China's Wealth Management market: Too big to be ignored

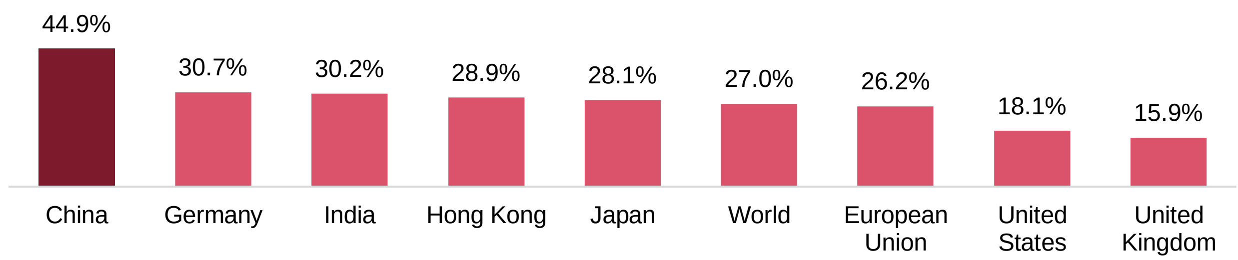
June 2023

Golden age of China's wealth management market presents compelling opportunities

International asset and wealth managers have long viewed China as a hugely attractive market and one where there is much to play for. The rise of Chinese wealth has profoundly changed the world as its economy continues to create tremendous wealth at great speed. Against this backdrop, asset and wealth managers have accelerated their strategic plans to engage in onshore wealth management activities in China. Market liberalisation of Chinese asset and wealth management markets began a long time ago, with the first sino-foreign investment management joint venture established in 2002. In recent times, policymakers and regulators have reinforced the narrative, taking steps to increase market access to international asset and wealth managers. Moreover, this enthusiasm has been felt in Hong Kong, a vital gateway enabling global capital to access China, and further afield.

Part of this attraction is because China's 1.4 billion citizens are sitting atop a seismic pool of savings which have the potential to flow to wealth management products. China's savings rate of 45% of GDP remains high and one of the highest among the largest economies. This has been a strong lure for a myriad of market players, as diversification from real estate and cash in bank accounts provide a compelling opportunity for international players to position their investment and wealth advisory service offerings to a large and growing market.

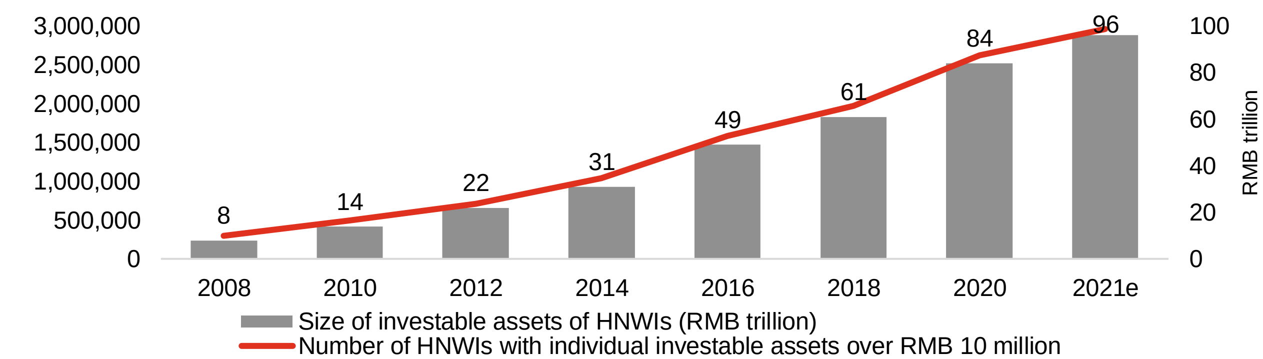
Figure 1: Current gross national savings as a percentage of GDP



Source: The World Bank, PwC analysis

The addressable wealth pool of China's affluent is only going to get larger. The number of high net worth individuals (HNWIs), defined as those with investible assets of more than RMB 10 million (around USD 1.5 million), reached 2.62 million. In terms of their wealth size, the HNWIs held a total of RMB 84 trillion (around USD 12.4 trillion) in investable assets in 2020. Much of this wealth has been created in recent times, against the backdrop of a new wave of entrepreneurs and business owners at the vanguard of wealth creation and innovation. With this, China's HNWIs have increasingly recognized the benefits of allocating assets overseas, and are actively seeking new investment destinations in view of long-term growth and diversification opportunities. Their asset allocation has also become more diverse with their focus gradually shifting to wealth management products and funds.

