About China Foreign Economic and Trade Trust Co., Ltd.

Founded in 1987, China Foreign Economic and Trade Trust Co., Ltd. (FOTIC) is one of the oldest trust companies in China. It is a wholly-owned subsidiary of Sinochem Group, one of the world’s top 500 companies, and is a vice president unit of the China Trustee Association. In the past 30 years, FOTIC’s service concept has been “prospects from promises.” It is dedicated to building a modern financial company through professional operations and business procedures that are innovative, service-oriented and people-oriented, in order to provide comprehensive and complete financial solutions to clients. FOTIC focuses on six major business lines: small and micro finance, industry finance, securities & trusts, capital markets, financial institutions and wealth management. It has a headquarters in Beijing and regional headquarters in east, south, southwest and northwest China. Its has operations nationwide. For more information, please visit: www.fotic.com.cn.

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# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preface</td>
<td>2</td>
</tr>
<tr>
<td>Executive Summary</td>
<td>4</td>
</tr>
<tr>
<td><strong>1. China’s Trust Industry at a New Crossroads</strong></td>
<td>8</td>
</tr>
<tr>
<td>1.1 China’s Trust Industry in Retrospect</td>
<td>8</td>
</tr>
<tr>
<td>1.2 Dramatic Change: China’s Trust Industry at a New Crossroads</td>
<td>11</td>
</tr>
<tr>
<td><strong>2. What Is the “Fundamental Purpose” of China’s Trust Industry?</strong></td>
<td>13</td>
</tr>
<tr>
<td>2.1 Learning from History: The Trust Industry Adapts to Change</td>
<td>13</td>
</tr>
<tr>
<td>2.2 Supply and Demand: Fundamentals of the Trust Industry</td>
<td>16</td>
</tr>
<tr>
<td>2.3 Demand: Five Trends in the Real Economy</td>
<td>17</td>
</tr>
<tr>
<td>2.4 Supply: Four Major Types of Service Trust Businesses</td>
<td>20</td>
</tr>
<tr>
<td>2.5 Looking Forward: Significance of the Development of China’s Trust Industry</td>
<td>22</td>
</tr>
<tr>
<td><strong>3. Future Opportunities in China’s Trust Industry</strong></td>
<td>24</td>
</tr>
<tr>
<td>3.1 Bright Prospects: Four Main Businesses Driven by Five Trends</td>
<td>24</td>
</tr>
<tr>
<td>3.2 Scale and Quality: Robust Growth, More Balanced Business Structure</td>
<td>26</td>
</tr>
<tr>
<td><strong>4. How China’s Trust Industry Will Win in the Future</strong></td>
<td>30</td>
</tr>
<tr>
<td>4.1 Shifted Momentum: An Era of Service-driven Trust Business</td>
<td>30</td>
</tr>
<tr>
<td>4.2 “Service +”: Three Models for Differentiation</td>
<td>32</td>
</tr>
<tr>
<td>4.3 Multi-pronged Approach: Strong Organization and Supporting Systems</td>
<td>40</td>
</tr>
<tr>
<td><strong>5. Regulatory and Legal Environments for Transformation</strong></td>
<td>52</td>
</tr>
<tr>
<td>5.1 Sound Regulatory System Unlocks Business Potential</td>
<td>52</td>
</tr>
<tr>
<td>5.2 Foster a Prosperous Trust Industry Through Laws and Regulations</td>
<td>53</td>
</tr>
<tr>
<td><strong>Conclusion</strong></td>
<td>56</td>
</tr>
</tbody>
</table>
Preface

A watershed in China’s financial history came in 2017. In his report at the 19th National Congress of the Communist Party of China (CPC), General Secretary Xi Jinping suggested deepening reform of the financial system and enhancing the ability of the financial services industry to serve the real economy. The National Financial Working Conference decided to establish the State Council Financial Stability and Development Committee, putting financial regulation onto the central government’s agenda. In the longer term, financial work will focus on preventing systemic risk, serving the real economy, and preventing chaos in the financial sector. China’s financial market is going back to its fundamental purpose.

In 2017, the asset management market entered a new phase. The boom in pan asset management started in 2012, after financial institutions put into place profit-oriented and loose monetary policies, which allowed banks to grow. AuM has skyrocketed from RMB 27 trillion in 2012 to RMB 118 trillion in 2016, as the efficiency of investment and financing has increased, and the industry has faced leverage and mismatch risks. The Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Comment), issued jointly by the PBOC and the SAFE, is a guiding example of this. Following these policy changes, competition in China’s asset management industry will become more orderly.

Furthermore, 2017 was a milestone for China’s trust industry. Looking back, the industry has undergone many rounds of rectification. It has been stuck in a cycle of expansion followed by rectification. In 2007, after the “two new rules” were announced, the trust industry moved towards standardization and order. During this process, the industry has grown. It has continued to innovate and serve the needs of customers. Growing from RMB 960 billion in AuM in 2007 to RMB 23 trillion in mid-2017, trusts have played an important role in the national economy, the people’s livelihood, and financial markets. The industry now stands at a new starting point.
The trust industry has a greater influence on society, the economy and financial markets, but the necessity for transition has grown even stronger. After ten years of rapid development, the external environment has become more complicated, and the structure of the industry has undergone major changes. Trust practitioners have started to reflect on exactly what “going back to fundamental purpose” really means. As a sub-industry in the financial sector, does the trust industry have business of its own? Facing competition from pan asset management, how will the trust industry develop in the future? How can trusts participate in the rise of fintech? As the industry calls for top-level planning, how should laws and regulations be improved? And how can the industry improve on the organizational support, institutional mechanisms, human resources, risk management, information technology and performance assessment required for business development? Standing at a crossroads, the industry faces confusion and challenges.

The 30th anniversary of the establishment of FOTIC also falls in 2017. We have always insisted on innovating the industry development model. We firmly believe in the role of strategic leadership and research. In 2015, the FOTIC Research Institute released the first report on the development of the trust industry, “Searching for a Development Path Under the New Normal and New Mechanism.” In 2016, we released “Research on Business Strategy and Strategic Changes for the Trust Industry.” We hope that this report, produced in collaboration with The Boston Consulting Group, and researched and written over a period of 6 months, will make a modest contribution to the development of the trust industry. We carried out 63 internal and external expert interviews, covering more than half of China’s trust industry and 55 topics, including front, middle and back offices. We have sought to outline the development history of the trust industry, clarify its prospects and future direction, despite its complex appearance, and offer operational recommendations for the trust industry based on global experience, in-depth insight and practice.

Going forward, both the global economy and the Chinese economy will enter a new phase. The competitive environment in China’s asset management will become more orderly, putting the trust industry stands at a new historical starting point. China’s trust industry has always recognized that “trustors” needs are the fundamental purposes of trusts. They aim to become the investment banking, asset management and wealth management experts in the Chinese economy. We sincerely hope that this report will allow us to communicate more broadly with the industry, and offer our thoughts and suggested actions for its development.

China Foreign Economic and Trade Trust Co., Ltd.
February 2018
Executive Summary

Amid structural changes in economic growth, tightened financial regulation and fiercer competition, China’s trust industry has arrived at a new crossroads. Against this backdrop, what opportunities will there be for the trust industry, and how should it seize these opportunities? This report explores the future development path for China’s trust industry by examining the basics of the trust business, market opportunities, successful models, and the regulatory environment.

I. The fundamental purpose of China’s trust industry lies in serving the real economy and people’s needs

The trust industry covers a wide spectrum of businesses, which have continued to evolve over time. Analysis of mature trust markets in the United Kingdom, the United States and Japan shows that three drivers are behind the changes in the scope of trust business: the macro economy, the financial regulatory system, and the capabilities of trust companies. In China, macro-economic transformation is deepening. The financial system is underdeveloped, and the trust industry still enjoys considerable comparative advantages. Such new developments will enable China’s trust industry to enter a new stage of development, play new roles and build a new portfolio of functions.

The basics of an industry reside in supply and demand. For the trust industry, demand arises from the development of the real economy and people’s needs, while the core functions of the trust business should be derived from its differentiated competitive advantages. The essence of the trust industry is an optimal balance between demand and supply. On the demand side, trust businesses should closely follow five trends in the real economy: structural optimization and upgrading of the industry, consumption upgrades, wealth management, new urbanization, and economic globalization. On the supply side, the trust industry should focus on four business areas: service-oriented trusts, private financing, wealth management and asset management.

In the current context, the development of the trust industry has three-fold significance. First, it serves the real economy by helping optimize stock and generate capacity. Second, it serves people’s needs by helping individuals and institutional trustees preserve and grow assets, facilitating wealth management and inheritance. Third, it helps drive financial reform. Owing to its cross-market, agile, flexible and innovative characteristics, the trust industry can help optimize the allocation of financial resources and act as a buffer for financial reform.
II. There are still significant opportunities for China’s trust industry

If the five economic trends and four business areas mentioned above are well integrated, they will create tremendous opportunities for China’s trust industry. In terms of total financing, private financing, wealth management and asset management are all expected to sustain rapid growth of 10% or above.

Market opportunities are increasing, and in the face of intense competition, trust companies are accelerating their transformation and improving their capabilities and market share. Looking forward, we anticipate that the trust industry will grow in both scale and quality. The total amount of assets held in trust is expected to grow from RMB 20 trillion in 2016 to RMB 38 trillion in 2021. Industry-wide revenues are expected to amount to RMB 194.5 billion in 2021, with non-proprietary trust business contributing RMB 145.9 billion, representing a CAGR of around 14% compared to 2016. Structurally speaking, industry-wide revenues were dominated by private financing and conduit business in 2016, which together contributed around 72% of total revenues. As asset management and wealth management businesses expand and conduit business contracts with the back-to-fundamentals drive, the trust industry is expected to adopt a more balanced and diversified revenue structure. The combined revenue share of asset management and wealth management is expected to grow from 26% in 2016 to 39% in 2021.

III. “Service +” will allow China’s trust companies to win

Historically, trust companies have enjoyed exceptional growth, driven by license-related benefits and the practice of implicit guarantees. However, these two drivers are losing steam under the back-to-fundamentals drive and strengthened functional regulation, and the trust industry therefore needs to build a new competitive edge in order to survive and thrive in wealth management and asset management businesses, in the face of intense cross-industry competition.

We believe that service is the key to success in the future. The connotations of service-oriented trusts are threefold. First, the nature of trusteeship allows for risk segregation and transaction management. Second, trading structures that are highly feasible, low risk, very convenient and efficient can be designed based on the structural flexibility and multi-directional investment of trust plans. Third, fiduciary, account management, IT support and other platform services can be provided to add operational value and increase client retention.

On the basis of services, the trust industry as a whole has the potential for faster improve-
ments in private financing, wealth management, and asset management capabilities, and trust companies have the opportunity to pursue more diversified and differentiated business models. Global best practices show that the trust industry will have three potential winning business models in the future.

