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Banks on the move

Establishing FinTech enabled Private Banks and Wealth Managers in China

Management summary

In line with China's economic progress over the past decades, both public and private sectors have accumulated an increasing amount of wealth – to such an extent that we believe it has become the second largest wealth management market in Asia Pacific[1]. Not surprising, China is also said to have the fastest rate of wealth creation in the world, coining four new billionaires per week[2]. This results in a significant increase in accessible banking assets in Mainland China.

With foreign capital as a focus area of China's current economic development plan, regulators have taken additional steps towards a less restricted financial sector. For the first time, foreign firms are allowed to apply for a majority stake in both securities firms and fund managers, with optionality for full control by 2020. This provides increased involvement with key business decisions, such as extension of business scope and additional control over risk management. Expected policy adaptions with regard to trade of Chinese bonds and acquisition of Chinese listed firms, present additional positive signs to bolster foreign players' hopes for greater market liberalization.

A variety of foreign players have commenced efforts to enter the race for Chinese assets, but are facing fierce competition from incumbents – large state-owned financial institutions, tech giants and FinTech players. Market entrants are forced to differentiate based on customer experience, product offerings and business model, i.e. smart eco-system partnerships. The market entry strategy and in particular where to play and how to win, will ultimately decide on the degree of success in the longer term.

To form a view, Deloitte looked at strategies to compete as a private bank or wealth manager in Mainland China. We assessed advantages and considerations when partnering with FinTechs as well as critical regulatory considerations and trends in government policies. Finally, we looked at demographics and supportive policy initiatives to evaluate a potential starting location. Based on our analysis, we have made the following observations:

1. **Put clients at the heart of your journey**
   Understanding, connecting and serving customers better is one of the key differentiating factors in an environment of fierce competition. Building skills and applying technologies to support sophisticated relationship management ultimately puts the clients at the core of the business.
2. **Plug into the FinTech ecosystem to enable speed and agility**
   A modularized operating model allows for a higher degree of agility, flexibility and speed – key factors to compete in China. In a fast paced and highly innovative market, new entrants can only compete by plugging into the local ecosystem and partnering with a mix of best-in-class tech giants and innovative FinTechs. The Greater Bay Area (GBA) is one of the prime locations in this regard offering a variety of interesting aspects as a new firm's potential preliminary site.
3. **The rapidly evolving regulatory environment is adding to complexity**
   The Chinese regulatory environment is constantly evolving, forcing firms to have a regulatory strategy in place which comprises both legal entity structure considerations and license deliberations. In order to be sustainable, it must be aligned with the business strategy and the potential future product provisioning and location.

[1] Source: Deloitte Research.
[2] Source: Hurun Report.

Put clients at the heart of your journey

The allure of the Chinese financial market is widespread and indisputable, which in turn creates an environment of fierce competition; new market participants compete not only against incumbents, mainly state-owned financial institutions, but also against both current tech giants[3] and emerging FinTech players. Such an environment requires compelling and elaborate strategies on how to differentiate and ultimately how to win.

We have evaluated three potential collaborative strategies international players might adopt to differentiate from the competition; providing enhanced customer experience; win through smart product provisioning and prepare for an onshore/offshore model.

Client centricity leading to enhanced customer experience

Gain market share by providing an enhanced customer experience through customized services and relationship management.

Enhancing the experience	Example
Connect with clients through sophisticated relationship management	Obtain forward looking credit evaluations by using artificial intelligence (AI) on a comprehensive set of internal and external data
Create value through better customer understanding	Extract propensity predictions on product choices and investment strategies by creating a 360 degree view of the customer via big data analytics
Capture returns through advanced delivery methods	Enhance robo-advisory to extract and pair market sentiments with existing customer risk profiles to provide informed, customer tailored, investment advice

Smart product provisioning

Compete based on product, by offering either a full suite of home-grown products across asset classes or by a depth of targeted, specific products differentiated in the market. In addition, its recommended to leverage one’s own distribution channel as a referral hub for adjacent products e.g. use existing sales channels to cross-sell.

[3] Additional details can be found in the section "Chinese Tech Giants at a Glance".

Prepare for onshore/offshore model[4]

Capitalize on global capabilities to provide cross-border investment opportunities in China by either leveraging the established product platform for Chinese clients, or leveraging the liquidity offshore for global cash management, e.g. Hong Kong being the largest CNH clearing center manages liquidity risk.

While each market participant might choose a specific strategy, or a combination thereof, we believe that the winners will devote their efforts to enhanced client centricity in order to create true differentiation in the market. It remains critical to build modularity in proposition as well as entity structure and platform in order to prepare for a possible onshore/offshore product model in the future.

