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New Rules on Bank's Wealth Management Subsidiary

By Sandra Lu | Eric Zou

Pursuant to the *Guiding Opinions on Regulating Asset Management Business of Financial Institutions* ("**Guiding Opinions**") promulgated on 27 April, 2018 and the *Measures on Supervision and Administration of Wealth Management Business of Commercial Banks* ("**Wealth Management Measures**") promulgated on 26 September, 2018, China Banking and Insurance Regulatory Commission ("**CBIRC**") promulgated and implemented the *Measures on Administration of Wealth Management Subsidiary of Commercial Banks* ("**Measures on Wealth Management Subsidiary**") on 2 December, 2018, which marks the establishment of a clear regulatory framework for wealth management subsidiary of commercial banks ("**Wealth Management Subsidiary**") covering requirements on business scope, shareholder qualification, admission of foreign investment and such other aspects fundamental to establishment and operation of Wealth Management Subsidiary.

Recently, a number of commercial banks, including the four largest state-owned banks (i.e. BOC, ICBC, CCB and ABC), have released public announcements regarding their plans to set up Wealth Management Subsidiary with proposed registered capital ranging from RMB1 billion to RMB16 billion. The proposed Wealth Management Subsidiary, as a brand new type of financial institution, has caused a

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sensation on the market. We are briefly analyzing below the opportunities and challenges brought by the Measures on Wealth Management Subsidiary from the perspective of offshore asset managers.

1. Offshore Financial Institutions to Hold Shares in Wealth Management Subsidiary

The registered capital of a proposed Wealth Management Subsidiary shall be no less than RMB1 billion or an equivalent amount in other convertible currency and shall be paid up in a lump sum in cash. The Wealth Management Subsidiary can be either wholly owned by a commercial bank duly incorporated in the PRC (solely for the purpose of this article, PRC excludes Hong Kong SAR, Macao SAR and Taiwan) or jointly owned by the PRC commercial bank and other onshore/offshore institutions, but the PRC commercial bank shall be the controlling and major shareholder.

CBIRC encourages reputable global financial institutions to invest in the Wealth Management Subsidiary as a strategic shareholder so that world leading experience and management expertise can be brought into the Wealth Management Subsidiary and the domestic market. Pursuant to the Measures on Wealth Management Subsidiary, any offshore financial institution that intends to take stake in Wealth Management Subsidiary shall meet key requirements including but not limited to the following:

(1) It shall have no record of material violation of laws and regulations in the most recent 2 years;

(2) It shall have been gaining profits in the most recent 2 consecutive financial years;

(3) It shall undertake in the articles of association of the Wealth Management Subsidiary that unless otherwise approved by CBIRC, it will not transfer its stake in the Wealth Management Subsidiary within 5 years; and

(4) Sound regulatory cooperation mechanism has been established between PRC financial regulator(s) and financial regulator(s) of the country or region in which such offshore financial institution domiciles.

It is not difficult for offshore asset managers to meet the abovementioned qualification requirements. This will pave roads for further opening up of banking industry and asset management industry of China.

2. Business Cooperation between WFOE PFMs and Wealth Management Subsidiary

Up till now, 16 WFOEs established by offshore asset managers have been approved as private securities investment fund managers ("**WFOE PFMs**") in China since 30 June 2016. WFOE PFMs have attached considerable attention to opportunities to cooperate with Wealth Management Subsidiary.

Pursuant to the Wealth Management Measures and the Measures on Wealth Management Subsidiary, commercial bank who has no asset management subsidiary can directly launch wealth management products ("**WMP by Banks**") and Wealth Management Subsidiary can launch WMP as well ("**WMP by Wealth Management Subsidiary**"). Both commercial banks and Wealth Management Subsidiary can launch and manage retail products and private products. However, the ways that WFOE PFM may cooperate with commercial banks and Wealth Management Subsidiary are subject to different regulatory requirements:

(1) WMPs by Banks shall not invest into the private funds managed by WFOE PFMs, shall not be entrusted to WFOE PFMs through a mandate arrangement , and shall not engage WFOE PFMs as the investment advisor.

(2) Retail WMPs by Wealth Management Subsidiary shall not invest into the private funds managed by WFOE PFMs and shall not be entrusted to the WFOE PFMs through a mandate arrangement.

(3) Privately-raised WMPs by Wealth Management Subsidiary can invest into the private funds managed by eligible WFOE PFMs and can be entrusted to the eligible WFOE PFMs as a mandate.

(4) Both retail WMPs and privately-raised WMPs may engage WFOE PFMs as the investment advisor.

When cooperating with the WMPs following the above models, WFOE PFM is called as a Cooperative Institution of the WMPs.

To cooperate with WMPs and to get the investment and mandate from WMPs, WFOE PFM shall meet the following eligibility requirements:

(1) WFOE PFM shall have registered with AMAC as a private fund manager for at least 1 year and shall be an AMAC member with no record of material violation of laws and regulations;

(2) To be an investment advisor for both retail WMPs and privately-raised WMPs , WFOE PFM shall

be an AMAC registered private securities investment fund manager with no less than 3 investment management personnel, whose securities or futures investment management performance is consecutively traceable for over 3 years, and such personnel has no negative practitioner record; and

(3) Any other requirements set out by the financial regulators.

3. Change of Industry Competition Landscape

Regulatory environment for WMPs has undergone great changes after the promulgation of the Guiding Opinions, the Wealth Management Measures and the Measures on Wealth Management Subsidiary. Such changes will also have great impact on the competition landscape of the whole asset management industry in China.

In the past, WMPs mainly invest in fixed income instrument. The Wealth Management Measures allows privately-raised WMPs by Banks to directly invest their WMPs into stocks, and retail WMPs by Banks to invest into the equity funds offered by Mutual Fund Management Company (“**FMC**”). The Measures on Wealth Management Subsidiary further allows retail WMPs by Wealth Management Subsidiary to invest into stocks directly. Furthermore, the minimum subscription amount for a retail WMP by Bank is RMB10,000 and no minimum subscription requirement on retail WMP by Wealth Management Subsidiary.

Regulatory changes like the above will, to a certain extent, upgrade the competition between FMCs and Wealth Management Subsidiary into a more comprehensive level.

However, it is also important to note that both retail funds and retail WMPs may enjoy their own benefits according to their applicable regulations. For example, retail funds managed by FMC, compared with retail WMPs, generally speaking shall be subject to stricter regulation in terms of product registration, distribution and investment, but enjoy preferential tax policies in terms of dividend distribution, which are not available to retail WMPs. In addition, retail WMP is a new business in China recently, third-party evaluation and rating mechanism still needs to be established. Competition and cooperation will be combined between retail funds managed by FMC and retail WMPs in a certain period of time.

Under such circumstance, offshore asset managers, when making decisions for their business and development in China, shall take into consideration all important factors such as governing laws and regulations, regulatory environment, business practice and opening up policies of the financial industry. For example:

(1) Apart from setting up and controlling FMCs, offshore asset managers may also consider setting up Wealth Management Subsidiary with Chinese commercial banks;

(2) Wealth Management Subsidiary will become the key player in the PRC retail asset management product market, and is expected to exert considerable influence in the near future, so that offshore asset managers need to fully assess the competition environment;

(3) Offshore asset managers need to consider how to realize thorough cooperation between WFOE PFMs and Wealth Management Subsidiary; and

(4) A number of offshore asset managers have already established joint venture FMCs with Chinese commercial banks, and such offshore asset managers need to fully consider whether or not their invested FMCs may have competition with the proposed Wealth Management Subsidiary to be established by their Chinese partners and how it will affect the allocation of sales and financial resources of the banks.

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