First is “service + finance.” Leveraging financial advisory, trading structure and other services, trust companies can tailor debt, equity and mezzanine financing solutions to meet clients’ needs for balance sheet optimization and business development.

Second is “service + wealth.” Focusing on the wealth management needs of high-net-worth individuals (HNWIs), trust companies can press home the advantages of trusteeship and fuse wealth management with integrated services including wealth protection and inheritance as well as asset allocation, thereby becoming a wealth steward of such clients.

Third is “service + asset management”. Centering on the investment needs of businesses or financial institutions, trust companies can offer fiduciary, distribution and financing support services and leverage self-built and external investment management capabilities, thus serving as an investment steward and asset management business integration platform for institutional clients.

On top of suitable business models, trust companies need to enhance four supporting systems to ensure successful transformation and development. Specifically, trust companies should pursue a diversified ownership structure and enhance organization and governance mechanisms; build a strategic HR management model that serves as a business partner; optimize their risk control frameworks to ensure professional risk management; carefully plan and further enhance IT capabilities, and keep abreast with new technologies and develop forward-looking deployment plans; adjust performance expectations based on their transformation strategies and adopt granular performance assessment methodologies.

IV. A sound policy environment is indispensable for the transformation of China’s trust industry

In addition to organic change, trust companies also need a sound policy environment. Drawing upon the experience of the United States, regulators can foster a favorable environment for the successful transformation of the trust industry by taking into account three aspects. First is coordinated regulation, which ensures aligned regulatory standards for the same type of business managed by multiple regulators and provides a level play-
ing field for the trust industry. Second is the establishment of an institution responsible for organizing investor education. Third, basic laws and regulations should be in place, including a complete basic legal framework for the trust industry. Trust property transfer as well as registration and disclosure rules should be well established. Legal obligations should be clearly defined and standards of conduct set for trustees. Tax and other supporting policies should be enhanced.
1. China’s Trust Industry at a New Crossroads

1.1 China’s Trust Industry in Retrospect

The history of the China’s trust industry is a history of transition. It has developed in line with China’s economic reforms. Since its establishment 40 years ago, it has adapted to changes and has been in a constant state of transformation. Looking back, the industry has undergone three stages of development. The fundamental driving force behind each transformation has been the changes in the macroeconomic and financial environment in which it operates.

First stage (1979-2000): initial exploration, rise and fall

The first trust company was founded in the year that China started to transition from a planned to a market economy. At that time, China’s economy was rebuilding itself, and there was a strong demand for social financing; however, the financial system was still in its infancy. It was very uniform and rigid, mainly occupied by banks. The capital market had yet to be established. There was a strong conflict between the robust demand for financial services and the extremely limited supply, creating a fertile ground for China’s trust industry.

In the first 20 years, the trust industry took advantage of the institutional gap and grew aggressively under the impetus of marketization, accumulating more than RMB 100 billion in trust assets. At this stage, the main objective of trusts was to meet the investment and financing needs of the relevant central government ministries, local governments and state-owned enterprises.

The trust industry was mainly engaged in two kinds of businesses, one was “quasi-banking” business including high interest rate loans, and “quasi-securities” business, including securities brokerage, proprietary securities investment, and issuing stocks and bonds. However, uncontained growth and over-innovation often hide periodical risk control and disorderly development. After five major rounds of rectification, the scale of trust asset management has also fluctuated.

Second stage (2001-2011): expansion, golden decade

After 2001, trusts entered a golden decade of development, mainly driven by the rapid development of the economy and the regulatory dividend in the financial sector.
On the one hand, the rapid investment-driven growth of China’s overall economy created a lot of financing needs. In particular, after 2007, the average annual GDP growth rate and the average annual growth rate of social financing remained at 9% and 23% respectively. On the other hand, a separate financial supervision system was formally established. With the introduction of the “one law and two regulations” after 2001\(^1\), trusts were the only financial entities under the new regulatory framework licensed to invest fully in the money market, capital market and non-listed companies, giving them more flexibility in their investment and financing business than banks and securities firms.

During this period, the AuM in China’s trust industry jumped from over RMB 100 billion in 2001 to RMB 4.8 trillion in 2011. Benefiting from the regulatory dividend of trust licenses, the rapid rise of the conduit business through partnerships with banks led to a boom in the scale and revenue of the trust industry after 2007.

During this stage, there were two main business models and sources of income for trusts. The first was revenue from debt financing. In the case of implicit guarantees, the trust company, because of the credit risk, makes money from the financing spread of the quasi-bank loan model instead of the transaction matching fee charged by the traditional investment banking business for private debt. Therefore, it makes a lot from each transaction, but there is also risk of default. The other model was helping banks to transfer funds to joint conduit business. The trusts had an advantage on the license side and earned low management services fees. However, due to the scale of bank demand, the fees from conduit services gradually began to account for a considerable amount of trusts’ revenue. “Conduit business” and “implicit guarantees” are the two biggest distinguishing features of the Chinese trust business in comparison with the trust industry overseas. Based on their license advantages and willingness to take on risk, trusts made a lot of money from financing spreads and service fees.

In the second phase, the trust industry had unique advantages over banks and securities firms, because its main business was not in direct competition with them, and internal competition was limited due to a lack of licenses. Therefore, with no internal or external threats, the trust industry developed very rapidly.

**Third phase (2012-2016): competition and cooperation in asset management, the beginning of differentiation**

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\(^1\)“Trust Law of the People’s Republic of China”, “Measures for the Administration of Trust and Investment Companies”, and “Measures for the Administration of Capital Trusts”. 

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After 2012, changes took place in the macro environment and in financial regulation, forcing the trust industry to transform itself again.

In macroeconomic terms, growth in demand for financing demand slowed, but demand for investment started to increase rapidly. On the one hand, China has entered a “new normal”, its economic growth rate has “fallen below 8%” and has continued to slow. Economic restructuring has accelerated. Growth in financing has shrunk while backward production capacity in traditional industries has been eliminated. On the other hand, the growth in household wealth, with more than RMB 100 trillion in financial assets held by individuals, and easing monetary policies have generated ample liquidity in the financial market, resulting in a substantial increase in the demand for wealth management and asset management. Therefore, trust organizations are beginning to realize that relying solely on traditional private financing will soon be unsustainable in the process of economic restructuring and that they need to seize new development opportunities.

In terms of the financial system and regulatory framework, China has basically completed its market-based interest rate reform. The China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and China Insurance Regulatory Commission (CIRC) have encouraged financial innovation and gradually liberalized asset management-like institutions under their jurisdiction. As a result, the financial industry as a whole has entered a “pan-asset management” era with mixed competition. Therefore, with the new market opportunities in asset and wealth management, trusts also face more intense cross-boundary competition from banks, securities brokers, funds and other institutions. Some leading trust companies have begun to realize that only by accelerating their transformation and leveraging their client resources and industry expertise in the private investment banking business can they build active investment management capabilities so as to seize new historic opportunities and compete in the pan-asset management field.

Overall, in the third stage, the trust industry maintained the characteristics of the second stage. It continued to develop its conduit business and private financing business and continuously shifted between different innovative models to profit from arbitrage in different markets. However, as the revenue growth of both business areas slowed and profitability declined, trust companies become more aware of the need to restructure. Individual leaders gradually established diversified business portfolios including asset management, wealth management and private financing. The industry moved from the homogeneity of the second phase to an era of split operations.
1.2 Dramatic Change: China’s Trust Industry at a New Crossroads

Analyzing the industry in 2017, we believe that the business environment in which the industry operates is once again going through fundamental changes.

The first change is in the macroeconomy. Since the 19th CPC National Congress, economic restructuring and supply-side reform have intensified. Traditional industries have been struggling to weather the difficult transition, and the central government has been making more effort to control local government borrowing. As economic growth slows, the growth momentum shifts and the roles and means of local governments in driving growth gradually change, there will also be a structural shift in the financing market for the trust industry.

The second change is in financial regulation. Financial regulation has a greater influence on the trust industry than the macroeconomy. The national government is very determined to strengthen regulation. The National Financial Working Conference decided to establish the State Council Financial Stability and Development Committee, therefore financial regulation is now on the central government’s agenda. The financial rectification campaign and return to serving the real economy has reached a climax. On the other hand, since the second half of 2016, a new cycle of asset management industry has begun. The PBOC, CBRC, CSRC and CIRC introduced new regulations to crack down on asset management, cut down conduit business and deleverage the industry, which are having an increasing effect. Regulation has shifted from the “heavy innovation and light control” of the last five years to “heavy standardization and risk prevention”. In November 2017, the PBOC, CBRC, CSRC, CIRC and the State Administration of Foreign Exchange (SAFE) jointly issued the “Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Comment)”, further clarifying the principle of “going back to the fundamental purpose”, and strengthening cross-functional regulation.

The third change is the overall competitive landscape of the financial industry. In the future, bank credit will increase its support for key areas and weak links in the real economy, guided by government policy. At the same time, as the capital market develops further, enterprise and government financing channels will become freer and more diversified. This will impact the traditional private financing business, which profits from interest spreads.

In the face of a stricter economic, regulatory and competitive environment in the mid-to-long term, the trust industry has once again reached a crossroads. The pressure
of sustainable development should not be underestimated. So how should the trust industry act in the future? In the next few sections, this report will discuss the future development of the industry by analyzing the following three key questions:

• What is the 'fundamental purpose’ of China’s trust industry?

• What opportunities should it take in the future?

• How can the industry remain competitive and differentiate itself?
2. What Is the “Fundamental Purpose” of China’s Trust Industry?

2.1 Learning from History: The Trust Industry Adapts to Change

Comparing supply and demand changes and the development of the trust industry in the UK, US, Japan and other developed markets, we have identified the following patterns:

First, the scope of the trust business is constantly changing.

Trust companies in the United Kingdom, the United States and Japan have transformed their business scope and focus according to changes in the external environment, for example, the UK’s trust industry has stuck to its fundamentals, and Japan’s trust industry expanded during World War II.

As shown in Exhibits 1 and 2, the trust industries in the US and Japan have undergone several stages of development. Historically, they have developed financing and even deposit functions. They have recently shifted to focus on functional services such as risk segregation, transaction management, and wealth management.

Exhibit 1. Development Stages and Scope of US Trust Industry
Second, the changes in business scope are determined by three factors.

- **Macroeconomic demand.** Rapid economic development and the rapid growth in private wealth have created a lot of demand for investment, financing and wealth preservation or appreciation. Due to major changes in the environment, such as economic restructuring and wars, countries’ differing emphasis on trust functions can lead to changes in trust business. Trusts rely on a flexible transaction structure and institutional advantages to attract funds and play financing functions.

