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北京国际信托有限公司
BEIJING INTERNATIONAL TRUST CO., LTD.

Making every step count

Insights for institutions on China's ongoing trust industry transformation

Jointly produced by Beijing International Trust Co., Ltd. and KPMG China

Foreword

In 2021, the trust industry in mainland China entered its 41st year of continuous operation. 2021 is expected to be a critical year for the development of the industry. On the one hand, trustees are united and actively contributing to the fight against the COVID-19 pandemic through charitable trusts, special bonds, special loans, and other means. On the other hand, as macroeconomic pressure has intensified, the risk exposures of certain institutions have had an impact on the industry's reputation. This has led to enhanced supervision and an unprecedented impetus to prevent and rectify financial risks. As a result, following years of growth, the industry has experienced a sudden slowdown. Through preparing during better times and learning from previous mistakes, some enterprises within the industry have been better prepared to meet the current challenges — while others are struggling to survive. Within this context, the industry has reached a crossroads at which it needs to pause and rethink its course.

At this juncture, transformation is a necessity for the industry. Most trust companies are asking similar questions about their business models and future direction, such as:

- What should our company's core business be?
- How can we use non-traditional business experience gained in the past to successfully compete with "Big Asset Management"?
- How can we transform and upgrade traditional business and expand new business areas?
- Which support systems should we use to drive our transformation?

Beijing International Trust Co., Ltd. (Beijing Trust) has been a witness and participant in the development of the trust industry in mainland China. As part of its ongoing mission to serve the real economy and China's trust industry, they have partnered with KPMG China to jointly examine and research the above-mentioned issues to develop this study, with the goal of making a lasting contribution to the industry's ongoing transformation.

This report, the product of over nine months of research, features an analysis of industry data assessing the current state of development of China's trust industry and predictions of future trends. It also provides best practices and case studies developed from in-depth interviews with leading asset management and wealth management institutions. The report discusses three key areas of transformation—wealth management, professional asset management and private equity investment—which will rely on the resources of trust companies, laying out a blueprint for business transformation and the development of support systems.

We hope that this publication can lead to a deeper exchange of views with experts, both inside and outside the industry, to provide advice and suggestions for the industry's future development.

Beijing International Trust Co., Ltd.
KPMG China
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Contents

Introduction: China's trust industry at a crossroads

In the course of its development the past than 40 years, mainland China's trust industry has experienced twists and turns; but by continuously innovating, it has played an active role in enriching the financial markets and making up for market shortfalls in bank credit. The industry has developed particularly rapidly over the past 10 years, with the scale of entrusted assets increasing nearly tenfold.

China's trust industry was originally positioned as a financing supplement for banks. In response to financial institutions' demand for arbitrage, some banks and other financial institutions have used the flexibility of the trust system to circumvent supervision by developing businesses through trust companies. This development has become a major force driving the rapid growth of trust assets and has resulted in the current "bloated" nature of the trust industry.

As China's domestic economic growth has slowed down and shifted gears, supply-side structural reforms are reaching a more advanced stage. For example, financial regulators are requiring financial institutions to return to their origins, which has led to a gradual weakening of the advantages of holding a trust license. Various other types of financial institutions are competing with trusts for market share in the asset management sector, and as a result, the trust industry has come to a crossroads as its enterprises face the need to transform and differentiate themselves.

The scale of trust assets has stopped falling; the rate of return continues to decline; while risks are increasing

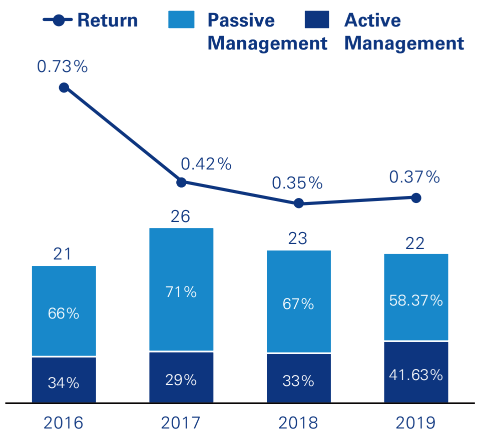
Since 2017, following stricter supervision with respect to deleveraging and preventing risks, business between banks and trust institutions (known as "channel business") has shrunk significantly, leading to a continuous decline in overall asset value within the industry. At the same time, rate of return has been declining year-on-year since 2016. This is partly due to a lag in the rate of return calculations following the prior liquidation of a large number of channel business, and also due to intensified competition in the industry and the gradual tightening of revenue on the asset side.

With the coming implementation of new asset management regulations and new fund trust regulations planned to come into effect by the end of 2021, some trust companies will be forced to accelerate the development of standard trusts and actively manage their business scale to maintain high-yield non-traditional businesses. As a result of this and other factors, we expect that the trust industry will see a further decline in returns.

Concurrently, the risk rate of trust assets has continued to rise since 2017, reaching 2.67% by the end of 2019 (see Figure 2 below). Although China has thus far effectively controlled risks related to the COVID-19 pandemic, international political and economic uncertainty is rising. The macro economy still faces severe challenges, and the exposure to hidden risks that have accumulated over time may accelerate.

Figure 1: Wealth management development (2016- 2019, %, RMB trillion)

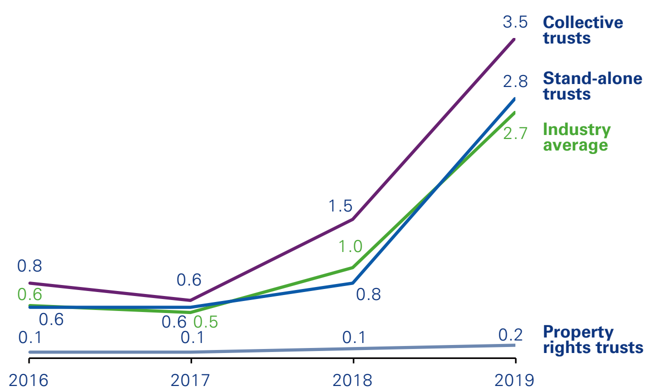
Scale of China's trust industry management



Source: KPMG analysis based on publicly available data

Figure 2: Risk ratio of trust assets (2016- 2019, %,)

Risk ratio of trust assets[1]