[4] Both outlined sub-strategies are still limited by current regulations and should be looked at as strategic options for the future.

Plug into the FinTech ecosystem to enable speed and agility

Financial institutions nowadays tend to implement more modularized value chains, building a core platform and using Application Program Interface (API) layers to tap into advanced capabilities from third-party partners, as appropriate. Although the Chinese FinTech ecosystem is vast and change is inherent, we picked a few illustrative areas along the customer journey, where partnering will likely be beneficial:

Leverage data analytics to target the right customer

Exponential increase in technology and computing prowess has spurred the advancement of data analytics. Banks have historically used structured data for a variety of use cases, but now, increasingly tap into unstructured data, to harness its true power. While entering China, data is the "currency" that banks need to use to target the right customer, offer the right products and services as well as provide the right experience the customers demand. Advanced data analytics provide competitive advantages such as:

- identifying high-potential prospects and customers,
- measuring customer and product profitability,
- improving specific elements of product – offer, price, channel, etc.,
- managing fraud effectively, and
- increasing transparency into risk exposure.

Instant onboarding as necessity

Once the right customer segments have been identified and targeted, a prompt and seamless digital onboarding is essential to create a positive upfront experience. Many local customers are used to instant gratification and the seamless experience of payment apps. As such it is necessary to leverage state-of-the-art technologies to complete Know-Your-Customer (KYC), source of fund proof, credit-underwriting and fraud detection in a very timely manner.

Choice of plenty over single source

The Chinese digital user is very comfortable in configuring their product choice from a vast product marketplace, instead of a single branded provider. Ecosystems created by giant e-commerce portals have become mainstream, not only for retail products, but all sorts of services, including financial products.

Lack of acceptance for long customer service time

The Chinese consumer has commenced on a journey towards a self-service model, with support from user interfaces that "delight", constantly available chatbots, and computer visions[5]. These tech-savvy customers are expecting seamless interactions through their mobile and online channels and no longer tolerate turnaround time exceeding a few seconds.

Portfolio management as a starting point

In an environment of ongoing deregulation and still somewhat limited product offering, portfolio management will be the starting point of most new banking relationships. In this regard, analytics will again become a key differentiating factor, providing valuable insights to, for instance, market risk, concentration risk and interest rate risk. The wide adoption of social media in China is providing a valuable source of Big Data for sentiment analysis, which is a key driver in many Robo-Advisory platforms.

Chinese Tech Giants at a Glance

Tech giants such as Baidu, Alibaba, Tencent and Jingdong (BATJ), to name a few, have transformed to strong players in all of the fields mentioned in this whitepaper; not only have they built a massive customer base with hundreds of millions of KYC records, but they have also deployed scalable cloud-based infrastructure, supporting their product marketplaces, capable of processing high transaction volumes. The availability of significant training data in their eco-systems including popular social media channels, allows for sophistication in AI, analytics solutions and sentiment analysis.

[5] Computer vision is a scientific field focusing on how computers gain understanding from digital images or videos.

Despite all the potential in the FinTech ecosystem, a foreign player must undergo thorough selection criteria and conduct due diligence to collaborate with a local partner. Considerations include:

- **Geographical location and reach of main operations:** given the fragmentation of the Chinese market, a foreign private bank or wealth manager will unlikely operate all over the Mainland. Different technology companies have different geographical roots and therefore coverage alignment must be considered.
- **Protection of data and intellectual property rights:** while a bank might enjoy state-of-the-art capability offered by a partner, customer data as well as business know-how through the collaboration might be captured and stored.
- **Openness and interoperability:** many tech giants operate their own version of key technologies, such as a "black-box AI engine" or a "proprietary block chain platform". In the future, users of such services might become captive customers, because a move to competitor platforms might be challenging. Having the capability to orchestrate in-house and partner developed API, as well as integration with group technology stack, will allow for real time data exchange and hence for higher flexibility.
- **Regulatory preference:** although the choice of technology offering might be abundant (from front-end channel platforms to back-end core banking platforms), most regulators remain conservative and will only allow usage of more traditional and market proven solutions. For instance, market entrants who attempt to choose a paradigm shifting, novel core banking engine, might experience lengthy regulatory approval negotiations.

While the above are all crucial deliberations, the path to win, points towards fruitful collaborations with local partners. This might offer benefits such as greater customer retention, new forms of revenue generation and sharing of costs. Additionally, a modularized operating model allows for a higher degree of flexibility and speed and becomes a necessity in any fast-paced and highly innovation-driven market. In China, as a prime example, new market entrants can only compete by plugging into the local ecosystem and partnering with a mix of best-in-class tech giants and innovative FinTechs. However, not insignificant risks must be taken into account, such as potential loss of customer interfaces, data security, reduced margins, loss of control or loss of brand identity.