Figure 2: China's HNWIs and the amount of their investable assets



Source: China Merchants Bank, China Private Wealth Report

A myriad of ways to access the burgeoning opportunity set in China

Whilst the longer–term opportunity to advise the Chinese affluent on how to manage their wealth is of course attractive, elements of the country's wealth management industry and capital markets are still in the process of fully opening up. To meet the burgeoning investor demands and expectations of the Chinese wealth owner, market players can consider a myriad of schemes and quotas that are already in place. There are a number of ways international asset and wealth managers can play.

Figure 3: Various licenses, programs and quotas determine how to access each segment

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="2">Domestic Chinese investors</th><th rowspan="2">Global investors</th></tr>
<tr><th>Qualified investors</th><th>All investors</th></tr>
<tr><td rowspan="3">Asset location</td><td>Onshore</td><td>Private Fund Manager (PFM)
• Allows foreign firms to serve qualified investors by launching onshore private funds.</td><td>Fund Management Company (FMC)
• Mutual funds sold to the general public.</td><td>• Stock Connect
• Bond Connect
• QFII scheme
• QFLP scheme
• Mutual Recognition of Funds (MRF)</td></tr>
<tr><td>Hong Kong</td><td colspan="2">Asset and wealth manager able to offer onshore clients access to:
• HK-listed stocks through Stock Connect;
• HK-listed bonds through Bond Connect;
• HK-domiciled funds via Mutual Recognition of Funds (MRF);
• Wealth management products via Wealth Management Connect.</td><td></td></tr>
<tr><td>Global</td><td>QDLP program
• Managers' onshore Chinese subsidiaries invest in various offshore funds;
• QDIE is similar scope to QDLP but is only available in Shenzhen.</td><td>QDII program
• Allows investors, either as asset owners or on behalf of clients, to invest offshore.</td><td></td></tr>
</table>

QFII - Qualified Foreign Institutional Investor
QFLP - Qualified Foreign Limited Partnership
QDLP - Qualified Domestic Limited Partner
QDIE - Qualified Domestic Investment Enterprise
QDII - Qualified Domestic Institutional Investor

At present, there are numerous market entry and distribution options available to market players seeking channels to access the Chinese wealth owner than ever before. Each option is also evolving, be it through more products added or an expansion in quota. Each option differs in its level of risk and potential reward, in addition to resource and capital intensity. In general, patient capital, staying power and commitment are the basic ingredients required for a successful China strategy, whether the plan is to access China from offshore (via Hong Kong) or from operating onshore.

Advantages of operating onshore

- ✓ Ownership of customer relationship
- ✓ Control of product and service offering
- ✓ Clearer understanding of investor needs
- ✓ Enhanced brand image to end investors
- ✓ Better market visibility of trends
- ✓ Accessibility to local talent pool
- ✓ Perceived commitment to country
- ✓ Potential synergies with local players

Policymakers and regulators continue to drive initiatives and policies providing more opportunities for asset and wealth managers. Several regulatory changes after 2017 have laid the foundations for change across the industry and have significantly altered the composition of industry players and the amount of assets under their management. This has tipped the balance in favour of the more heavily regulated sectors such as FMCs as well as wealth management subsidiaries of banks.

Currently, the asset and wealth management industry AUM has reached USD17.3 trillion (as of Dec 2022) and the investment structure has fundamentally shifted over the last five years to standard market orientated products, away from non-standard quasi-guaranteed products. Standard market orientated products are those considered the norm by international standards, where investors take their own investment risk and asset managers mark-to-market underlying assets. Non-standard products refer to those often quoted at par and whose ultimate recoverability was often quasi guaranteed by the product manufacturer and/or distributor.