1. Risk ratio of trust asset = trust asset involving litigation / Total trust asset

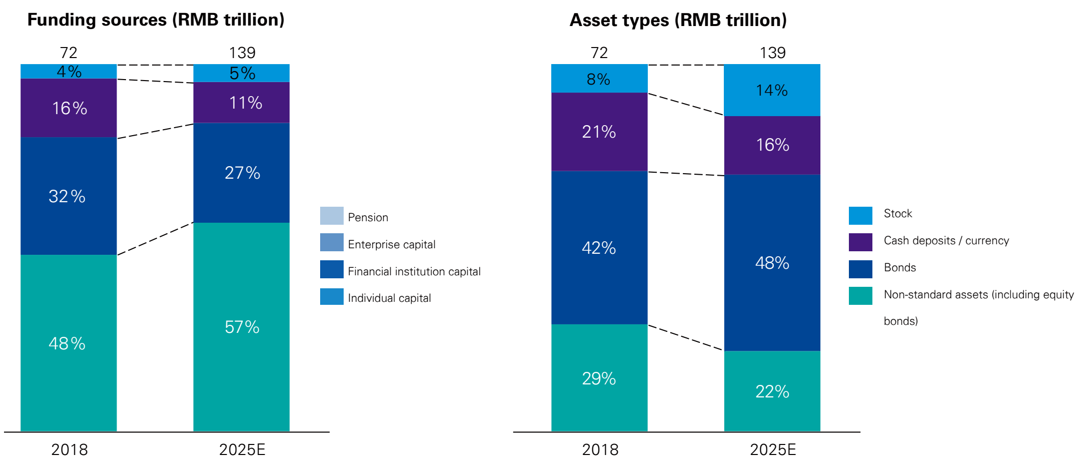
Source: KPMG analysis based on publicly available data

Trust companies are under pressure with respect to capital and assets

As a result of regulatory reforms, development of multi-level capital markets, and the growing trend in China of using household savings to make investments, the scale of China's asset management industry has continued to grow rapidly. It is estimated that by 2025, the overall scale of the industry will reach RMB139 trillion, excluding double-counted channels (See Figure 3 below). If achieved, this would represent a doubling of the size of the industry in 2018. Despite this optimistic outlook, changes to the structure of the industry will put tremendous pressure on trust companies to transform their businesses, with regards to both capital and assets.

Figure 3: Comparison of the scale and structure of the asset management industry

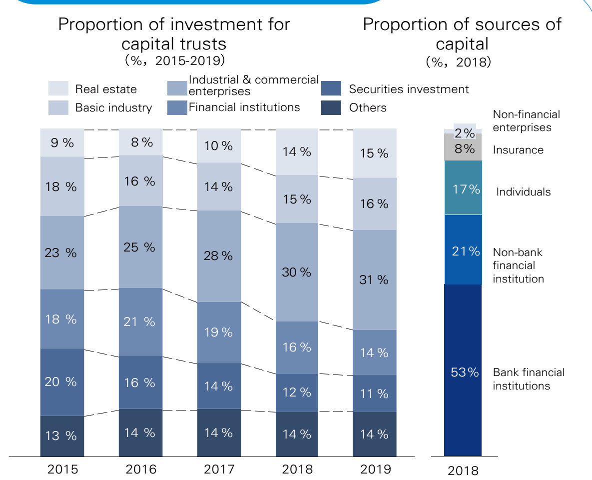
Comparison of current and future China's asset management industry scale and structure changes (excluding channels)



Sources: WIND, the PBOC, CASS, National Bureau of Statistics of China, Research Department of CICC, and KPMG analysis based on publicly available data

On the asset side, fund trusts' investments are still dominated by real estate, infrastructure, and industrial and commercial enterprise assets. Assets in these three business areas, which are mostly traditional non-standard assets, still accounted for more than 60% of total investments at the end of 2019 (see Figure 4). In terms of proportions, non-standard assets are expected to continue to decline as a share of total investment, falling to around 22% by 2025. On the other hand, the share of standardised assets will continue to increase. Furthermore, regulators are requiring trust companies to adjust their asset structures. The new asset management regulations impose requirements related to comprehensive net worth, and the Interim Measures ("exposure draft") also propose a rule that would restrict non-standard debt assets to not more than 50% of all collective fund trust assets.

Figure 4: Sources and investment destinations of trust assets



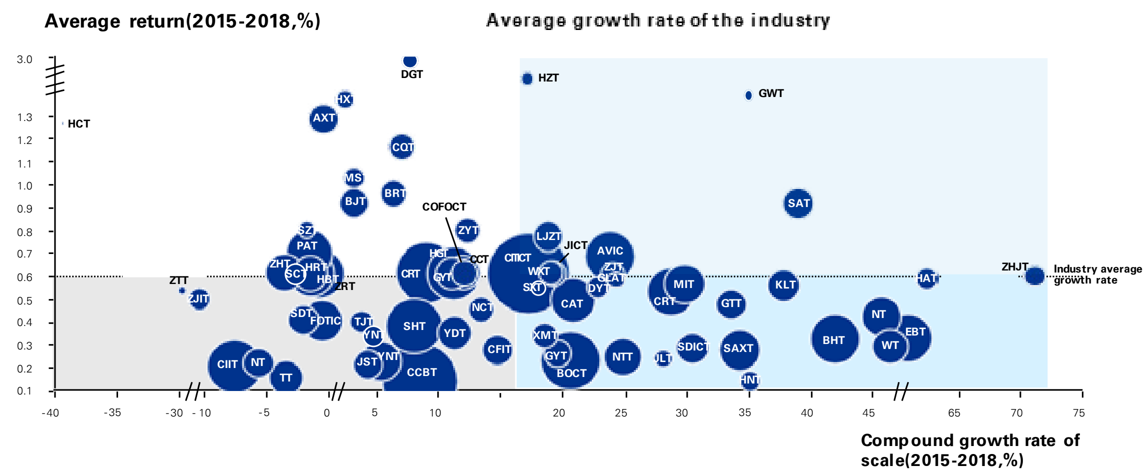
Note: 1. Other non-bank institutions include fund companies and their subsidiaries, securities/futures companies and their subsidiaries, private equity funds
Source: China Trustee Association, CICC – Report on China's Wealth Management Industry (“中国资产管理行业：面向未来的‘一二三四五’ ”)

As the scale-driven growth model becomes unsustainable, trust companies are working to differentiate themselves

From the perspective of capital, the dominant status of bank funds will be hard to change in the short term; however, increased regulatory scrutiny will make it difficult for trust companies to continue to acquire capital from traditional banking channels. The scale of insurance asset management continues to grow, but there are still gaps between the investment capacity of trust companies and the requirements surrounding insurance investments. In addition, the qualification requirements for cooperative institutions have restricted the ability of many small and medium-sized trust companies to obtain insurance funds. In recent years, the wealth management business has become increasingly important for trust companies on the capital side. However, this business is limited to the current capabilities of channels they can access. The wealth management business accounts for less than 20 percent of trust companies' total capital, while trust companies' proprietary wealth management business only accounts for a fraction of this figure.

For this study, we conducted a statistical analysis using the average rate of return and scale growth of 68 domestic trust companies in China over a three-year period from 2015 to 2018 (Figure 5). The results suggest that the development of most trust institutions in China in the past few years has been led by scale-driven growth. However, in the current macroeconomic and regulatory environment, the scale-driven development model is proving difficult to sustain, causing some "bloated" institutions to face increased pressure to transform their operations.