Spotlight: Greater Bay Area

GBA[6] covers Hong Kong and Macau along with nine cities in China's Guangdong province. An amalgamation of three different jurisdictions into one economic zone, combined with the highest density of high net worth individuals (HNWI) and an outburst of FinTech companies, makes it an attractive hub for international banking players.[7]

Figure 1 – GBA Location

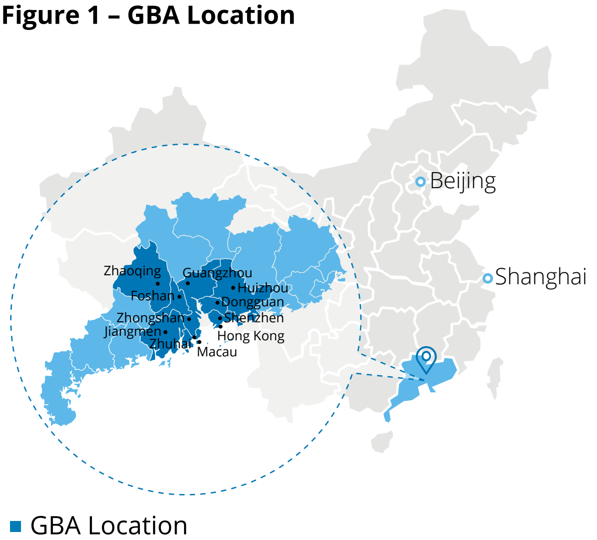
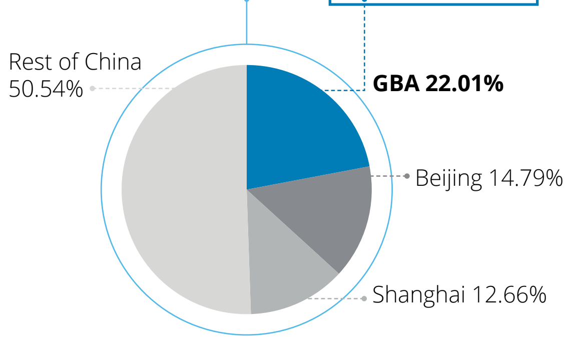


Figure 2 – GBA Demographics[9]

	China	GBA	%
GDP (US$)	12.2T	1.5T	12%
Total Population	1.3B	70M	5%
HNW Population	1.16M	0.26M	22%



What makes GBA unique?

- **Favorable demographics** – GBA is bringing over 69 million inhabitants together, making it one of the most densely populated bay areas in the world. While on one hand it has the highest concentration of HNWI[8] within China, on the other, wealth is unevenly distributed, thereby creating opportunities for financial inclusion products.
- **Amalgamation of unique characteristics** – Each of the 11 cities of GBA are uniquely specialized, and when combined together, offer synergies for banking operations. For instance, Hong Kong is the international financial center and can manufacture financial products for a bank. Shenzhen is the silicon valley of China with FinTech companies that financial institutions can partner. Macau has the world's highest GDP per capita, hence might provide investable funds.
- **Infrastructure investments** – GBA has a mature infrastructure to facilitate both domestic and international mobility of products and people. One example is the recent launch of the high speed rail to increase connectivity from China to Hong Kong, which creates a sense of proximity and interconnectivity.
- **Adoption of technological innovations** – While a mature infrastructure and uneven distribution of wealth facilitates product, people, and capital flows, the three different jurisdictions with different systems of laws and regulations disrupt the seamless flows of information across boundaries. Nonetheless, enterprises specializing in FinTech strategies are bridging this gap in GBA. For instance, Distributed Ledger Technology (DLT) is facilitating cross border KYC without breaching data protection laws.

[6] GBA cities include Hong Kong, Macau, Guangzhou, Shenzhen, Zhuhai, Foshan, Zhongshan, Dongguan, Huizhou, Jiangmen and Zhaoqing.
[7] More details on GBA can be found in Deloitte's Thought Leadership – "FinTech Strategy for the Greater Bay Area in China" and "Decoding the Outline Development Plan for Guangdong-Hong Kong-Macao Greater Bay Area (GBA)."
[8] HNWI is defined as households with investable assets of over USD 1.5 million.
[9] Source: Deloitte Research, Hurun Wealth Report 2018.