- **Financial regulations and market structure.** The more complete a country’s financial system, the financial institutions there will be and the stronger their professional capabilities will be. The trust industry is more focused on playing on its own institutional advantages and concentrating on fundamental business areas such as risk segregation, transaction management, wealth management and asset management. On the other hand, if the financial system has obvious professional capabilities and is missing functions, the trust industry needs to take on other financial functions by applying its systems flexibly.
• **Trusts’ own capabilities.** As well as being affected by the external environment, trust institutions also make choices about their business based on their resources. First, whatever the market environment is like, trust institutions can develop their business based on the independence, continuity and security offered by the trust system. Secondly, if the trust company has long-term investment or financing or other types of financial services and has accumulated significant business experience and expertise in specific business areas (such as private financing or proprietary investment business), then when external factors allow, trust companies often choose to continue to deepen their operations and establish their dominance in such businesses.

Historically, the positioning and scope of China’s trust industry have been directly affected by the overall economic environment in China, the development of the financial market and the industry’s own operating conditions. It has transformed its role at different stages of development according to internal and external factors. (See Exhibit 3.)

In the future, the market environment of China’s trust industry will undergo a fundamental change. It will be affected by three decisive factors and show the following characteristics:

**Exhibit 3. The Significance and Functions of China’s Trust Industry Have Evolved over Three Stages of Development**

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<td>Security business</td>
<td>Private investment</td>
<td>Private investment</td>
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<td>Deposit and lending business</td>
<td>Transactions management</td>
<td>Risk segregation</td>
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<td>Public investment banking</td>
<td>Private investment</td>
<td>Transaction management</td>
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<td>Proprietary investment</td>
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<td>Risk segregation</td>
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<td>Quasi-banking, quasi-securities role: solution to the contradiction between the strong financing demand in the real economy and the limited supply of financial services</td>
<td>Connector for the financial system: solution to the contradictions between limited bank resources and the burgeoning financing needs under the separated regulation system</td>
<td>Shock absorbing and catalytic role of macro-control: solution to the contradiction between macro-control policies and market development inertia</td>
</tr>
<tr>
<td>Serving unmet asset management needs: offer products that other financial institutions can not provide to meet differentiated AM and WM needs</td>
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• **The macro economy.** On the one hand, economic restructuring and new development themes such as industrial optimization, new-type urban construction and overseas expansion will generate a continuous demand for investment and financing. On the other hand, as household wealth continues to grow, consumption upgrades are expected to accelerate, driving new demand for credit. At the same time, the number of HNWIs and demand for wealth management are also on the rise.

• **The financial system.** Direct financing in the capital market has developed rapidly, but it has lagged behind developed countries for a long time. Wealth management and asset management businesses will flourish but their penetration remains low. Regulatory structures are still divided by industry, but in the future they will become more coordinated.

• **Trusts’ own capabilities.** The trust industry has taken important market positions in private financing, wealth management and asset management.

In the future, China’s trust industry will move into a new development stage and play a new role in building a new business function portfolio, influenced by changes in the external environment and driven by the development of the financial industry.

### 2.2 Supply and Demand: Fundamentals of the Trust Industry

Looking at the changes in the trust industry overseas and in the Chinese market, it is clear that we should find the fundamentals of an industry. We should look at supply and demand. First, from the perspective of demand, industries should clarify who they are serving and what needs they are meeting. Second, in terms of supply, they should clarify what function they are performing. Demand should come from the development of the real economy and people’s needs. Supply should be based on the differentiated competitive advantages of the trust industry. The powerful combination of the two is the fundamental purpose of the trust industry.

• **Fundamental business of the trust industry from the demand perspective**

Trust companies are the trustees. Their direct clients are trustors, including businesses, individuals, financial institutions and local governments. **This fundamental demand should come from the needs of the real economy and the people’s demands for a better life.** The 19th CPC National Congress pointed out that the major contradiction in society is now **the contradiction between unbalanced and inadequate development and the people’s ever-growing needs for a better life.** As trusts serve these fun-
damental needs, they should also try to resolve this contradiction. Businesses that only meet the needs of trustees, but do not help develop the real economy and become sustainable trust businesses will eventually collapse. For example, some types of conduit businesses have helped banks avoid regulations. Although they protect trustees’ revenue, the flow of funds has not been conducive to economic restructuring and industries’ balanced development, which has prevented the effective deployment of resources on a macro level. As another example, implicit guarantees appeal to risk-averse funders, but such financing distorts the risk-free interest rate, raising social financing costs and hindering industry development. It also reverses asset-side and capital-side returns, and wrongly encourages enterprises to engage in arbitrage rather than industry operations, thereby creating idle funds, and distraction from businesses’ original purposes, which has negative effects on the overall economic development and the stability of the financial system.

- **Fundamental business of the trust industry from the supply perspective**

The trust industry has covered a wide range of businesses over its history, both in China and internationally. However, the function and value of the trust industry should be based on its comparative advantages over other financial institutions. If a trust function, such as deposit and lending business, does not have comparative advantages, then sooner or later it will be replaced by other organizations, and will not become a sustainable foundation of the trust.

By comparing the experiences of developed markets and China’s current situation, we can explore the fundamentals for the future development of China’s trust industry.

**2.3 Demand: Five Trends in the Real Economy**

Looking forward, China’s real economy will enter a new phase and gradually shift from high-speed growth to high-quality development. With the transformation in the development model, economic restructuring, and the transition in the engine of growth, there will also be new development opportunities for the trust industry. The five major themes will be industrial optimization, consumption upgrading, wealth management, new urbanization and overseas expansion.

**A. Industrial optimization**

Financial institutions are often limited by their risk appetite and the efficiency of approvals. They have limited clients and methodologies; therefore they cannot
provide sufficient financial support for industrial optimization. Emerging industry companies often do not have enough collateral and long-term credit records, and struggle to get financing support from banks and the capital market. Their financing channels are relatively narrow and their financing quotas relatively low. The transformation and upgrading of traditional industries generated a wave of M&As and restructuring. Existing standardized financing methods are not able to meet these complicated and diversified financing needs, therefore integrated and innovative financing is urgently needed.

The trust industry has significant experience in mezzanine and structured finance. By continuously strengthening its structured investment and financing capabilities, it can support fund allocation and support industry optimization and adjustment through private financing, sector funds, buyout funds and private equity investment. For example, Yingda International Trust supports clean energy, smart grids and other fields by issuing trust plans, as well as establishing clean energy industry funds and power supply chain investment and development funds.

B. Consumption upgrades

In terms of the scale of supply and service methods, consumer investment and financing services are still in their infancy, and do not meet the emerging and varied consumer demand. Take consumer finance business as an example. With the rise in consumer awareness, the market has entered a rapid development phase. However, companies’ financing and risk control capabilities vary, and some are obviously lacking in these areas.

Trusts can implement various business models such as ABS on a flexible basis to meet the financing needs of consumer financial services institutions effectively. In this process, trusts have gradually accumulated data and improved their IT capabilities to enhance their risk identification and control. This has laid the foundation for expanding business in the future to outsourcing operations, exporting risk control capabilities and direct lending. For example, FOTIC has built a smart integrated service platform for small and micro-finance, providing a one-stop service system for financing, operations, data and credit as well as brand cooperation and risk management.

C. Wealth management

Currently, the limited range of products and services in the wealth management market are unable to meet the diversified needs of customers for wealth preservation, growth and inheritance. China’s wealth management industry is in an early stage
of development. It faces problems including poor integration of services and a lack of professional staff; therefore it is unable to serve the needs of HNWI and UHNWIs for risk segregation, tax avoidance, inheritance, philanthropy, integrated investment and financing allocation.

Trust companies can provide wealth products and asset allocation on a flexible basis based on the diverse needs of HNWIs, build family governance models and offer tailored intergenerational succession programs. For example, Ping An Trust’s wealth management business not only offers family trusts and asset custody, but also manages trust assets and designs flexible return distribution conditions to satisfy clients’ demand for individual distributions in intergenerational inheritance trusts.

D. New urbanization

It is difficult for social capital to provide adequate funding for the large number of supporting construction projects created by the needs of “intensive, smart, green and low-carbon” new-type urbanization development, creating a large financing gap. As “deleveraging” continues, the collateral model for local government debt will no longer be viable. The government continues to promote urbanization and therefore new financing tools and innovative financing models are needed.

Drawing on their expertise in designing trading structures and the infrastructure industry, trust companies are actively exploring various financing models and encouraging the government, financial institutions, high-net-worth investors and other social funds to participate in infrastructure investment. Examples of these initiatives include cooperation between large-scale construction groups and local governments to set up master funds, cooperation with local government investment platforms or industrial parks. Trusts provide funding and specialized service support for local infrastructure through financial means such as equity, debt, “equity and debt combinations” and securitization.

E. Overseas expansion

Most domestic financial service institutions lack experience in overseas markets. The scale and level of existing services cannot meet the investment and financing needs from overseas expansion and overseas personal wealth management. China’s financial institutions started to expand overseas relatively late, so they do not have a lot of experience in this area. This is partly because of a lack of industry knowledge, and partly because they do not understand the cultural practices and legal norms of the destination countries.
China’s trust industry has expanded overseas more quickly in recent years. It is also actively cooperating with national foreign policy strategies such as the “bringing-in and going global” strategy and the “Belt and Road Initiative”. It has continued to accumulate international business licenses, and is also building professional teams with overseas market experience as well as an international business platform to better serve the overseas financial needs of its core clients. For example, AVIC Trust has made investments in general aviation, airport construction, manufacturing and general aviation operations services by launching an “aviation industry fund” to integrate the development of the general aviation industry with the “Belt and Road Initiative”. The 19th CPC National Congress government work report proposed innovating methods of overseas investment and actively promoting international cooperation to allow closer trade ties and smoother capital flows. Trusts will play a greater role in the future in advancing overseas economic development, international trade and capital flow through flexible and innovative investment and financing solutions.

2.4 Supply: Four Major Types of Service Trust Businesses

Judging from the needs of the macroeconomic environment, the trust industry must and is able to play a more important role in serving the real economy and growth in private wealth.

Looking back at the development of the industry both in China and abroad, the trust industry has covered a variety of license functions in different environments. However, in the future, the industry must select areas to engage in according to its own comparative advantages.

We have divided these potential business functions into three categories, taking into consideration the financial system and the advantages of the trust industry (See Exhibit 4):

- **The core functions**, including risk segregation and transaction management, are the trust system’s unique advantages over other elements of the financial system, and will not change.

- **The extended services** are based on trusts’ advantages in risk segregation and transaction management, and include asset management, wealth management, and private financing. Trust institutions have differentiated advantages over other financial institutions in these areas, therefore they are also fundamental business areas.

- **Auxiliary businesses**, including investment, public investment banks, deposit and
loan business, securities brokers and trust companies, are not able to differentiate themselves from other financial institutions. They are additional businesses arising from changes in the external environment, not fundamental functions of trusts.

In conclusion, we believe the trust industry should focus on four business areas: service trusts, private financing, asset management and wealth management.