Figure 5: Average return and scale of 68 trust companies in China



Company name abbreviations

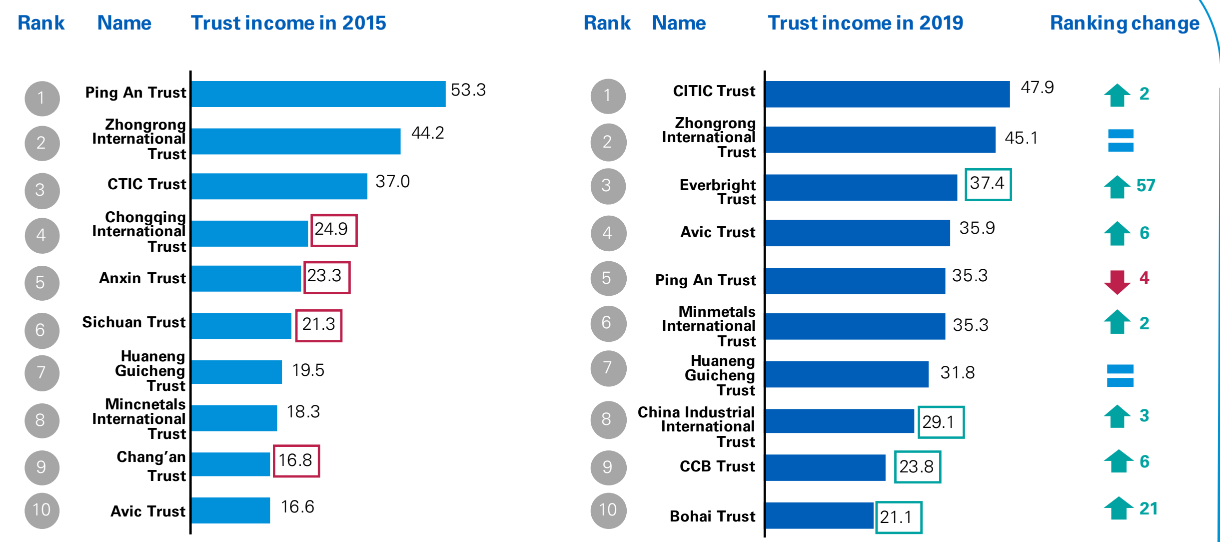
AVIC	AVIC Trust	GYT	Guoyuan Trust	PAT	Ping An Trust
AXT	Anxin Trust	GYT	Guangdong YuecaiTrust	SAT	Shanghai Aijian Trust
BHT	Bohai Trust	HAT	Huaao Trust	SAXT	Shaanxi Trust
BJT	Beijing International Trust	HBT	HwabaoTrust	SCT	Sichuan Trust
BOCT	Bank Of Communications Trust	HCT	Huachen Trust	SDICT	SDIC TAIKANG Trust
BRT	Bairui Trust	HGT	Huaneng Guicheng Trust	SDT	Shandong International Trust
CAT	Chang'an Trust	HNT	Hunan Trust	SHT	Shanghai Trust
CCBT	CCB Trust	HRT	Huarong Trust	SXT	Shanxi Trust
CCT	China Credit Trust	HXT	Huaxin Trust	SZT	Suzhou Trust International
CFIT	China Fortune International Trust	HZT	Hangzhou Trust	TJT	Tianjin Trust
CIIT	China Industrial International Trust	JGT	Jingu International Trust	TT	Tibet Trust
CITICT	CITICTrust	JICT	JIC Trust	WT	Western Trust
COFOC	COFOC Trust	JLT	Jilin Trust	WXT	WanxiangTrust
CQT	Chongqing Trust	JST	Jiangsu Trust	XMT	XiamenInternationalTrust
CRT	China Railway Trust	KLT	Kunlun Trust	YDT	Yingda International Trust
CRT	CR Trust	LJZT	Lujiazui International Trust	YNT	Yunnan Trust
DGT	Dongguan Trust	MIT	Minmetals International Trust	ZHJT	Zhejin Trust
DYT	Daye Trust	MST	China Minsheng Trust	ZHT	Zhonghai Trust
EBT	Everbright Xinglong Trust	NCT	New China Trust	ZJIT	Zhongjiang International Trust
GLAT	Guolian Trust	NT	Northern Trust	ZJT	Zijin Trust
GTT	Guotong Trust	NT	National Trust	ZRT	Zhongrong International Trust
GWT	Great Wall Xinsheng Trust	NTT	New Times Trust	ZTT	Zhongtai Trust
				ZYT	Zhongyuan Trust

Note: 1. The size of circles refers to the scale of trust assets
2. The y-axis refers to the average return from 2015 to 2018
3. The x-axis refers to the compound growth rate of trust from 2015 to 2018
Source: KPMG analysis based on publicly available data

In the past, the market was often evaluated in a scale-oriented manner. To a certain extent, this scale-focused development model concealed the quality of business development within trust companies. This phenomenon is reflected by changes in the industry's revenue rankings over the past five years, which suggest that the industry's structure is increasingly unstable (see Figure 6 below).

In the future, we expect that differentiation of trust companies will intensify. Institutions with solid business foundations, sound business structures and excellent risk management practices will stand out as the industry goes through this adjustment period, while other "bloated" institutions may have to scale down operations and face lower revenues in years ahead. When the dust settles from the current period of adjustment, it will become increasingly clear which organisations were not sufficiently prepared for these eventualities.

Figure 6: Trust income of the top 10 domestic trust companies (2015, 2019, RMB hundred million)



Red circle = "Companies who exited the top 10 in 2019", Green circle = "Companies new to the top 10 in 2019"

Note: 1. Trust income refers to net fee and commission income as they appear in annual financial statements
Source: KPMG analysis based on publicly available data

Trust companies in China face challenges to adapt to new regulatory models

Through the course of the development of China's trust industry prior to 2017, the industry was constrained by a governance cycle of "Development-Rectification-Further Development-Further Rectification." Since 2017, the industry has been subject to a new regulatory model with a clearer orientation. While the overall trend has been stricter supervision, regulators have adopted various measures to guide trust institutions back to their origins in an integrated and supportive manner. Regulators are also helping trust companies position themselves, with the overarching themes for industry development becoming "service orientation," "returning to origins," and "transformation and innovation". Active management capabilities are also now regarded as a core area of competitiveness within the industry. These changes have required trust companies to adjust and upgrade their business structures, profit models and internal support systems, among other areas (see Figure 7). However, from the perspective of the industry in China as a whole, most trust companies are not yet equipped to take these steps.

