs. crisis situation Escalation processes Communication processes 	<div style="background-color: #000080; color: white; padding: 5px; text-align: center;">Governance and Communications</div> 	
			<div style="background-color: #00BFFF; color: black; padding: 5px; text-align: center;">Business operations during resolution</div> <ul style="list-style-type: none"> Ensuring sufficient financial resources and operative actionability in case of resolution <ul style="list-style-type: none"> – Specific governance concept – Availability of information – Valuation – Internal/external communication

Legend: Common elements

7 RECESSION READINESS

we see 7 key lessons that China financial institutions can learn from international experience here

Key Lessons learned

I

FIs had not adequately planned for their own recovery in the event of severe stress

II

Resolution by acquisition needs to be handled with care to avoid contagion to the acquirer

III

Clarity around supervisory governance is essential to effective crisis management

IV

Planning in advance for FI failure reduces the cost of that failure

V

Early and decisive action has a higher immediate cost – but materially lower long-term cost

VI

The largest and most complex institutions need a different resolution approach

VII

Balance sheet structure and state support weakened market discipline

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