- **Service trusts** — trust services such as risk segregation and transaction management based on trusts’ natural advantages, legal structure and ability to design trading structures in combination with platform services such as account management and operations support. Service trusts include the following three aspects:
  
  - First, risk segregation and transaction management based on trusts’ natural institutional advantages.
  - Second, planning more feasible, lower risk, more convenient and more efficient investment or financing structures based on the flexibility of trusts and their advantages in varied investments (including the money market, capital market and industry investment).
◦ Third, provide operational value-add and increasing customer retention through fiduciary, account management, IT support and other platform services.

• **Private financing** — provide financing services to clients by combining financial instruments and connecting institutions and HNWIs, based on clients’ financing needs.

• **Wealth management** — manage client assets and offer advice on wealth preservation, growth and inheritance etc.

• **Asset management** — identify and manage assets to create ROI for clients based on their investment needs.

### 2.5 Looking Forward: Significance of the Development of China’s Trust Industry

In summary, under the current environment of macroeconomic restructuring, urgent financial needs, the weak financial system and the trust industry’s comparative advantages, the development of the trust industry is significant in three major ways:

• **Serving the real economy: optimization of existing capacity and economic growth**

  ◦ **Optimization of existing capacity.** As of the second quarter of 2017, China’s trust industry had invested RMB 10 trillion in the real economy, playing a major role in financing. During the development of existing capacity and the transformation and upgrade process, there is an urgent need for financing from trusts with higher risk appetites.

  ◦ **Growth.** As more and more trusts enter the asset management businesses such as venture capital, private equity and mezzanine investment, the trust industry will play an important role in the development of innovative and emerging industries.

• **Serving the people: provide wealth and asset services for members of the public and related organizations**

  ◦ **Wealth preservation and appreciation.** Trusts can effectively increase individuals’ incomes, as a form of investment. According to statistics, the ROI on
trust products in 2016 was about 7%. The industry provided direct trust services to more than 430,000 natural person investors and about RMB 230 billion in revenue for clients, making trusts a major form of investment for individuals.

- **Property management and inheritance.** Trusts are capable of meeting clients’ property management needs well, based on their superior systems. For example, the principle of independence of trust property helps clients effectively segregate risks and protect trust assets across generations. Trust inheritance ensures that trusts will not be terminated due to the death of the trustor or the trustee, up until they expire. Therefore, property protection trusts and property inheritance trusts are possible. They are also hard for other financial institutions to duplicate.

- **Push forward financial reform: optimize financial resource allocation and buffer against the impact of reform**

  - **Optimizing financial resources.** First, trusts can help to open up China’s direct financing market and enhance the overall efficiency of the financial system. With the crackdown on implicit guarantees, trusts will naturally become the leaders in private direct financing. Second, trusts can also make up for the weak links in the existing financial system and improve the use of financial resources. On the one hand, through flexible transaction structure design, trusts provide customized financing solutions with a variety of financial instruments to help companies to grow sustainably. Trust companies also have a high risk appetite and a more mature risk control system, therefore they can move into some areas that commercial banks are reluctant or unable to enter, such as emerging industries and start-up companies. Trusts support economic transformation through industry funds, private equity investment and other forms of funding.

  - **Act as a buffer for the effects of financial reform.** With macro-control policies, including tighter regulation, and the functional coordination between FIs, institutions are adjusting their business operations, which may have an impact on investment and financing markets in the short term. In order to serve the real economy, the trust industry can act as a buffer, connecting with the real economy across multiple markets, and lessen the effects of market volatility caused by supply-side reforms.
3. Future Opportunities in China’s Trust Industry

3.1 Bright Prospects: Four Main Businesses Driven by Five Trends

The trust industry has bright development prospects in five major areas: industry optimization, consumption upgrading, wealth management, new urbanization and overseas economic expansion. These topics can be further be divided into four types of trust business: service trusts, private financing, wealth management and asset management, which in combination will create powerful opportunities for the trust industry. (See Exhibit 5.)

We predict that the trust industry will grow rapidly in four business areas. (See Exhibit 6.) Financing services, wealth management and asset management services will maintain an annual growth rate of more than 10% per year. We anticipate that the trust industry will achieve faster growth than other FIs and gradually occupy a more important market position.

Exhibit 5. Four Major Business Areas for the Trust Industry Driven by Five Trends in the Real Economy

<table>
<thead>
<tr>
<th>Five major trends in the real economy</th>
<th>Service trusts</th>
<th>Private financing</th>
<th>Wealth management</th>
<th>Asset management</th>
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</thead>
<tbody>
<tr>
<td>Industry optimization</td>
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<td>Consumption upgrades</td>
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<td>Wealth management</td>
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<td>New urbanization</td>
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<td>Overseas economic expansion</td>
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</table>

- Financing for emerging industries & industry restructuring
- Cooperative lending, securitization financing
- Risk segregation
- Financing for new infrastructure projects
- Overseas M&A financing
- Overseas asset allocation
- Overseas industry investment funds

- Industry buyout funds
- High-net-worth WM, family trusts
- PPP, industry buyout funds
- ABS
- ABS
- ABS
A. Financing services market

We estimate that total social financing\(^2\) will reach RMB 266 trillion in 2021, an average annual growth of about 11% over five years, of which loans by trusts\(^3\) are expected to grow from RMB 6.3 trillion in 2016 to RMB 13.4 trillion in 2021, an average annual growth of about 16%.

There are several drivers that will affect the scale of trust loans. First, growth in the overall demand for social financing. Over the past five years, social financing has grown at an average annual rate of 15%. In the next five years, with the slowdown of GDP growth and the gradual transformation from an investment to a consumption economy, growth in demand for social financing is expected to fall to 11%. Second, the proportion of direct financing will rise. Overall, equity and debt direct financing currently only accounts for 15% of total social financing. However, as capital market reforms deepen, the proportion of direct financing is expected to rise, but indirect financing will still remain dominant.

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\(^2\) Total social financing refers to the total amount of central bank financing, including bank loans, bank acceptance bills that have not been cashed, entrusted loans, trust loans, non-financial corporate bond financing and equity financing.

\(^3\) Includes conduit business.
Third, in the indirect financing system, the ratio of bank loans is expected to decline slightly, mainly because trusts, because of their flexibility, are better than banks at capturing financing opportunities such as emerging industries and consumer credit.

In addition to loan financing, the trust industry is expected to move closer to the investment banking business in the future, providing more asset-light private debt products to profit from transaction matching fees as well as asset-based securitization financing services. After implicit guarantees are broken up, trusts’ quasi-investment banking business is expected to grow, freeing their financing business of risk, capital and asset constraints. By raising capital utilization and return on assets, revenue from financing will increase rapidly.

B. Wealth management market

We estimate that in 2016, the value of China’s personal wealth management market will be approximately RMB 126 trillion, with fast growth of 12% over the next five years, reaching RMB 221 trillion in 2021. Trust companies have advantages in serving HNWIs with between RMB 6 million and RMB 30 million in investable assets and are expected to serve a total market of about RMB 15 trillion.

C. Asset management market

As the financing and wealth management markets have grown, the asset management market has also expanded as an intermediary between the two markets. The release of the “Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Comment)” will speed up the standardization and development of the overall asset management market. In 2016, the scale of China’s asset management market was about RMB 118 trillion, including about RMB 40 trillion in conduit business. Excluding conduit business, the market size of asset management is expected to increase from RMB 78 trillion in 2016 to RMB 154 trillion in 2021, representing an average annual growth rate of about 15%. The scale of assets held in trust by trust companies, not including conduit business, is expected to reach RMB 21 trillion, accounting for about 13.5% of the asset management market, with 17% growth in balances.

3.2 Scale and Quality: Robust Growth, More Balanced Business Structure

If the trust industry can effectively return to its fundamental purpose and serve the real economy, it will grow steadily and develop a more balanced business structure. (See Exhibit 7.)
We estimate that in the future, the total volume of assets held in trust will increase from RMB 20 trillion in 2016 to RMB 38 trillion in 2021. Revenue in the trust business (excluding proprietary business) is expected to achieve an average annual growth rate of 14%, reaching about RMB 145.9 billion in annual revenue by 2021. Total revenue is expected to reach RMB 194.5 billion by 2021.

By business area:

- **Private financing.** We are optimistic about the strengths and capabilities of the trust industry in private financing, and we believe that it will continue to grow rapidly in this area in the next few years. However, revenue in the financing business has not grown with scale. After implicit guarantees were removed, profitability from spreads fell, while revenue from matching fees increased, therefore the amount earned from each transaction fell.

- **Wealth management.** The trust industry has natural advantages in high-end wealth management. As the industry becomes more client centric, the scale of asset management expands, and services become more diversified, trusts will grow rapidly as a result of more prominent advantages in wealth management.
• **Asset management.** The trust industry has significant development potential in this area. Alternative assets will still be the area with the highest yields. Alternative investments will continue to grow rapidly. Trusts have comparative advantages in industry expertise and accumulated assets.

• **Service trusts — partnerships.** Multiple channels and nesting is the unique product of the separation of regulation by industry in China. According to the instructions of the 19th National CPC Congress, preventing systemic financial risks will become the top priority for financial regulation in the near future. Conduit business will cause an increase in the number of layers of nesting in the financing market and lengthen capital chains. Complex transaction structures in the middle layers can easily create hidden risks, obstructing systemic financial risk prevention. In the long term, the scale of this business area will drop notably. However, certain types of conduit business were mainly established for business operations rather than regulatory arbitrage. For example, from a regulation point of view, banks are not forbidden from investing in stock. However, due to the lack of legislation on wealth management and restrictions on business qualifications, banks cannot directly participate in capital market investments as they do with other wealth management products. With the release of the “Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Comment)”, conduit business has gradually become more standardized. To sum up, we predict that the cooperative service trust business — which is mainly conduit business — will slow down and become less prominent with the rise of other business areas, under the general trend of systemic financial risk prevention, unified regulation of assets, and the trend of trusts “returning to the fundamental purpose.” Nevertheless, such trusts will not disappear completely.

• **Service trusts — capability-type.** The service-driven trust model will only stimulate private financing, wealth management and asset management, but also allows companies to earn extra service fees through separate billing. In the future, trusts will capitalize more on their risk segregation and transaction management strengths to increase their revenue from asset-based securitization and fund clearing services. In addition to direct revenue, service trusts will also play an important strategic role in supporting other business areas (detailed below).

We estimate that by 2021, the trust industry will take on a more diverse and balanced structure.

• In terms of scale, the ratio of conduit business is expected to drop significantly from 61% to 45%, and the proportion of non-conduit service trusts and investment trusts
(including active asset management and family trusts) will increase significantly, from 22% to 35%.