The Chinese wealth owner becoming more holistic

A remarkable share of China wealth has been accumulated in a very short period, compared to the West, as a result of the country's meteoric rise over the past few decades. Most of this wealth creation has been channeled into domestic real estate and cash in bank accounts in the absence of a fully fledged wealth management industry. Moreover, there is a USD 50,000 annual limit transferred outside of Mainland China for citizens, which effectively restricts the amount they can allocate to overseas stocks, insurance, funds, etc. However, with wealth continuing to compound at a robust rate and an inflection point now reached, the typical Chinese investor is increasingly looking to diversify into wealth management products, in addition to investing more of their portfolio outside of renminbi denominated assets. Wealth owners have recognised the benefits of allocating assets overseas and are actively seeking new investment destinations. With this, Hong Kong has remained the favored destination to access global investment exposure.

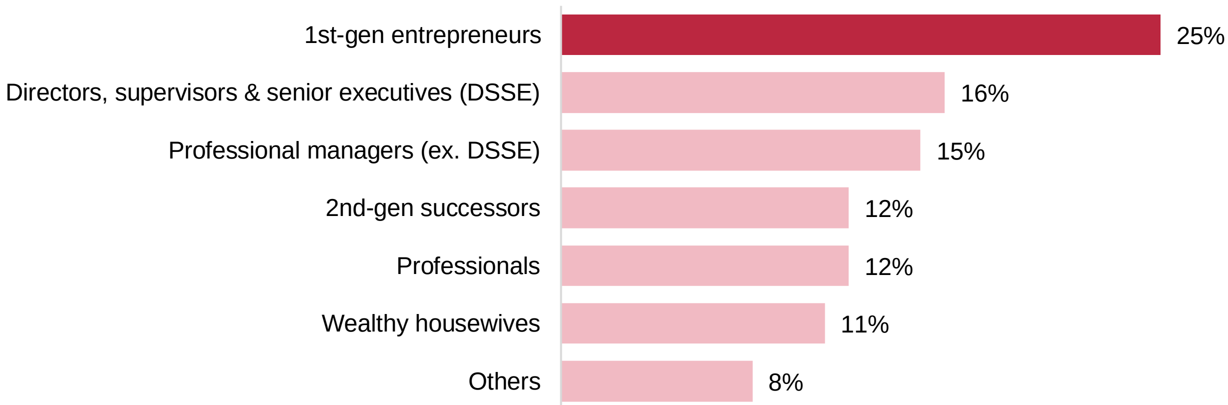
Figure 4: Top 10 Ultra High Net Worth (UHNW) countries

Rank	Countries	Population of UHNW	Total wealth	Wealth per UHNW
1	US	121,465	USD 13.4 tr	USD 110.4 m
2	China	51,145	USD 5.6 tr	USD 109.6 m
3	Germany	19,870	USD 2.2 tr	USD 112.0 m
4	Japan	16,585	USD 1.4 tr	USD 85.1 m
5	Hong Kong	15,235	USD 1.0 tr	USD 64.1 m
6	UK	14,885	USD 1.1 tr	USD 76.9 m
7	Canada	13,060	USD 1.1 tr	USD 87.4 m
8	France	12,150	USD 1.2 tr	USD 102.4 m
9	Switzerland	9,090	USD 1.0 tr	USD 106.4 m
10	Italy	8,500	USD 1.1 tr	USD 126.4 m

Source: World Ultra Wealth Report 2022, Altrata

High net worth individuals (HNWIs) and ultra high net worth individuals (UHNWIs) have ever-evolving expectations regarding value, needs and preferences which have catalysed new trends and developments over time. Many are first-generation entrepreneurs and business owners who are starting to seek comprehensive financial advice on everything from asset management to wealth planning.