Figure 7: Impact of regulatory measures on business

Regulatory measures	Business impact
In April 2018, the People's Bank of China (PBC), China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC), and State Administration of Foreign Exchange (SAFE) jointly issued the Regulating Asset Management Business of Financial Institutions (referred to as "New Rules on Asset Management").	(−) Traditional financing trust
In August 2018, the China Banking and Insurance Regulatory Commission (CBIRC) issued the Notice on Strengthening Trust Regulation within the Transition Period of Regulating the Asset Management Business (Circular No. 37)	(+) Transaction management, charitable trusts and family trusts
In October 2018, two trust companies obtained the pilot qualification as the special scheme manager of the exchange	(+) Asset securitisation and publicly traded REITs
In April and November 2018, 12 trust companies received qualifications for underwriting debt financing instruments of non-financial enterprises.	(+) Asset securitisation, bond underwriting and wealth management
In May 2019, the CBIRC issued the Notice on Carrying out the Work of Consolidating the Results of Controlling Chaos and Promoting Compliance Construction (Circular No. 23)	(−) Preliminary financing of property development projects
In June 2019, the CBIRC issued the Notice on Matters concerning the Investment in Assembled Funds Trusts with Insurance Funds.	(−) Insurance asset investment
In August 2019, the Notice of Trust Institution Supervision Department of CBIRC on Further Improving Trust Supervision in the Second Half of the Year was issued. Interviews and window guidance were also performed.	(−) Real estate trust
In January 2020, Guiding Opinions of the China Banking and Insurance Regulatory Commission on Promoting the High-quality Development of Banking and Insurance Industries was released.	(+) (+) Asset securitisation, wealth management, family trusts, charitable trusts and equity investment trusts
In May 2020, the CBIRC released the Notice on the Interim Measures for the Administration of Fund Trusts of Trust Companies (Exposure Draft)	(+) (−) Securities investment, wealth management, non-standard credit of service trusts

Source: KPMG analysis based on publicly available data

Legend (+) Positive (−) Negative

Review of the three stages of development of China's trust industry and opportunities for transformation

Since the first trust company was established in mainland China in 1979, China's trust industry has undergone more than 40 years of development. From 1979 to 2007, China's economy was in a transitional stage and the demand for financing was strong. Banks, which essentially had a single function during this time, could not sufficiently address the diversity of financing needs within the country. Against this backdrop, China's trust industry introduced trust investments. During this time, trust enterprises had diverse characteristics and were involved in both "bank-like" and "securities-like" businesses. To date, the trust industry has undergone six major rectifications. Now that a basic regulatory framework has been established, the country's trust industry is poised to enter the next stage of its development (see Figure 8 below).

The introduction of the government's RMB4 trillion economic stimulus plan in 2008 ushered in an era of cooperation between banks and trust enterprises. During this period, the trust industry was given the mission of "replenishing" bank loans. As a result, the trust industry proceeded to develop rapidly, and the scale of trust assets increased nearly tenfold. However, as financial institutions' demand for arbitrage rose, some trust companies became channels for such arbitrage due to the flexibility of their systems. As trust assets grew rapidly, the trust industry as a whole became "bloated."

Since 2017, domestic economic growth has slowed down and shifted gears, and supply-side structural reforms have entered a more advanced stage. Against the backdrop of heightened financial supervision and the introduction of new asset management regulations, the advantages of trust licences are not as significant as they once were. Financial institutions such as brokerages, funds, insurance asset management entities and bank wealth management subsidiaries continue to compete with trusts for market share in the asset management sector. The trust industry has once again come to a crossroads as its enterprises face the need to transform and differentiate themselves.

Figure 8: The three stages of China's trust industry development

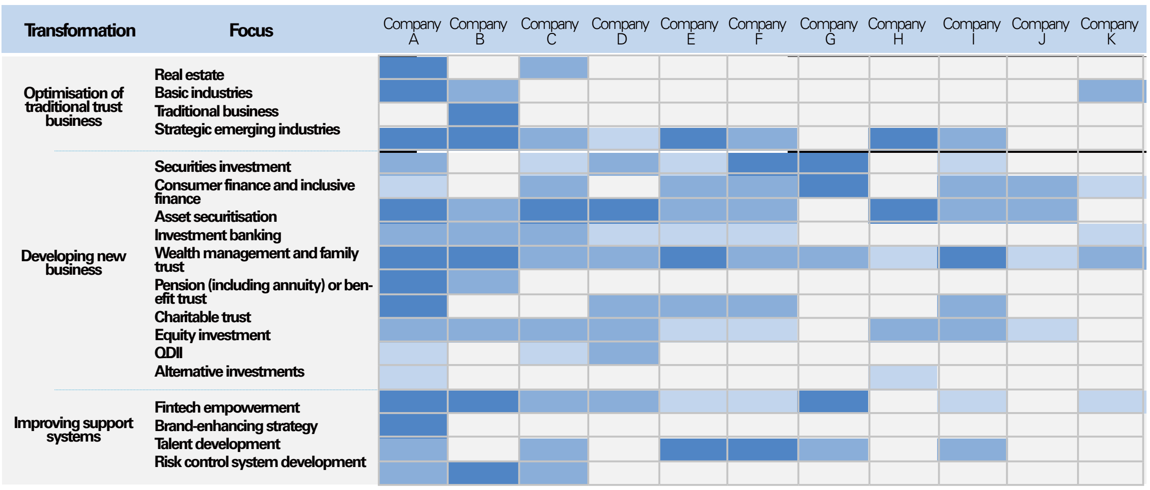
	Trust investment (1979-2007)	Bank-trust cooperation (2008-2016)	Exploring transformation (2017 - now)
Position	· **Broad exploration** Diversified trust-related business with vague positioning - both bank-related and securities-related businesses were covered	· **Supplement of bank loans** Main focus was placed on "quasi-bank loan debt financing" and "bank channel business", with high degree of homogeneity	· **Transformation and differentiation** "Services for real economy", "essence-oriented", and "strategic innovation" have become the industry consensus, and active management capabilities are regarded as a core area of competitiveness
Regulation highlights	· **After six major rectifications, a basic regulatory framework for the trust industry was initially established** · Six rectifying campaigns were conducted to eliminate irregular businesses. Trust business scope and business positioning were redefined, and **"investment" was no longer in the scope of the previous trust investment companies** · **A system based on one law and two rules was established**, which includes the Trust Law, Measures for the Administration of Trust Companies and Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds.	· **Focusing on bank-trust cooperation business, the industry first received recognition before standardising and policy tightening** · In December 2008, the China Banking Regulatory Commission (CBRC) issued the Guidelines on the Business Cooperation between Banks and Trust Companies , which **first recognised the cooperation between banks and trust companies.** · From 2010 to 2011, CBRC consecutively issued the Notice on Regulating the Relevant Matters on Wealth Management Cooperation between Banks and Trust Companies, Measures for the Administration of Net Capital of Trust Companies and Notice on Further Regulating Wealth Management Cooperation between Banks and Trust Companies **to restrict bank-trust cooperation business.**	· **The adoption of new asset management regulations and various regulatory policies has strongly affected the positioning of the trust industry** ✓ In April 2018, the New Rules on Asset Management and its supporting rules were formally released to unify the regulation of various asset management institutions. The rules clearly require de-nesting, de-leveraging and de-access, and removing the practice of guaranteed repayment. Besides, the rules also support family trusts, property rights trusts, and transaction management trusts that meet regulatory requirements and invest funds in the real economy. ✓ In May 2019, the China Banking and Insurance Regulatory Commission (CBIRC) issued the Notice on Carrying out the Work of Consolidating the Results of Controlling Chaos and Promoting Compliance Construction. In August, the CBIRC issued the Notice on Further Improving Trust Supervision in the Second Half of the Year, which significantly restricted real-estate-related trust and channel business and pushed the market's judgment and awareness of strong supervision to a new high.