- In terms of revenue structure, the prominence of private financing is expected to drop from 55% in 2016 to 48% in 2021. The share of asset management and wealth management business in revenue will grow rapidly, increasing from 26% in 2016 to 39% in 2021.
4. How China’s Trust Industry Will Win in the Future

4.1 Shifted Momentum: An Era of Service-driven Trust Business

The trust’s industry extraordinary development in the past has been based on four factors:

- The huge financing needs created by rapid macroeconomic growth.
- The investment needs produced by rapid increases of household wealth.
- The split in financial regulation by industry and license dividends under the underdeveloped capital market system.
- Products made attractive by implicit guarantees.

The first two factors will remain for a long time, but the latter two have gradually weakened the potential for horizontal competition in the trust industry. Either the “return to the fundamental purpose” highlighted in the 5th National Financial Work Conference or the “Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Comment)” in November 2017 clearly stipulated the direction for cross-industry regulation and breaking down implicit guarantees. Without the license dividend and implicit guarantees, how can trust companies create new competitive advantages in the private financing, wealth management and asset management businesses?

We believe that in order to win, the trust industry will have to focus on service. By building a stronger trust service capabilities, the industry could break through the competition and gain a foothold in the extremely competitive wealth management and asset management industries.

What are service trusts? How can the industry create greater value for trustors or trustees? As mentioned above, we believe service means improvements in the following three aspects:

- First, risk segregation and transaction management based on trusts’ natural institutional advantages.
- Second, plan more feasible, lower risk, more convenient and more efficient investment or financing structures based on the flexibility of trusts and their
advantages in varied investments (covering the money market, capital market and industry investment).

- Third, provide operational value and increase customer retention through fiduciary, account management, IT support and other platform services.

As shown in Exhibit 8, following the investment and financing value chain, service trusts can develop key capabilities and enhance their competitiveness in private financing, asset management and wealth management. For example:

- **Private financing.** On the funding side, trust companies can obtain funds more easily by setting up service trusts in collaboration with banks, and through retention of high net worth clients. On the client side, trusts can acquire assets through financial consulting and other similar services, so they can anticipate and take advantage of more financing opportunities, while enhancing risk control.

- **Wealth Management.** Use the first point above as an example. Drawing on their institutional advantages, trust companies can provide transaction management services, such as charitable trusts and family property inheritance, thereby making them more attractive to HNWIs and UHNWIs, increasing their high-end wealth management client base and retention.

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**Exhibit 8. The Investment and Financing Value Chain**

[Diagram of the investment and financing value chain]

**Complete value chain for investment and financing**

- Project (business needs) → Financial products (securities etc.) → Investment portfolio (funds etc.) → Client asset portfolios

- Private financing business
  - Services for businesses, funders

- Asset management business
  - Services for funders

- Wealth management business
  - Services for HNWIs

**Source:** FOTIC analysis; BCG analysis.
• **Asset management:** Use the third point above as an example. Trusts can provide business management systems, entrusted clearing and other services for private equity funds. This will help them integrate private equity funds further on the trust platform and also develop FoF and MoM asset management businesses by analyzing the operating data of each fund.

4.2 “Service +”: Three Models for Differentiation

The trust industry can upgrade and accelerate its business in private financing, wealth management and asset management by concentrating on service. Companies will also develop diversified business models. As shown in Exhibit 9, we believe that China’s trust industry should consider three areas of differentiation based on the different focuses of the three businesses: “service + financing”, “service + wealth management” and “service + asset management”.

• **Service + financing:** provide tailored debt, equity and mezzanine financing solutions according to client demand through services such as financial advisory and transaction structure design, based on optimization of clients’ balance sheet structure and business development needs.

![Exhibit 9. 3 Differentiated Future Development Models for China’s Trust Industry Based on Service +](image-url)
• **Service + wealth management:** bring the advantages of the trust system into full play to meet the wealth management needs of HNWIs, integrate service and wealth management, and provide a range of services including wealth protection and inheritance, asset allocation, acting as wealth managers for HNWIs.

• **Service + asset management:** build an investment management and asset management platform for institutional clients in house or by drawing on external capabilities, focusing on enterprise needs, including fiduciary, distribution and financing support services.

In our view, the practices of certain leading international companies can provide a reference for China’s trust companies:

**A. Service + wealth management**

**Family office — Bessemer Trust**

In the wealth management space, Bessemer Trust has built a service-centric philosophy to take the lead in the family trust business. Bessemer Trust has engaged in highly specialized and customized services, which have been the cornerstone of its business for more than a century. It offers broad, in-depth and specialized services. First, it provides a variety of detailed functions, with three major categories — investment, wealth planning and office services — and 12 sub-categories, covering practically all the needs of family wealth management across the entire value chain. Second, its services are highly customized and has always insisted on 3:1 customer service to ensure high quality and meet individual needs. Third, it has pursued specializations: a single Bessemer service team will include experts covering finance and accounting, banking, insurance, tax, investment, real estate, business management, philanthropy and family wealth stewardship services. Bessemer manages over US$ 100 billion in client assets. With its service model, it not only collects management fees, but also legal, tax, and transactional consulting fees. We discuss Bessemer in more detail in the first special topic.

**B. Service + asset management**

**Investment services + MoM — Russell Investments**

On the asset management front, Russell Investments moved into the Manager of Managers (MoM) business by offering advisory services for institutional investors. (See Exhibit 10.) Russell has gone through roughly three stages of development. In the 1970s, it started
with pure advisory business. For institutional investors, Russell built a money manager assessment system, which was widely recognized for its time-tested rigorous framework and advanced assessment concepts. Through fund advisory services, Russell built basic research capabilities and established relationships with investors based on trust. In the 1980s, Russell developed an MoM business, leveraging its money manager research and selection capabilities. As a fiduciary, it created multi-fund portfolios for insurers and other large institutional investors, thereby earning portfolio management fees in addition to pure advisory fees. With hands-on investment practice, Russell established strategic alliances with various asset managers around the world and built a global multi-manager network, strongly defending its sources of assets. After 2000, with a growing institutional investor base and an expanding network of investment managers, Russell started to take advantage of its cross-asset class, cross-fund manager platform to offer more integrated multi-asset, multi-strategy solutions, which enjoyed great popularity among large institutional investors in a post-crisis market environment of low interest rates and high volatility.

### Outsourced CIO — BlackRock

Defined benefit plan clients constitute one of the key segments of BlackRock, the world’s largest asset manager by assets under management. These clients, especially SMEs, are...
not versed in investment management and lack the manpower and energy to handle complicated processes such as account management, reporting, and regulatory compliance. As a leading asset manager, BlackRock serves defined benefit plan clients primarily by offering a wide range of outsourced services, including system development, account management and reporting, as well as asset allocation and other advisory services. In this way, it acts as a fiduciary and ultimately becomes clients’ outsourced CIO, offering one-stop investment management services. (See Exhibit 11.)

**Boutique asset management platforms — BNY Mellon Asset Management**

Another typical example of service-driven asset management is BNY Mellon. (See Exhibit 12.) Originally a commercial bank with very weak foundations for investment management, BNY Mellon gradually distinguished itself in scale from other bank-affiliated asset managers in the United States from three aspects. Firstly, through custody and clearing services, BNY Mellon attracted many deep-pocketed investors to its platform. Secondly, through M&A of boutique asset managers, it built investment management capabilities and was able to provide multi-strategy portfolios. Thirdly, it focused on serving defined benefit plan, insurance and other institutional clients with investment solutions, which not only include portfolio management and asset allocation strategies but, more impor-
tantly, are tailored to clients’ asset-liability profiles, cash flows, and regulatory and tax requirements. Such solutions were critical to BNY Mellon’s success in the institutional asset management market.

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Exhibit 12. BNY Mellon: Multi-boutique Asset Mgmt. Platform
Independent feeder fund operations with unified platform-based mgmt. and resource allocation

<table>
<thead>
<tr>
<th>Investment managers</th>
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<tbody>
<tr>
<td>BNY Mellon Cash Investment Strategies</td>
</tr>
<tr>
<td>Investment focus: money market funds; full array of short-term strategies</td>
</tr>
<tr>
<td>Mellon Capital Management</td>
</tr>
<tr>
<td>Investment focus: absolute return; global asset allocation; active/index funds and fixed income; active forex investment; portable Alpha strategy; diversified Beta strategy; commodities</td>
</tr>
<tr>
<td>Insight Investment</td>
</tr>
<tr>
<td>Investment focus: Leading players in liability-driven investment, fixed income, multi-asset, absolute return and equity solutions</td>
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<tr>
<td>...</td>
</tr>
<tr>
<td>15 other funds</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Distribution &amp; investment services</th>
</tr>
</thead>
<tbody>
<tr>
<td>BNY Mellon Asset Management International</td>
</tr>
<tr>
<td>Focus: Customized solutions for separate accounts via collective funds</td>
</tr>
</tbody>
</table>

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Precise Positioning to Seize Opportunities for HNWI Wealth Management

1. Great potential in China’s HNW individual wealth management market
In 2016, China had 2.1 million HNW and UHNW households, with investable assets amounting to about RMB 54 trillion, according to BCG research. It is estimated that by 2021 the number of HNW and ultra-HNW households in China will reach 4 million, with total investable assets exceeding RMB 110 trillion. In order to tap the great potential of the wealth management market, trust companies should take the opportunity to transform their business models. (See Exhibit 1.)

2. Focus on the needs of HNWIs and UHNWIs
In the future, trust companies should focus on HNWIs and UHNWIs to press home their comparative advantages. Wealth management needs vary by market segment. HNWIs and UHNWIs value integrated service capabilities that include product design, risk segregation and asset allocation. Compared with banks, securities firms and other competitors, trust companies can leverage their institutional and license advantages and design precise trust structures to better meet the key needs of these two segments.

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Sources: literature search; company website and reports.
1 Defined-benefit pension plans.
3. Integrated capabilities built through key business initiatives

Drawing upon the experience of the US market with HNWIs and UHNWIs, trust companies in China can pursue two wealth management business models, namely integrated wealth management and family office.

Owing to the independence, risk segregation and privacy of trust property, trusts enjoy competitive advantages in the wealth management market, especially in serving the special needs of UHNWIs, such as concentrated family property and family business ownership, and flexible allocation of rights to earnings. For this reason, trust companies have a greater potential to develop family office business. However, a family office requires a multi-disciplinary team of professionals, which represents a challenge to trust companies given their current states and talent pools. Therefore, trust companies should plan appropriate development paths. They can focus on integrated wealth management at the current stage to build up their capabilities and then opportunistically develop family office business in the future. (See Exhibit 2.)

- **Model 1: integrated wealth management**

Integrated wealth management business is positioned as basic wealth stewardship for HNWIs. It provides integrated planning to help clients with wealth preservation, en-

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Source: BCG global wealth database; BCG analysis.

Note: Amounts were converted to RMB from US dollars at the exchange rate of 1:6.642; because of rounding, not all percentages add up to 100.