Figure 5: Occupation mix of China's HNWI population



Source: China Private Wealth Report, China Merchants Bank

The Chinese wealth owner becoming more holistic

Increasing financial literacy has also provided an impetus for demand in financial advice as their needs become more holistic in nature. China's wealth owners have varied wealth goals and priorities, but generally, younger cohorts prioritize wealth creation while mature cohorts seek wealth preservation and protection. Moreover, the affluent are in need of integrated asset allocation, advisory and wealth management services which are personalized in nature.

Figure 6: How are customer behaviours evolving

UHNW	**Growing expectations of digital maturity from financial advisors to meet the investment needs of customers.** **Demand for more digital interaction** when accessing portfolio information, with real-time information a necessity.
HNW	**Increasing need of virtual advisory** as the pandemic has impeded travel and F2F interactions with financial advisors. **Physical touchpoints will remain important** as customers highly value personalized engagement.
Mass Affluent	**Increasing price sensitivity** due to pricing information transparency and competitive pricing across the industry. **Reliance on online solutions** to resolve traditionally advisor-led tasks, e.g. purchasing funds and monitoring portfolio and performance.

There will be a gigantic transition of wealth between generations and this provides another catalyst for the successors of wealth to revisit their financial planning, and in doing do, offers an opportunity for market players to position their wealth management service offerings. This enormous shift of wealth between generations will have far reaching implications as trillions of dollars change hands.

It is estimated that…

USD 3 trillion of wealth will pass to the next generation within **10 years**

USD 8 trillion of wealth will pass to the next generation within **20 years**

USD 15 trillion of wealth will pass to the next generation within **30 years**

Source: 2022 Chinese Family Office Industry Trends Report, UBP and Hurun Research Institute

Amidst China's 'common prosperity' campaign and the global shift to sustainable investing, wealth owners are increasingly investing or donating to various causes, increasing impact investing and philanthropic activities. With this trend gaining traction and an increasing societal expectation of the affluent to direct capital to develop the broader economy, asset and wealth managers which provide ESG and philanthropic solutions to their clients stand to benefit. This could be one of the differentiating factors when servicing the Chinese wealth owner.

The current wealth management landscape and opportunity for international players

China's domestic banks have a strong foothold in the wealth management market in the relative absence of international private banks. The Big 4 banks, joint-stock banks and other leading domestic banks have been building out their wealth management propositions, generally targeting the HNWI and the top end of the mass affluent segment. Third party independent financial advisors (IFAs) are also leading providers of wealth management services. IFAs have started to take market share from banks due to a combination of brand, customized products and a focus on growing their networks of financial advisors, in addition to their digital capabilities and differentiation of their portfolio solutions. These groups remain smaller relative to the banks in their absolute scale, but are growing robustly. Securities companies, which typically run integrated business models with product manufacturing, distribution, research, market-making and custodian capabilities are also providers of wealth management offerings.

Figure 7: China private banking AUM - Top 5 players

Rank	Bank	Bank type	Client count	AUM	AUM Threshold
1	Bank A	Joint-stock	122,064	RMB 3,394b	RMB 10m
2	Bank B	National	199,500	RMB 2,322b	RMB 8m
3	Bank C	National	147,300	RMB 2,160b	RMB 6m
4	Bank D	National	177,200	RMB 2,020b	RMB 6m
5	Bank E	National	170,000	RMB 1,847b	RMB 6m