Source: KPMG analysis based on publicly available data

The transformation of trust companies' business is in progress

Trust companies in China are at a crossroads. They are facing external pressure from competitors as well as internal pressure to adjust their businesses. Many trust companies in China have explored business transformation in recent years, but the actual results of these transformation efforts have varied. Based on public information and case studies from industry institutions, we have determined that domestic trust companies are actively exploring transformation in three areas: optimisation and upgrading of traditional business, expansion of new business, and optimisation of support systems.

Figure 9: Transformation of market-leading trust companies in China



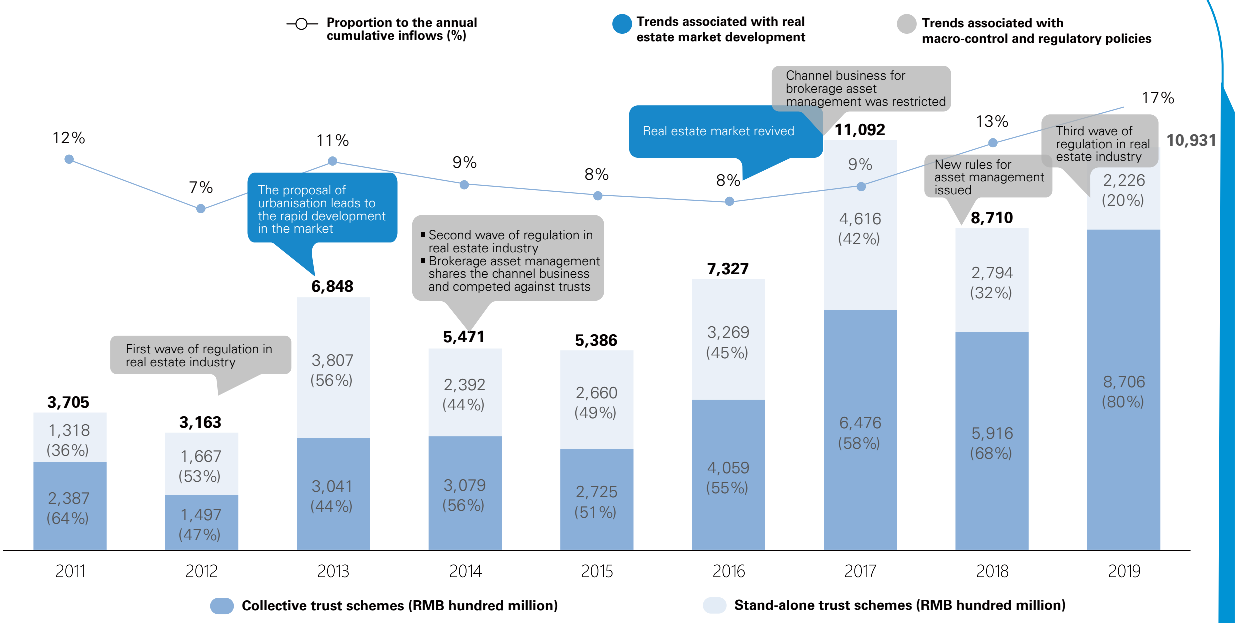
Note: The coloured sections reflect the fields in which the company is transforming. The darker and lighter shades represent the relative progress on transformation, with darker shading indicating a higher degree of transformation. Data covers the development of the target companies over the past three years. Company names have been anonymised.
Source: KPMG analysis based on publicly available data

In the following sections, we share our views on the direction and focus of business transformation in the three areas: transformation and upgrading of traditional trust businesses (including real estate trusts, government trusts, and industrial and commercial trusts), the expansion of new business (asset securitisation, securities trust, fund business, wealth management, family trust), and optimisation of support systems. We also provide commentary regarding market prospects and industry transformation practices.

Real estate investment trusts (REITs)

In the long run, real estate will remain the primary area of competition on the trust asset side, and upgrading of business models will be key to future transformation.

Figure 10: New REIT funds in China over the years and their proportion to the annual cumulative inflows (RMB hundred million, %, 2011-2019)



Source: KPMG analysis based on publicly available data

The proportion of REIT assets to total trust assets has continued to rise in recent years. These assets have become an important part of trust asset portfolios and we believe that this will continue to be the case in the future. Meanwhile, REITs are adjusting their profit models and business plans in reaction to changes in the real estate market and regulatory policies. These changes are taking shape in three main ways:

First, REITs are transitioning from a traditional debt financing model to a real equity investment model. They are starting to use investment models to actively manage real estate projects and gain greater returns. However, at the same time they are facing numerous challenges pertaining to capital redemption, the acquisition of high-quality assets, and the need to upgrade their risk control and operational capabilities.

Second, REITs are developing "non-standard to standard" services such as asset securitisation. At present, trust institutions usually act as the managers of special purpose vehicles (SPVs) in the transaction structure for asset-backed note (ABN) products. However, asset securitisation is often characterised by a high degree of business homogeneity and relatively low returns. For this reason, enterprises in the industry are expanding their business capabilities in this area to better seize associated opportunities.

Third, REITs are expanding their investment scope from residential developments to more diverse types of real estate. Some trust companies in China have begun to explore less traditional types of real estate investments, such as commercial real estate, logistics real estate, industrial parks, tourism real estate, pension real estate, cultural real estate, etc. Among these, commercial real estate and tourism real estate have thus far been the most popular. Trusts are also beginning to transition towards real equity investment methods when handling these new types of real estate.

Figure 11: Cases of trust companies' real estate business transformation

Transformation of REITs	Industry practices
1 Substantial equity investment	**Trust A - Assembled Funds Trust Scheme No.1 of Poly Real Estate's equity investments** **Background:** Trust A invested in a real estate project in Wenzhou, China developed by Poly Group via issuing trust schemes and subscribing limited partnership shares. The trust scheme amounted to approximately RMB 300 million and the shareholding percentage exceeded 50%. The scheme follows the one-share-one-vote rule with equal right to dividend distribution. **Cooperation model:** Trust A assigns personnel to attend the project company's Board of Directors and exercise voting rights on the company's major decisions. In addition, Trust A regularly reviews the company's monthly operating reports and financial statements and supervises the sales collection accounts.
2 Asset securitisation	**Trust B - Asset-backed note of Red Star Macalline Group Corporation Ltd.** **Background:** In May 2019, Red Star Macalline Group Corporation Ltd issued the first asset-backed note in China's household industry. The fundraising amounted to RMB 1.3 billion with a term of 18 years. The senior tranches are rated as AAA. **Cooperation model:** Trust B serves as the management agency for issuing vehicle of the asset-backed note. The future rental income from the household product malls will be the underlying asset.
3 Diversified real estate businesses	**Trust C - Urban renewal project of Sun Palace Zhong Rong Plaza** **Background:** In September 2016, Parkson Group sold all the equity and related creditor's rights of shareholders of its Sun Palace Parkson Property Co., Ltd. The transferees were Shenzhen Qianhai Tulan Investment Center and Shanghai Changkun Investment Management Co., Ltd. **Cooperation model:** The trust issued a funds trust scheme which amounted to RMB 1 billion to subscribe the LP shares of Shenzhen Qianhai Tulan Funds, to ultimately acquire Beijing Parkson Department (Store Sun Palace Branch) and renovate the mall after completing the acquisition. It is estimated to exit in 2021. Based on the utilisation rate of 70% and occupancy rate of 90%, the annual rental income amounted to approximately RMB 193 million.