1 HNW households are defined as those with greater than $1mn in investable financial assets, and ultra-HNW households as those with greater than $5mn in investable financial assets.

2 Private investable financial assets include offshore assets but exclude non-financial assets such as real estate and luxury goods.
hancement and inheritance. A typical example is Merrill Lynch Wealth Management. Two key success factors have led to it becoming the world’s leading wealth manager.

First, it has built a product platform with diverse offerings and distinctive advantages. With strong capabilities for integrating internal and external products, Merrill Lynch offers a wide range of products with the underlying assets covering equities, bonds, funds, commodities and credit derivatives. It has also created distinctive “product suites”, which are custom-tailored investment portfolios that help effectively improve client retention and satisfaction.

Second, it has established a professional investment advisory team that excels in service. For example, Merrill Lynch focuses on a “one-on-one” customer service model. In order to build a dedicated, professional investment advisory team, it recruits top experts in legal, tax, finance and other fields with an acceptance rate of only 5%. It has also developed a mobile training system designed to enhance advisors’ sales abilities for complex products through graded courses that emphasize a combination of professional competence and marketing skills. In its periodic performance assessments, Merrill Lynch uses a multi-dimensional evaluation system, under which the bottom 5% of performers are eliminated every year to motivate employees to serve clients more efficiently.
Chinese trust companies should build differentiated product platforms to develop their integrated financial management business, and build “flagship products” that are suited to the China market. For example, they can introduce a diverse range of equity products through securities clearing business; in partnership with foreign players, they can offer high-quality overseas wealth management products. Moreover, they should build a team of professional investment advisors, with systematic recruitment, training, business development and performance appraisal methodologies designed to enhance the team’s expertise. For example, in business development, they can continue to implement a mobile model, improve service efficiency with mobile terminals and roll out more value-added services through online channels.

- **Model 2: family office**

Positioned as a senior wealth steward that serves UHNWIs, a family office plans across different areas, offering family wealth protection, management and inheritance solutions tailored to client needs. A case in point is Bessemer Trust, the world’s top family office. Founded in the United States in 1907, Bessemer serves more than 2,400 clients with over US$ 100 billion under management, ranking top 5 among the world’s richest family offices.

The success of its business model can be attributed to three key factors:

1) Customized, integrated services. Bessemer offers investment management, wealth planning and family office services, which can be further divided into 12 specialized services. Maintaining a 3-to-1 client-to-employee ratio, Bessemer aligns its broad capabilities with the unique needs of each family, offering custom-tailored asset advisory, portfolio management, customized asset allocation, investment strategy & research, trust & estate, tax & risk management, family & next generation, philanthropy, human resources, bill payment & accounting, private banking, and custody & reporting services.

2) Professional team. Bessemer recognizes the importance of building professional teams. A typical service team is usually composed of expert advisors in finance, accounting, banking, insurance, tax, investment, real estate, business management, philanthropy, stewardship and other fields. An average senior advisor is expected to have over 20 years of industry experience and a tenure of more than 10 years with Bessemer. Moreover, to ensure professionalism, Bessemer has set up a securities firm dedicated to providing trust clients with investment services such as open market trading, long-horizon equity investment, and real estate investment.

3) “Culture of service, not sales.” Since its inception Bessemer has provided professional services rather than adopting a sales-driven profit model. It offers appropriate, unbiased advice through a wide range of asset allocation and investment services. Bessemer provides clients with the best solutions for their wealth inheritance needs, earning hefty legal and transaction advisory and annual service fees on top of the traditional management fees.
4.3 Multi-pronged Approach: Strong Organization and Supporting Systems

In building the differentiated business models described above, trust companies should enhance four supporting systems in order to better capture the opportunities arising from the transformation of the industry.

A. Governance and performance assessment

Most Chinese trust companies face institutional constraints in their governance structures, performance assessment and incentives, product innovation and other aspects. **Trust companies should be encouraged to foster a diversified ownership structure through introducing strategic investors, pursing an IPO or other means.** Diversified ownership offers many benefits. First, it is conducive to robust corporate governance and operational independence; second, it helps improve financial stability and mitigate risks in the industry; third, it allows for market-based mid to long-term incentives that invigorate the industry; fourth, it helps remove the investor perception of “implicit guarantees” associated with trust products.

The signposts of business management are business targets and performance assessment,
which include shareholders’ expected business targets for and performance assessment of trust companies, and trust companies’ own internal business targets and performance assessment. Driven by shareholders’ focus on AuM growth, profit growth and ROE, trust companies tend to have strategic myopia and an aggressive risk appetite. Going forward, shareholders should rationalize their performance expectations, and improve the existing KPI system by including non-financial metrics like revenue and profit structures, to encourage trust companies to push ahead with transformation, which will require time and patience.

Trust companies commonly adopt an extensive internal performance assessment approach that values quantity over quality, with limited incentives for innovative businesses. Ineffective internal performance assessment systems lead to an overdependence on conduit and private financing businesses and an organizational inertia that results in low motivation for innovation. Therefore, trust companies should reinvent their performance assessment systems in line with their transformation strategies to allow for granular metrics. For example, wealth management business requires a lot of input at the incubation stage and should be looked upon favorably in performance assessment. Incentive and disciplinary mechanisms should be developed for investment business, and both quantitative and qualitative metrics should be used to ensure the stable and healthy development of asset management business.

B. Human resources

All trust businesses compete on talent, whether it is in financing, asset management or wealth management. However, the trust industry has seen a severe brain drain, risking losing momentum as a result of high turnover.

Trust companies should develop both rules and a culture for human resources management. On the one hand, they should establish sound HR rules that reflect changes in people management in response to business transformation. On the other hand, they should design and optimize their benefit systems, such as providing long-service awards and innovation awards and organizing regular outdoor training programs, in order to build a strong corporate culture and enhance employees’ cultural identity.

C. Risk management

Trust companies have made some progress in building an effective risk management system and are building a corporate culture that stresses “risk control”, not only to ensure sustainable development but also in response to regulatory requirements to guard
against financial risks. Going forward, trust companies will face increasing risk exposure and management complexity as transformation deepens. They should heighten their risk awareness and improve their professional risk management capabilities.

With heightened risk awareness, they should implement strict risk control and compliance norms in business development and build an appropriate risk culture. They should clearly define fiduciary duties in different businesses, carefully assess operational, credit and market risks on an ongoing basis, and strengthen their risk mitigation capabilities. For example, trust companies can review their internal processes and carry out self-assessments to set key risk metrics for regular monitoring. In so doing, they can not only provide a solid foundation for successful transformation but also help create the environment necessary for the healthy development of the industry.

With a view to professional risk management, trust companies can consider shifting their risk organizational structures from “independent policing” to “matrix-styled collocation” that enables closer collaboration with business departments and focuses more on providing risk solutions. The “independent policing” model commonly seen in trust companies emphasizes the independence of risk control, resulting in a lack of understanding and support for innovative businesses that are critical to strategic transformation. For innovative businesses such as equity investment and consumer finance, trust companies can consider the matrix management model, where risk reviewers are integrated into business departments but mainly report to the risk management department. This organizational structure can not only improve the risk team’s understanding of business and professional review capabilities, but also to some extent reduce the antagonism between the risk department and front-office business departments, changing the role of the risk department from passive risk monitoring to active risk management with risk solutions proposed to support business innovation and development.

Some trust companies already have good risk management foundations and professional risk control practices. They can consider further incorporate risk management into their overall strategies, and gradually build a systematic, comprehensive risk management system to more accurately reflect risk levels and efficiently identify, measure, monitor, control and report all kinds of risk exposure, thereby ensuring robust operations and stable value creation.

D. Information technology

The trust industry has a weak IT foundation as trust companies used to undervalue the importance of IT and hardly invested in this area. To support strategic transformation,
trust companies need to gradually enhance their IT capabilities through a three-step approach including planning, development and innovation. As the first step, trust companies should formulate an IT plan based on their strategies and development paths. They should also step up financial input and build a strong professional IT team to be well prepared to implement the plan. The second step is to develop IT systems. At the early stage, trust companies should use external resources as appropriate and purchase standard products from external suppliers, such as valuation, accounting and clearing systems. However, they need to rely on internal research and development to secure customized systems required for their strategic businesses. In research and development, they should establish uniform data standards and integration processes to facilitate information sharing and data integration management across different departments and systems. In this way they can avoid information silos and build systems that underpin consistent, smooth front-end customer journeys. The third step builds on the success of the previous phases. Trust companies can explore ways of applying robo-advisors, big data, cloud computing and other emerging technologies to lead business innovation and ultimately make information technology their core competitiveness.

New Technologies Present Opportunities for Trust Companies to Innovate

Many industries have felt the disruptive impact of ubiquity of the Internet and mobile connectivity and the wide application of new technologies such as big data and cloud computing. Restricted by weak data and IT foundations, trust companies in China lag behind in deploying new technologies. The industry is already exploring the use of new technologies in three areas: channel innovation, product and service innovation, and operational innovation. However, there is still a lot of room for improvement compared with leading foreign practices. (See the Exhibit below.)

1. Channel innovation
Mobile marketing has become a key channel for trust companies, with online advertising, marketing and reservation functions widely adopted in the industry. Leading players in applying new technologies, such as Ping An Trust, are already offering digital, automated customer service, allowing online self-service functions including advisory, investment, product and account information, returns history, redemption, and deal cancellation.

Going forward, besides driving digitalization, trust companies should also keep abreast of developments in artificial intelligence (AI). China’s State Council issued the Next Generation Artificial Intelligence Development Plan on July 20, 2017, highlighting AI as a key national strategy. In this context, trust companies can consider deploying AI and other cutting-edge technologies to support and even gradually replace human customer service, thus saving labor costs and improving service availability and standardization.
2. Product and service innovation

Some trust companies are already leveraging big data, cloud computing and other technologies to develop innovative products and services. CITIC Trust, for example, uses big data to uncover the spending needs and preferences of target customers and then tailors consumer trust products for them. Chang’an Trust is seeking to employ big data and cloud computing technologies to build a financial cloud platform (SaaS) with supply chain business processing, warehousing & logistics and finance modules, thereby offering supply chain trust products targeting SMEs. On this platform, the company can monitor and analyze key process data across the supply chain to enhance risk control before, during and after lending.

In the future, trust companies can step up their application of robo-advisors, blockchain and other innovative technologies.

- **Robo-advisors:** The recent years have seen rapid growth in robo-advisors in Europe, US and other mature wealth management markets. Robo-advisors can bring significant returns for wealth managers in two aspects. On the one hand, robo-advisors can replace human advisors and provide investment advisory services at lower costs, which allows wealth managers to extend their services to clients at medium and low wealth levels (e.g. with investable assets lower than US$ 100,000) who were not served previously by human advisors.
New Technologies Present Opportunities for Trust Companies to Innovate (continued)

advisors. On the other hand, robo-advisor technology can help human advisors serve high-end clients more efficiently. For example, backed by AI analysis, a robo-advisor can help human advisors offer more personalized portfolio advice to high-end clients. It can also provide human advisors with dynamic, real-time client information (such as marriage, childbirth and other moments that matter most to clients) through social media scanning, so that human advisors can readily anticipate and respond to client needs for precise marketing. In the China market where robo-advisors are still at an early stage of development, trust companies can seize the opportunity to expand robo-advisor business and offer wealth management products to wider groups, thereby improving customer experience and reinventing their service and operating models.