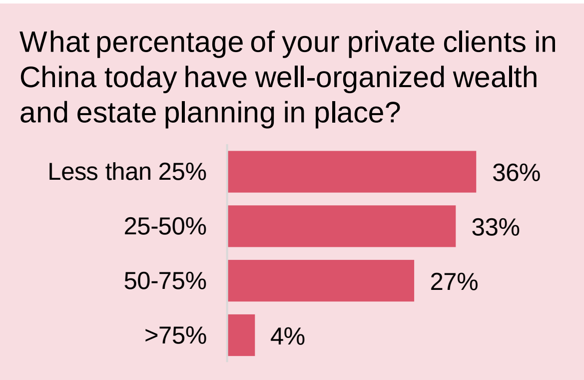
Source: Asian Private Banker

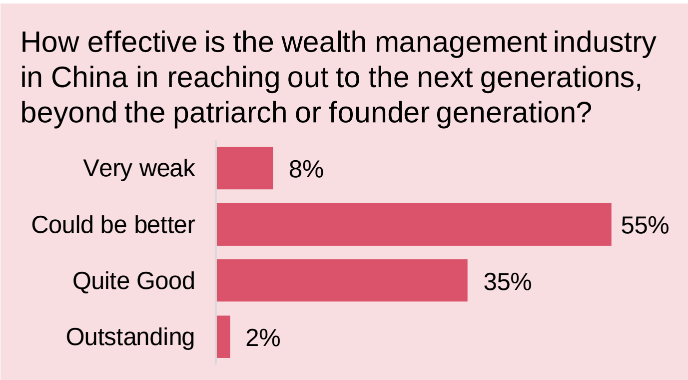
Joint-stock banks are one type of commercial bank in China.
Joint-stock banks conducts business independently and adopts a highly marketized operation.

The needs of the average Chinese individual investor will continue to evolve. Compared to the West, the level of planning advice clients receive around investment options is still evolving. This is an area in which international asset and wealth managers have an advantage, as they have depth and breadth in various asset classes and a more distinctive service offering as compared to their local counterparts.

Around the globe, international wealth managers have a successful track record of helping wealth owners expedite optimal wealth planning, legacy and succession solutions. By providing personalized and well-executed holistic wealth management solutions, international players can stand out from domestic players in China. Moreover, putting investor interests first and building long term trust is a prerequisite, especially as the market gradually evolves from a market where product pushing has been more prevalent. Customer centric propositions focused on individual investor needs rather than mass product pushing are beginning to emerge, but China is still in a transition and it will be some time until the market fully gravitates to an advisory based model.

Figure 8: China has yet to reach what is considered to be normal practice in the wealth space





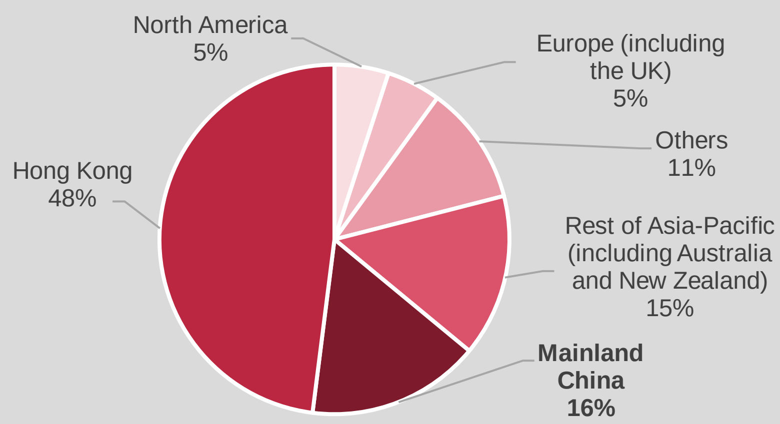
Source: Hubbis Digital Dialogue Series: Chinese HNW and UHNW Clients – Wealth Structuring & Planning for the World Ahead

Hong Kong as the super connector and the Greater Bay Area (GBA)

With China a significant strategic growth opportunity for many global and regional financial institutions, many players have opted to access China opportunities through Hong Kong via an 'offshore' model. This relationship-driven market, which requires sophisticated and customised services is currently dominated by private banks.

Offshore investment channels through Hong Kong continues to be an attractive way for servicing Chinese wealth given the various inbound and outbound investment channels as mentioned earlier. In addition, Hong Kong is a popular offshore investment and service location given its high connectivity, diversified talent pool, effective legal system, competitive tax regime, and supportive regulatory environment.

Figure 9: Private Banking and Private Wealth Management Business – by investor base



Hong Kong is very well positioned to capture opportunities arising from the rapid and ongoing accumulation of wealth arising from Mainland China.