Source: KPMG analysis based on publicly available data

Government trusts

Policy-driven recovery may not alleviate debt concerns; “non-standard to standard” models are challenging traditional business models

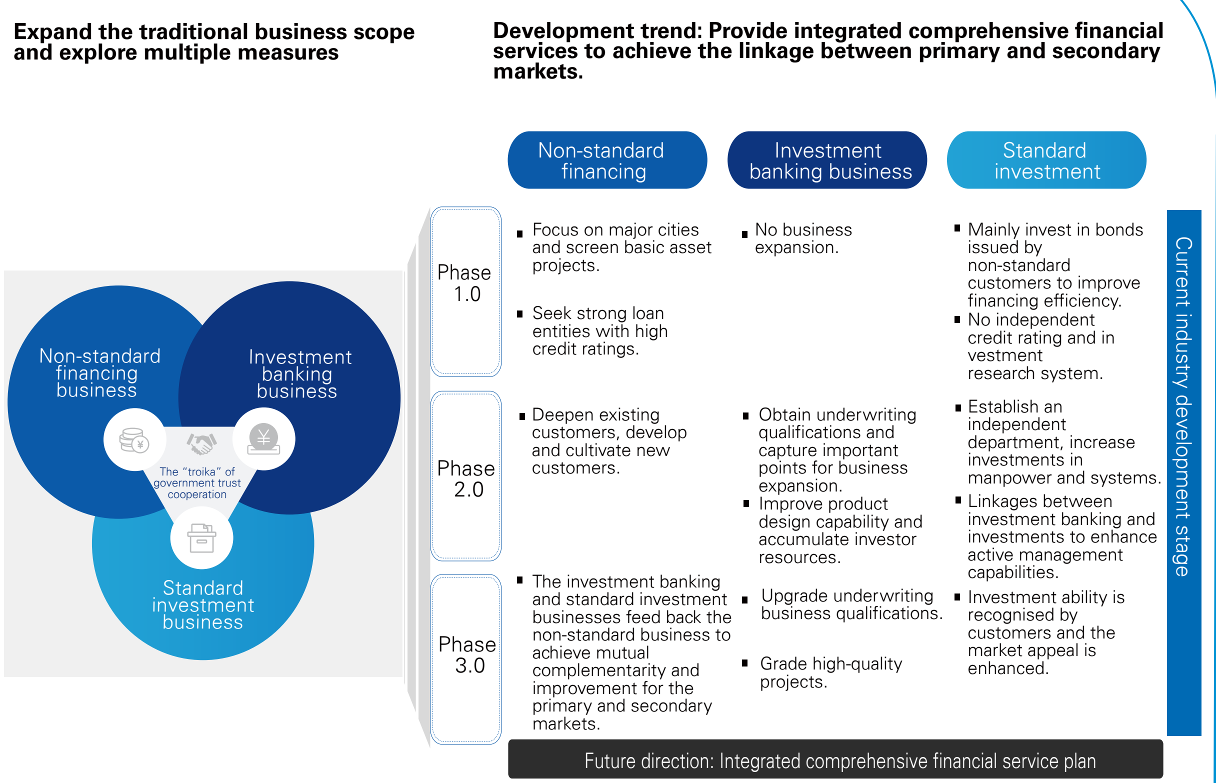
Since 2014, traditional financing methods such as infrastructure trust loans have been constrained by policies that aim to regulate implicit government debt and encourage direct financing, as well as by a decline in the costs associated with local government bond financing.

Publicly available data shows that a large amount of government debt will mature between 2020 and 2024, with an average of RMB2.7 trillion of such debt maturing each year. As such, local governments are under increasing pressure to repay these debts when they become due. In addition, as macroeconomic measures further restrict land financing, some local governments that are highly dependent on land financing are facing revenue problems.

Since the second half of 2018, pressure on the development of government trusts has eased as the country has vigorously developed “new infrastructure,” focused on improving “weak links,” and encouraged direct financing and innovative investment and financing methods. In 2020, as a result of the COVID-19 pandemic and the slowdown in the global economy, the government proposed a new “dual circulation” development model, calling for domestic circulation and international circulation to reinforce each other. In addition, the government has proposed increasing infrastructure investment.

In the years ahead, government trusts will need to simultaneously transform their counterparty selection processes while upgrading their business models. This counterparty selection process should focus on various factors, such as financial strength, default risk, financing needs and asset prices. With respect to the upgrading of business models, government trusts should focus on exploring "non-standard + standard" products and "non-standard to standard" business models. In addition, some trust companies are also exploring public-private partnership (PPP) models, but in doing so they potentially face difficulties such as low expected returns and mismatched investment maturities. As such, scale of participation in this area is still relatively small.

Figure 12: The "Troika" of government trust cooperation



Industrial and commercial enterprise trusts

These trusts will focus on industries and business cultivation to gain a competitive edge

As the theme of "controlling risks and promoting transformation" takes hold in the trust industry, the growth in the number of industrial and commercial enterprises has fallen significantly and the overall market value of their stocks has declined slightly. At present, trust companies are facing many difficulties when engaging in business that involves industrial and commercial enterprises. Firstly, they have insufficient experience in industrial investment and are not able to effectively recognise asset values and conduct risk control. Second, in these areas, trust companies have to deal with certain inherent shortcomings with respect to their investment capabilities. For example, state-owned enterprises and other large enterprises that are not financial investment or real estate-focused find it easy to gain access to large amounts of capital at low cost. In contrast, trust financing costs are relatively high, so trust companies do not have a competitive advantage in this regard. Generally speaking, trust companies in this sector are looking to harness their resources in order to transform in the areas of industry specialisation, enterprise types and business models.

When selecting an industry, trust companies need to pay more attention to long-term benefits; and after making their selection, they need to focus on business cultivation. In terms of emerging fields, leading trust companies are focusing on healthcare, technology and the modern service industry.