- **Blockchain:** With such features as disintermediation, tamper resistance and traceability, blockchain can make a great impact in securitization, family trust, securities clearing and asset trading platform businesses. In securitization business, blockchain data on underlying assets in the entire process from lending to trading can help trust companies carry out real-time monitoring and accurate forecasting of cash flows. XFinTech, for example, has launched an ABS cloud platform, which provides authentic and real-time cash flow and asset information with the aid of blockchain technology. Domestic trust companies can choose to collaborate with these leading players to enhance the operational efficiency of ABS business in the short term and emulate them through independent research and development in the medium to long term.

In family trust business, trust companies can create smart contracts corresponding to trust plans. Once such contracts are in the blockchain, they can be executed automatically according to specified events and times, allowing for automatic distribution of medium to long-term assets and returns. In securities clearing business, smart contracts allow matching between buyers and sellers, digital registration, and on-time clearing and settlement, all automatically. In terms of asset trading platforms, given that blockchain information is tamper-proof and requires joint maintenance, China Trust Registration can consider building a decentralized asset trading platform that is transparent, secure, reliable and efficient, to facilitate secondary market trading of trust products.

3. Operational innovation

New technologies, such as big data, cloud and artificial intelligence, can help optimize trust business operations primarily from three aspects: risk control, precision marketing and cloud system deployment. On the risk control front, a few leading trust companies are already applying big data-based solutions to their consumer finance businesses. Through more accurate customer portraits plus multi-dimensional behavioral data — both static and dynamic — trust companies can not only
New Technologies Present Opportunities for Trust Companies to Innovate (continued)

enhance their online pre-loan anti-fraud capabilities and optimize their credit models, but also issue timely risk warnings during and after lending and improve debt collection. In terms of precision marketing, some trust companies with fledgling information systems are building data centers for big data analysis. They extract relevant data from management systems for standardization and secondary processing and thus create a data center-based interactive system, which serves as the basis for relationship and marketing management applications. In terms of system deployment, some trust companies have begun to build proprietary cloud platforms and plan to deploy cloud-based front, middle and back office systems. This will help them enhance the efficiency of iterative system development and reduce system operation and maintenance costs while meeting their innovation and development needs.
1. China's burgeoning consumer finance market

As consumer spending power and attitudes to consumption have changed, China has seen a significant upswing in consumer spending and rapid growth in consumer credit. According to BCG estimates, China's consumer credit outstanding amounted to about RMB 4.4 trillion in 2016 and is expected to sustain a high CAGR of 18.4% in the next five years and exceed RMB 10 trillion by the end of 2021. (See Exhibit 1.)

In the meantime, consumer credit scenarios will also change considerably. In China, 3C (computers, communications, and consumer electronics) consumer finance currently accounts for nearly half of the market, while consumer credit demands in other scenarios remain to be tapped. In a booming market where the consumer landscape has shifted, occupying the rapidly growing mainstream consumer finance scenarios, either directly or indirectly, will be critical to business success.

2. Leveraging advantages to focus on institutional clients' financial needs

In China, consumer finance market players primarily include personal consumer credit institutions and the institutions that serve them.

Exhibit 1. China’s Consumer Credit Market Has Grown Rapidly in Recent Years. Consumer Credit Outstanding Amounted to RMB 4.4tn in 2016 and Is Expected to Top RMB 10tn by 2021

China’s consumer credit outstanding\(^1\) is expected to sustain medium to high growth in the next five years and reach RMB 10.3tn by 2021

Sources: PBOC; CBRC; Credit Card Blue Paper; expert interview; BCG consumer finance model.

\(^1\) Personal credit loans outstanding, including credit cards, loans from consumer finance companies, P2P loans (personal) and personal loans from small-loan companies, but excluding personal home loans, residential mortgages, auto finance, etc.
In the short term, trust companies can serve financial institutions, especially those that are licensed. Major personal consumer finance institutions, such as banks, consumer finance companies, small-loan companies, online P2P lenders and internet giants, all have their own business weaknesses. Constrained by institutional factors, banks have complicated service and operational processes and lackluster customer experience. Most consumer finance companies, small-loan companies, P2P lenders and internet giants have weaker financing capabilities, and need to improve their risk management. For these reasons, a service market has developed for such institutions, and has grown rapidly in recent years.

There are four kinds of service providers for those institutions: financial service providers, intermediary service providers, data risk control service providers and managed operations service providers. Compared with other market players that serve the financial needs of institutional clients, the strengths of trust companies lie in their licenses, capabilities and strategic focuses. Firstly, trust companies have a wider range of financial service qualifications. Secondly, compared with other non-bank market players, trust companies have greater credit risk management capabilities and experience and thus can help them implement more rigorous and high-standard business risk management. Finally, compared with large licensed financial institutions like banks, trust companies are generally more strategically focused and can enhance their competitiveness through ongoing input of resources.

Accordingly, trust companies should focus on the financial needs of institutional clients first and, after increasing their scale and capabilities, can then expand into other areas. (See Exhibit 2.)

In the long term, trust companies, empowered by technology, have the opportunity to directly serve personal consumer finance needs. In the short term, trust companies will face two major challenges in this regard. Firstly, they usually have a streamlined organizational structure dominated by top financial professionals, who are not suited to labor-intensive customer acquisition and operational activities before, during and after issuing personal loans. Secondly, constrained by institutional factors, most trust companies have a low risk appetite for consumer finance and are less tolerant of the negative impact of risks on their reputation. In the medium to long term, with technology-enabled improvements in operational management efficiency and underlying asset risk control, a few trust companies with strategic foresight, leading technologies and focused input of resources will be able to engage directly in consumer finance services primarily through online channels.

3. Four major initiatives to enhance capabilities and build a competitive edge

Trust companies must center around clients’ financial needs when developing consumer finance business, and strengthen their risk control capabilities. In order to further develop consumer finance business and build core competitive advantages, trust companies can consider four key initiatives:

Firstly, careful selection and maintenance of business partnerships. According to BCG fore-
casts, the future consumer finance landscape will become more concentrated. Nearly 70% of consumer credit demand will come from tourism, 3C, property rental and home improvements scenarios. Trust companies generally lack online and offline customer acquisition channels for these scenarios; therefore, careful selection and maintenance of partners that have customer and traffic resources in key spending scenarios will be critical to the success of consumer finance business.

Trust companies should partner with leading players in each segment, paying special attention to three key capabilities: 1) capital strength; 2) business capabilities, including customer acquisition, channel management and risk management capabilities; and 3) data and IT capabilities, including capabilities to access data on different service scenarios and apply technologies to optimize operations and enhance end customer experience.

Depending on business needs, trust companies should gradually deepen cooperation with selected partners and thus cement relationships that bring quality business resources. Trust companies can start with project-based cooperation to establish business relationships and improve mutual understanding. They can enable business data exchanges and system interconnectivity with partners based on these relationships and even establish strategic partnerships. Finally, based on full understanding...
of partners’ resources and capabilities, they can consider equity investment to establish even closer ties and share the financial returns from the rapid growth of target companies.

Secondly, IT system building and application of new technologies. With the rise and broad adoption of mobile connectivity, big data, AI, and cloud computing, trust companies can leverage new technologies to improve their operational efficiency and customer experience in key business processes, especially risk management, customer service and debt collection.

- **Risk management:** Biometrics, big data and machine learning technologies can be used to enhance risk control. For instance, companies can use biometrics technology to identify borrower identities. They can build a business scenario-specific, machine learning-based risk control model based on multi-dimensional key customer information to improve the automation and accuracy of consumer credit risk control through constant self-iteration and optimization.

- **Customer service:** Trust companies can expand their online customer service channels and use AI to enhance the standardization and automation of customer service. For example, online and automated processing is possible throughout the credit journey from application, review and lending to repayment.

- **Debt collection:** Big data and online channels can help improve operational efficiency. For example, big data can uncover the borrower’s real contact information, which can be used for automated debt collection by telephone or text message and/or via the internet.

Thirdly, in collaboration with partners, trust companies can enhance their comprehensive risk management capabilities. Besides leveraging new technologies, trust companies should also collaborate with their partners to strengthen their risk management capabilities:

- **Pre-loan investigation:** Trust companies should leverage their partners’ data and business experience to verify credit customer information and cooperate with them to establish and optimize risk control models. In tourism applications, a trust company can adjust the results of the consumer credit risk assessment based on travel information provided by its partners.

- **Credit review:** In this process trust companies should make full use of their partners’ anti-fraud systems and capabilities. In e-commerce applications, a trust company can verify the borrower’s identity during the lending process with its partners’ online and offline resources.

- **Post-loan management:** With the help of its partners, a trust company can understand and assess a consumer’s willingness to repay the loan to guard against default risk. In education applications, a trust company can assess a client’s willingness to repay the loan for risk alert purposes based on the borrower’s attendance record. In property rental applications, a
trust company can reach out to its partners to collect debts from customers in default and evict seriously defaulting tenants.

Fourthly, trust companies should build an integrated consumer finance service platform. By constantly enhancing their risk control and information technology capabilities, trust companies will be increasingly able to serve the financial needs of institutional clients. They can then take a step further to expand into other service areas. For example, they can export their risk control and product design capabilities. They can also engage in operation management, providing pre-loan review, post-loan monitoring, debt collection via outbound calls, and other services. Market-leading trust companies can build an integrated consumer finance service platform to sharpen their competitive edge in serving consumer finance institutions and gain greater influence and bargaining power.

Take JD Finance’s Structural Finance Group for example. At the beginning, it was positioned as an internal ABS service provider focused on the financing needs of JD’s consumer finance products such as Baitiao. As such, it gradually built smart systems that cover cash flow management, stress testing, pricing models and other functions as well as risk management and pricing capabilities. The division then transformed itself into an ABS service provider and capital intermediary in the market, exporting big data-based risk control, system technology and online operations capabilities and investing in mezzanine funds with its own funds. In this way, it has grown from an internal function to a financial services provider in the market with independent profitability. JD Finance intends to build it into an open ecosystem focused on securitization to enable external partners across the value chain and create a cloud ABS trading platform.
5. Regulatory and Legal Environments for Transformation

Benchmarking against maturer trust systems in the United Kingdom, the United States and Japan can shed some light on the future development of China’s trust regulatory system. (See Exhibit 13.)