16% of the total AUM in the private banking and private wealth management business in Hong Kong were sourced from Mainland Chinese investors.

Source: Asset and Wealth Management Activities Survey 2021, Securities and Futures Commission

The fast-growing affluent population in China, especially in the Greater Bay Area (GBA), will be the new growth driver for international asset and wealth managers in the coming years. The region holds immense potential for wealth creation and offers itself as one of the greatest wealth management opportunities in the China. The GBA has a rich and deep pool of savings and the demand for globally diversified products and services is gaining traction. Noting this trend, policymakers and regulators in the region launched the Wealth Management Connect (WMC) scheme in the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) in September 2021. The arrival of the WMC scheme is one of the biggest gamechangers introduced to date regarding market access between wealth management markets in Mainland China and Hong Kong, and it is envisaged the initiative will be expanded and continuously enhanced as a track record is built up.

Wealthy GBA residents have a strong appetite to invest in new offerings

- The GBA is home to **20%** of China's UHNW and HNW households
- Over **40%** of the GBA's UHNWIs are aggressive risk-takers
- **70%** of the region's UHNWIs and HNWIs have expressed strong interest in increasing their investments in foreign financial products as they become available

Source: Oliver Wyman, Avaloq

Building an effective and sustainable China wealth management strategy

Policymakers and regulators have encouraged a series of regulatory innovations to progressively open the market up to international financial institutions, delivering better market access and investor confidence. The market is not static and is still in full growth mode. With this, there are no shortage of opportunities in China's wealth management market, but tapping this growth can prove elusive for international asset and wealth managers simply looking to replicate a strategy from its home market. To enter a complex country like China without understanding the directive of policymakers and regulators is not recommended.

The robust growth of the market has brought with it increasing operational complexity and risks. We believe that these risks are to be managed rather than avoided. This is not to say that the challenges and risks that exist now will no longer be there in the future. International asset and wealth managers that have a good understanding of the market, are bold enough to localise decision making and come up with solutions to the practical nuances of being a 'foreign' institution in China, will undoubtedly be well positioned for upside.

Figure 10: Considerations for a successful China market entry strategy

Vision, objective and strategy	✓ Have a clear understanding of the way to deliver value propositions to a unique market ✓ Consider differentiating factors given market is awash with local competitors
Licensing requirements	✓ Carefully navigating which license and quota requirements are best suited to firm strategy ✓ Be aware of timeframe for licensing application and volume of information required
Onshore product capability	✓ Ensuring teams are empowered and localized ✓ Investing the time to understand product trends and investor needs
Partnerships with distributors	✓ Be mindful that distribution capabilities lead to better market visibility of product trends ✓ Consider third party distribution channels
Potential for M&A and deals	✓ Investing into local product manufacturers and distributors may be attractive at the right price ✓ Be creative in structuring partnership agreements given uniqueness of market
Relationships with stakeholders	✓ Building rapport with regulators and policymakers is essential ✓ Aligning firm strategy with policy direction and supporting the development of the market

Looking ahead: The right strategy, resources and commitment is required

When it comes to China, the numbers are usually big and the wealth management industry is no exception. The wealth management industry in China has progressed significantly since its inception, reaching extraordinary heights. Having a huge domestic market is an obvious factor in making the industry so attractive, however there are other significant variables at play. The rapid development across investor expectations, regulatory landscape and competitive landscape is providing a catalyst for industry players to revitalise their China market strategy.

Many international asset and wealth managers have waited and assessed how the industry adapts to the changing dynamics, regulatory driven and investor driven, before deciding on their course of action relating to their China strategy. While many international players operating in Hong Kong have a mainland China market presence of some sort, through a joint venture with a local player or full ownership in an onshore entity, many have hardly scratched the surface.

When deciding on next steps, be it through operating in China or raising capital from Chinese investors for investing offshore, pursuing a tailored approach is vital and simply importing a tried and tested strategy used in other markets is not encouraged. Various aspects of the wealth management market must be well understood before success can be found and this includes sizing the market of each segment, competitor dynamics, licensing and regulations as well as the numerous market access channels available.

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