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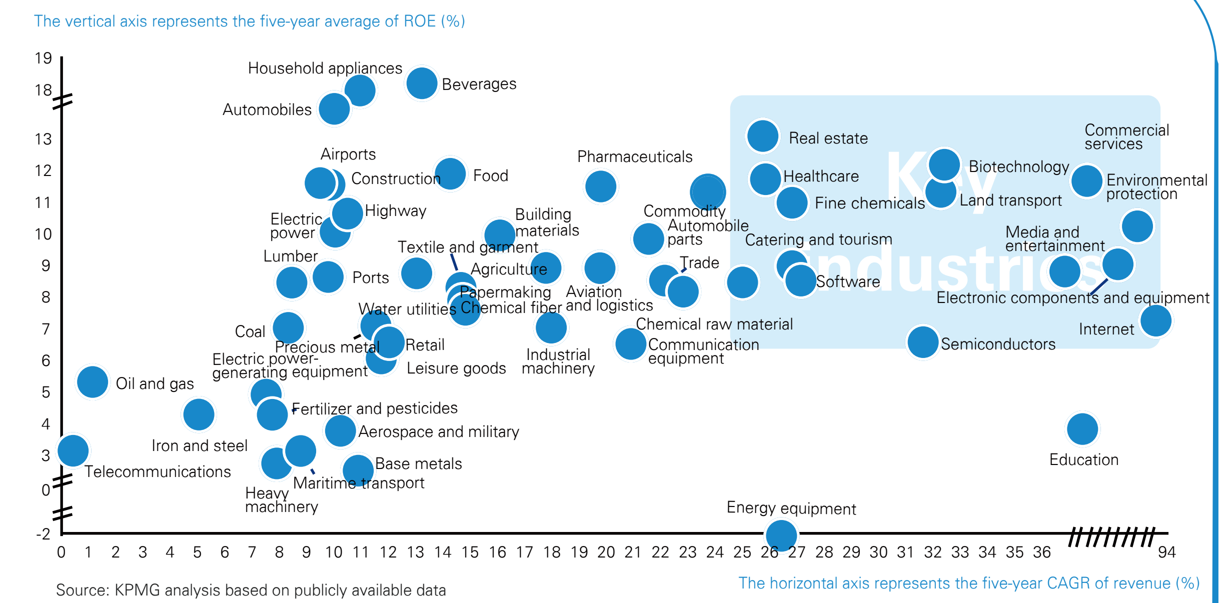
Figure 13: Analysis on the growth and ROI of various industries in China (%, 2014-2018)



Source: KPMG analysis based on publicly available data

Trust companies should develop inclusive financial services for small and medium-sized enterprises (SMEs)

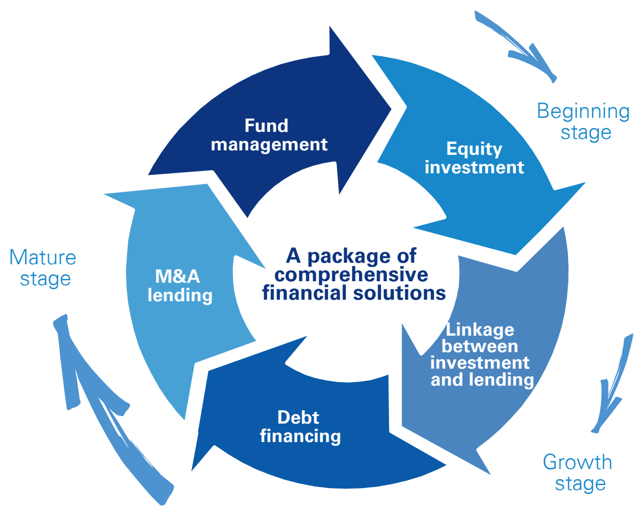
It has become difficult to perform risk control for key customer groups that need inclusive financial services due to insufficient credit information, small and scattered loan amounts, lack of credit enhancement measures, post-loan management issues and collection problems. To achieve this, some trust companies in China utilise risk control technology and intelligent operation platforms to provide SME financing, supply chain financing and other services. In this way, they are able to support the real economy in line with state policies while also generating profits. However, we have found that some trust companies try to lock in additional income by using methods such as outsourced guarantees. Unfortunately, in many cases, they do not understand the risks involved, which can be significant.

Leading trust companies look to provide a package of comprehensive financial solutions that support the entire life cycle of enterprises

Currently, some trust institutions in China are starting to provide large and medium-sized enterprises with a range of innovative services, such as asset securitisation, supply chain financing, and perpetual bonds, to help enterprises optimise their financial structures and improve liquidity. In addition, some trust institutions are cooperating with central and state-owned enterprises to form industrial funds, which are used for the purpose of industrial upgrading.

With respect to investment in emerging enterprises, trust companies should select target companies that have experienced solid growth. They can start with equity investment to inject capital into the company in order to help the company grow. After the company enters the growth stage, trust companies can work with partners such as commercial banks to help enterprises access investment and loan services.

Figure 14: Multiple investment and financing modes for enterprises by growth stage



Source: KPMG analysis

The impact of China's economic transformation on the trust industry

Against the backdrop of a weakened global economy, China's economy has entered a new normal, and its growth rate has slowed. In 2020, China faced a more complicated domestic and international macroeconomic environment. The outbreak and global spread of COVID-19 has not only impacted China's economy in the short term, but also has created uncertainty in the medium- to long-term global economic outlook. At the same time, China's economy is shifting from its previous stage of rapid growth to a period of significant structural transformation.

Trend #1: Investment and internal consumption are the main forces driving China's future economic growth

In line with the "dual circulation" concept, China's economy will become more consumer-driven in the future. These changes will present new development opportunities in industries such as medical care, transportation, communications, education, and entertainment. Attention should be paid to how "new infrastructure" in areas such as 5G, logistics, environmental protection, etc. will affect different areas of the economy.

Trend #2: Supply-side structural reforms continue to be implemented

Supply-side reforms mainly focus on four core issues: resolving excess manufacturing capacity, guiding the real estate market back to a more sustainable level, preventing and resolving financial risks, and reducing corporate costs. We expect these reforms to continue to deepen in the years ahead.

Trend #3：: Urbanisation will be a main driving force for future economic development

China's urbanisation rate reached almost 60 percent in 2018, which at that time was still significantly lower than most developed countries. Following the additional relaxation of China's hukou (household registration) system in 2019, the country's population has increasingly shifted to urban areas. Analysts estimate that the urbanisation rate will reach 70 percent by 2030, which will drive steady growth in real estate, infrastructure investment, construction and consumption.