The regulatory and legal systems for trusts in the United States are of greater reference value for China due to their top-level design. Both the US and China markets can be divided into individual, corporate and hybrid segments. Like China, the United States also regulates banking and trust businesses separately under the principle of “independent functions and separate accounting and management”, with clearly defined boundaries. Drawing upon best practices from the trust regulatory and legal systems in the United States, we would like to offer suggestions on the future development of China’s trust industry in the following paragraphs.

5.1 Sound Regulatory System Unlocks Business Potential

In terms of trust regulation, China can learn from the coordinated regulation and investor education in the United States.

Exhibit 13. Considering Client Bases, Business Types, Competitive Landscapes and Regulatory Methods, Regulatory and Legal Systems for Trusts in the US Are of Greater Reference Value for China

<table>
<thead>
<tr>
<th>Clients</th>
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<tbody>
<tr>
<td>China</td>
<td>Individual, corporate and hybrid (pension plan trusts, etc.) clients</td>
<td>Primarily individual clients</td>
<td>Individual, corporate and hybrid (employee benefit trusts, etc.) clients</td>
</tr>
<tr>
<td>Japan</td>
<td>Individual, corporate and hybrid (pension plan trusts, etc.) clients</td>
<td>Separated regulation</td>
<td>Unified regulation by a single agency</td>
</tr>
</tbody>
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<tr>
<th>Business</th>
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<tbody>
<tr>
<td>China</td>
<td>Financing</td>
<td>Investment</td>
<td>Transaction mgmt.</td>
</tr>
<tr>
<td>Japan</td>
<td>Mixed regulation</td>
<td>Self-discipline by industry association</td>
<td>Mixed regulation</td>
</tr>
</tbody>
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<tr>
<th>Competitive landscape</th>
<th></th>
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<tbody>
<tr>
<td>China</td>
<td>68 trust companies – no monopoly</td>
<td>Primarily personal trusts</td>
<td>Trust departments of large commercial banks and a few trust companies - no monopoly</td>
</tr>
<tr>
<td>United States</td>
<td>Primarily personal trusts</td>
<td>Multiple regulators - separation</td>
<td>Trust departments of large commercial banks and a few trust companies - no monopoly</td>
</tr>
<tr>
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<tr>
<th>Regulation</th>
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<tbody>
<tr>
<td>China</td>
<td>Multiple regulators; regulation plus self-discipline, market discipline and safety measures</td>
<td>Multiple regulators</td>
<td>Multiple regulators</td>
</tr>
<tr>
<td>United States</td>
<td>Mixed regulation</td>
<td>Self-discipline by industry association</td>
<td>Separated regulation</td>
</tr>
<tr>
<td>Japan</td>
<td>Self-discipline by industry association</td>
<td>Self-discipline by industry association</td>
<td>Mixed regulation</td>
</tr>
</tbody>
</table>

Sources: literature search; expert interview; BCG analysis.
A. Ensure coordinated regulation and uniform regulatory standards

The trust industry in the United States is overseen by multiple federal regulators, such as the Office of the Comptroller of the Currency, the Federal Reserve Bank, and the Federal Deposit Insurance Corporation. To avoid regulatory overlaps and vacuums, the Federal Financial Institutions Examination Council developed the Uniform Interagency Trust Rating System to enhance coordination and ensure consistency between different regulators.

While China’s trust industry as a whole is regulated by the CBRC, some trust businesses are also functionally overseen by the CSRC and other regulators. In developing innovative businesses, trust companies face a management mismatch resulting from the regulatory mismatch, which has arisen due to a lack of coordination between different regulators. Implementing consistent regulatory standards across all regulators will help level the playing field for trust companies and encourage the development of the industry.

B. Establish a sound investor education system

The Office of Investor Education of the US Securities and Exchange Commission is responsible for coordinating investor education about various types of investment products. Education about investment trust products covers product definitions, investment risks, investment returns and purchase channels.

In China, China Trust Protection Fund is tasked with mitigating and handling risks in the industry and protecting the rights and interests of investors. However, this kind of protection is largely on an after-the-fact basis, and there is a lack of pre-investment risk education. Therefore, Chinese regulators can consider setting up a dedicated agency responsible for orchestrating investor education. Before that, the China Trustee Association and trust companies should take on some of the responsibility for investor education to raise investors’ awareness of risks associated with trust products, thus laying the foundation for the further development of equity investment, family trust and other high value-added businesses and future innovation.

5.2 Foster a Prosperous Trust Industry Through Laws and Regulations

China can mainly learn from four aspects of the US trust legal system: the uniform legal framework and specialized laws, trust property transfer as well as registration and disclosure rules, the investor protection mechanism, and the supporting laws and regulations.
A. Build a uniform legal framework with specialized laws

The US federal trust statutory law system consists of the Uniform Trust Code (UTC), the Trust Company Reserve Law, the Trust Indenture Act and other codes, supplemented by academic reference works such as *The Restatement of the Law of Trusts*. The UTC is compiled from generally accepted common law principles in trusts and is used by many states as a model: 32 states have adopted the UTC, and one other state has included it in its legislative plan. In addition, the United States has introduced specialized laws and rules for specific trusts such as real estate trusts, legacy trusts, and charitable trusts.

China’s legal framework for trusts is composed of “one law and three regulations.” However, the Trust Law (2001) only defines the trust relationship, and a uniform “Trust Business Law” has yet to be enacted to govern trust businesses. Moreover, China has not yet introduced specific laws and regulations on key businesses such as real estate investment trusts, family trusts and equity trusts, which has hindered business development and led to regulatory difficulties. In the future, China should enact a Trust Business Law and other guiding documents to help trust companies form clear expectations, thereby promoting the development of trust businesses and enhancing regulatory transparency.

B. Establish clear procedures for property disclosure and transfer, and develop sound trust property transfer, registration and disclosure rules

The Anglo-American legal system recognizes dual ownership of trust property, that is, the trustee holds nominal title and has the right to possess, use and dispose of trust property, while the trustor has real title to trust property. In this way, the independence of trust property is legally established. Stipulating the trustee’s rights and obligations has the same effect as a trust property disclosure, hence there are no separate trust disclosure rules in the United States.

Although the US experience cannot be copied into China’s civil law-based legal system, which emphasizes “one item, one right”, its essence and principles are still of reference value for China. As China’s prevailing law does not specify whether trusts constitute a transfer of property, in practice trust documents are usually not directly recognized as evidence for transfer of property, resulting in complicated legal formalities for trust property transfer. We suggest that as an initial and urgent step, the Trust Law should clarify as soon as possible the procedures for transferring property rights, and existing property registration agencies should offer trust property registration services to allow for decentralized registration. In the future, China can gradually establish and enhance its trust property transfer, registration and disclosure systems based on overall planning.
C. Clearly define the trustee’s legal obligations and strengthen investor protection

The United States enacted the Uniform Prudent Investor Act (UPIA) in 1994 and incorporated it into the UTC in 2000. Now adopted in 45 states, the UPIA summarizes the prudent investor rules and stipulates the legal obligations of the trustee. For example, the prudent investor obligation is process-oriented rather than outcome-focused, and positive investment returns do not necessarily justify inappropriate behaviors. In the event of trust property losses, the court of law will strictly follow the procedures and provisions of the prudent investor obligation to rule whether there has been any dereliction of duty on the part of the trustee.

China’s trust laws and regulations are still underdeveloped. The Trust Law and the Measures for the Administration of Trust Companies stipulate the trustee’s obligation of prudence, requiring the trustee to conform to the obligations of honesty, good faith, prudence and efficiency, but it does not provide specific standards. In the event of investment losses, it is difficult to judge whether the trust company has fulfilled its prudent investor obligation, and the interests of investors are not effectively protected. Therefore, the obligations of the trustee should be specified further and the regulation of investor suitability should be strengthened to protect the rights and interests of investors.

D. Enhance supporting laws and regulations to encourage the development of trust businesses

Trust businesses require supporting laws and regulations. The US law, for example, provides that the transfer of real estate to an irrevocable trust is exempt from property tax. In the United States, the trustor is usually given income tax deductions on the establishment of a charitable trust. For example, individuals’ charitable donations of their estate are fully exempt from estate tax. Such tax incentives have promoted the development of family, charitable and legacy trusts in the United States, giving trusts considerable advantages in wealth inheritance and charitable causes.

China has not yet introduced any rules on non-trading real estate transfers. When real estate is changed into trust property, a repetitive high real estate transaction tax is levied. This to some extent narrows the range of options for trust property, hindering the development of property trusts, family trusts and other businesses. Furthermore, the lack of specific tax incentives has dampened enthusiasm for giving to charitable causes by establishing charitable trusts. Therefore, we suggest that China should enact supporting laws and regulations to help trust businesses flourish.

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4 The trustor gives up all ownership rights to the assets and the trust and, unless agreed by the beneficiary, the trust is irrevocable.
Conclusion

As the macroeconomic structure improves, regulatory policies are tightened and competition grows increasingly fierce, China’s trust industry faces both opportunities and challenges. Standing at a new crossroads, the trust industry needs to consider its future development direction carefully. In this report, by looking back on the evolution of China’s trust industry, we have analyzed its essence and significance, identified future opportunities and directions for transformation, and helped Chinese trust companies differentiate themselves, discover their core competitive strengths, and find a path forward in the new era.

Looking forward, we believe that China’s trust companies can become truly customer-centric and win with expertise. Adhering to the philosophy of “service +”, they will be able to seize opportunities to build differentiated business models and continue to act as a strong driver of the real economy. By remaining committed to transformation, confident in meeting challenges and adhering to the fundamental purpose, China’s trust industry is set to enter a new stage of development and build a brilliant future.
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Acknowledgments

The authors’ special thanks go to Mr. Jianming Qi, Party secretary of the China Trustee Association (CTA) and Mr. Gaihuan Cai, chief economist of the CTA for their guidance and support for this report.

We are also grateful to those who participated in the research and preparation of this report. They include the FOTIC Strategy Management team, including Mr. Feifei Tao, assistant to general manager of FOTIC Strategy Management, and researcher Mr. Rao Fu, as well as the BCG Greater China Financial Institutions practice team, including project team member Mr. Wei Zheng; principal Ms. Tammy Tan; project leaders Ms. Yue Liu, Ms. Natalie Hua and Ms. Sally Sun; and consultants Ms. Dongni Zhang, Ms. Wenqi Zhang, Mr. Leo Sun and Ms. Jiaorong Wan. We would also like to thank the members of the production and editorial team, including Ms. Li Gu, Mr. Jeremy An, Ms. Yu Liang, Ms. Hui Zhan Mr. Zhiyong Sun, Mr. Chris Parker and Mr. Ethan Ye. In addition, this report would not have been possible without the valuable advice and support of BCG global experts Mr. Keith Halliday and Mr. Blaine Slack.

Finally, we would like to thank the scholars, experts and colleagues that participated in the interviews or offered help for this report.
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