The rapidly evolving regulatory environment is adding complexity

The rapid growth of China's financial services industry and recent efforts around liberalization have led to a complex and rapidly evolving regulatory environment that requires significant interpretation. With numerous regulators e.g. the People's Bank of China (PBOC), China Banking and Insurance Regulatory Commission (CBIRC) and China Securities Regulatory Commission (CSRC) as well as evolving regulations, there are multiple options for new market entrants, setting up their legal entities and be licensed to sell products. Careful consideration of the various structures, entities and licenses is required along with strong relationships with the relevant regulators to maintain an open dialogue, gain approval for structures that may not have existed in the market and provide a window into how things will evolve.

Legal entity structure options should be looked at in the wider context of the firm’s global set-up, strategy for the Chinese market and respective tax assessments for the long term. Depending on the determined scope of products and services, entity options can vary among wholly foreign owned enterprises (WFOE), JVs as well as subsidiaries or branches of existing China entities.

Licensing considerations and options, should be aligned with the business strategy, location strategy as well as with the future product provisioning and timelines. Key licensing considerations for foreign invested securities firms, commercial banks, future brokers and/or fund managers, are outlined below:

Foreign Invested Securities Firm

A foreign invested securities firm requires a license from CSRC to offer securities brokerage, investment banking or investment advisory services, or to engage in proprietary trading.

- It takes CSRC up to six months to review and approve or reject an application to establish a foreign invested securities firm. Within six months of receiving an approval, shareholders are required to make capital or in-kind contributions, appoint directors, have supervisors and senior management in place, and apply for and obtain a business license. Within 15 business days of obtaining the business license, the newly established securities firm shall apply for a securities license from CSRC. CSRC will then decide on issuing a license within another 15 business days after receiving the application.
- The initial business scope of a foreign invested securities firm must match the securities business experience of its controlling/largest shareholder.
- A foreign invested securities firm may also apply for a public fund management license or be registered as a private fund manager.

Foreign Invested Futures Brokerage Firm

A foreign invested futures brokerage firm approved by CSRC may engage in commodities futures brokerage business, and may also apply for qualifications to engage in financial futures brokerage, offshore futures brokerage and futures investment advisory services.

- It takes CSRC up to two months to review and approve or reject an application to establish a futures brokerage firm or an application for a qualification to engage in financial futures brokerage, offshore futures brokerage or futures investment advisory services.
- A futures brokerage firm may also apply for a public fund management license or be registered as a private fund manager.

Foreign Invested Fund Manager

A foreign invested public fund manager requires a license from CSRC to distribute and manage publicly offered securities investment funds.

- It takes CSRC up to six months to review and approve or reject an application to establish a foreign invested fund management company. Within 30 days of receiving the approval, the applicant shall apply for and obtain a business license from the company registration authority and a fund management qualification certificate from CSRC.
- A foreign invested private fund manager needs to be registered with the Asset Management Association of China.

Wealth Management Subsidiary of Foreign Invested Commercial Bank

A foreign invested commercial bank may establish a wealth management subsidiary to distribute and manage publicly or non-publicly offered wealth management products and to provide wealth management consulting and advisory services.

- It takes up to four months to receive permission from CBIRC to establish a wealth management subsidiary plus six months preparation period (can be extended for up to three months) and up to two months to receive permission to open the business.
- An investor and its affiliates may control no more than one wealth management subsidiary or have non-controlling equity in no more than two wealth management subsidiaries.

One or a combination of the above mentioned licenses might be relevant, depending on the overall business strategy. A player already present in China needs to assess if its existing legal entities and/or licenses can be reused or a new set-up is required, which can also depend on the location choice to build up the new venture. In order to do so, one needs to evaluate the services of existing entities and respective licenses against its future business model, to understand if they are complementary or conflicting and if they support the targeted locations.

Tying everything together

When exploring options to establish a private bank or a wealth manager in Mainland China, the overall strategy should consist of the following building blocks based on foundational elements of customer centricity:

- a blueprint on where to play and how to win,
- a FinTech eco-system evaluation and collaboration strategy, and
- a thorough assessment of the regulatory environment and a respective action plan.

By putting clients at the heart of their journey, a winning firm will be able to understand, connect and serve customers better and ultimately create value and capture returns for them in a more sophisticated way. Success in the Chinese market will further be dependent on the ability to build agility into the operating model and enable interconnectivity with the local FinTech eco-system. This will drive new forms of revenue generation, sharing of costs and greater customer retention. In addition, a thorough and continuous regulatory assessment as well as a regulatory strategy will ensure compliance with local laws and regulations, in a constantly evolving environment.

To learn more about Deloitte's advisory services on Financial Services Strategy, FinTech Strategy as well as Legal and Regulatory, please contact our specialists.

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Endnotes

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