Figure 15: Contribution of total investment, total consumption and net exports to economic growth (%, 2001-2019)

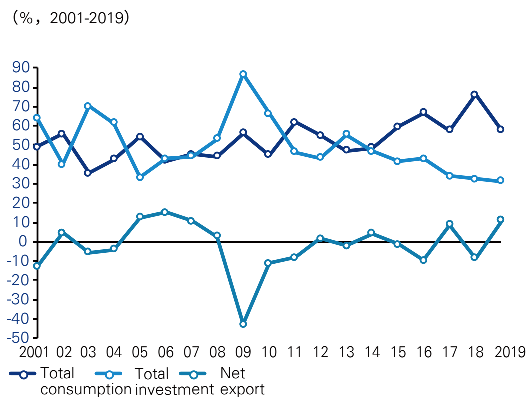
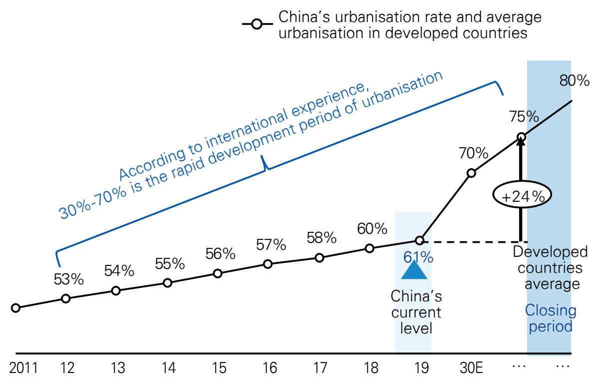


Figure 16: Forecast of future urbanisation level



Source: Public data

New business development areas

Asset securitisation: Significant market potential, but market positioning is critical

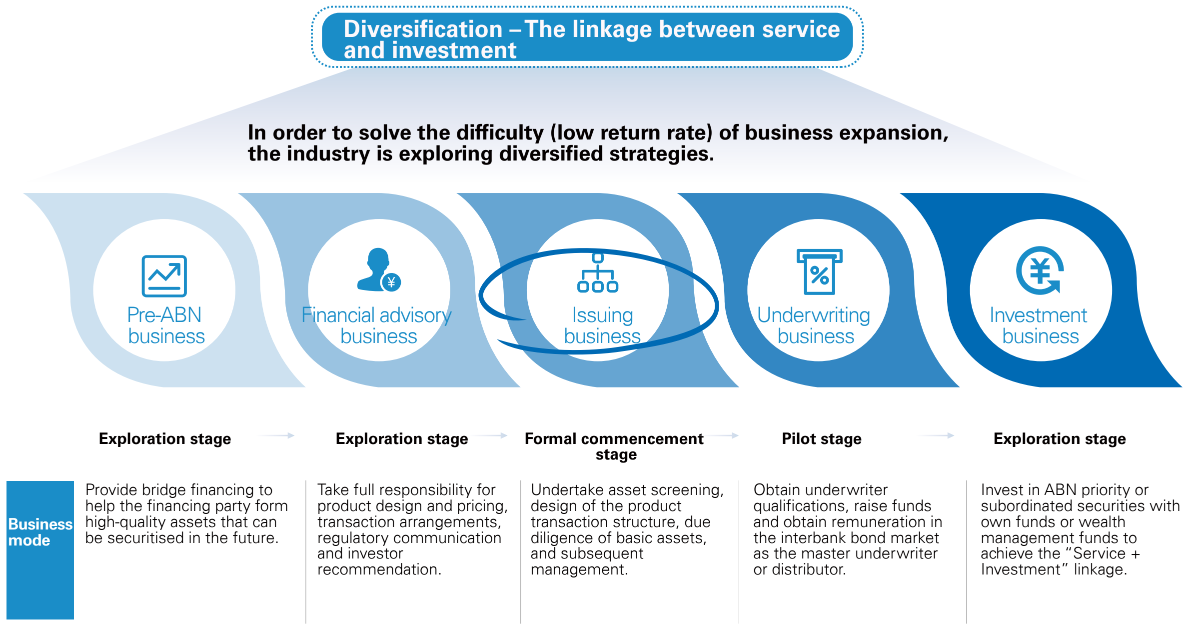
As a result of favourable policies, the supply and demand of asset-backed security (ABS) products are booming in China. In 2019, the scale of newly issued ABS products exceeded RMB2 trillion, with a compound annual growth rate (CAGR) exceeding 40 percent over the past five years. As a result, many financial institutions are strategically focusing on the rapid development of the asset securitisation industry and related innovations.

In the asset securitisation sector, trust companies have unique advantages with regards to client resources and industry background. Firstly, they have strong contracting capabilities, extensive experience conducting non-standard financing and ABS/ABN business, and significant client resources. Second, trust companies have strong asset identification and cash flow reconstruction capabilities, especially for basic assets in real estate, infrastructure and other fields. Trust institutions are also well-versed in identifying significant risks and evaluating investments, and are able to leverage their professional asset service capabilities to fully realise the investment value of underlying assets.

However, trust companies have traditionally filled the special purpose vehicle (SPV) role when participating in the asset securitisation business. Asset securitisation is characterised by a high degree of business homogeneity, and barriers to entry are low. In addition, the rate of return has been reduced to a few tenths of a million amid intense pricing competition, and generally the income that smaller trust companies generate from this business does not even cover their costs.

In the face of homogeneous competition, trust companies have explored differentiated development strategies that leverage their own characteristics. Some leading institutions, mainly in the banking sector, have started by signing contracts with clients for resources and using large commercial banks to obtain credit ABS business opportunities. Some institutions have obtained underwriting qualifications and shifted from SPV services to underwriting; and they have coordinated with securities investment trust companies to expand their capital market investment capabilities. Others have explored the "active management" asset securitisation business model by adjusting their business perspectives and locking in business opportunities through engaging in "pre-ABS/ABN" operations. Finally, some have become involved entire service life cycle, starting from the formation of the underlying assets and have combined the above services with back-end investments in order to increase returns.

Figure 17: The linkage mode between services and investment for trust companies to participate in the ABN business



Source: KPMG analysis based on publicly available data

Going forward, as policy support continues and the market continues to rapidly develop, the underlying assets in the asset securitisation market will become more diverse, and the qualification process for market participants will be further liberalised. These developments will undoubtedly present many business opportunities for trust companies.

Increasingly, trust companies are expanding their business scope and positioning themselves as comprehensive service providers by integrating "pre-ABS/ABN" services, entrusted services, financial advisory and underwriting. Trust companies should also consider using the ABS model to invest in mezzanine and secondaries with controllable risks and higher returns, and they should fully leverage their own unique asset management capabilities.

Securities investment trusts: transformation trends and related strategy

China's securities market has developed rapidly over the past 10 years. At the end of 2019, the market value of stocks and bonds was about RMB160 trillion, but their share of GDP was still far lower than that of developed markets. The market potential for the standard asset management business is huge, and it has become a strategic focus for asset management institutions of all types.

In accordance with new asset management regulations and the capital trust regulations, requirements related to the proportion of "standard product" business have become the most important regulatory issue for the asset structure of trust companies. Enhancing securities investment capabilities has become an important way for trust companies to develop standardised business. However, compared with securities investment institutions such as public equity funds, the asset management arms of securities firms, and 'Sunshine' private equity funds, the overall capabilities of trust companies is still relatively weak.

For this reason, trust companies need to formulate development strategies that are tailored to their own resources and capabilities. As a result of regulatory policies and external competition, the prospects for providing channel-type transaction management services in the 'Sunshine' private equity sector are bleak. Therefore, actively managed securities investment trusts are mainly focusing on developing their cash management business, Funds of Funds (FOF)/Multiple of Money Invested (MOM), and autonomous investment vehicles for stocks and bonds.

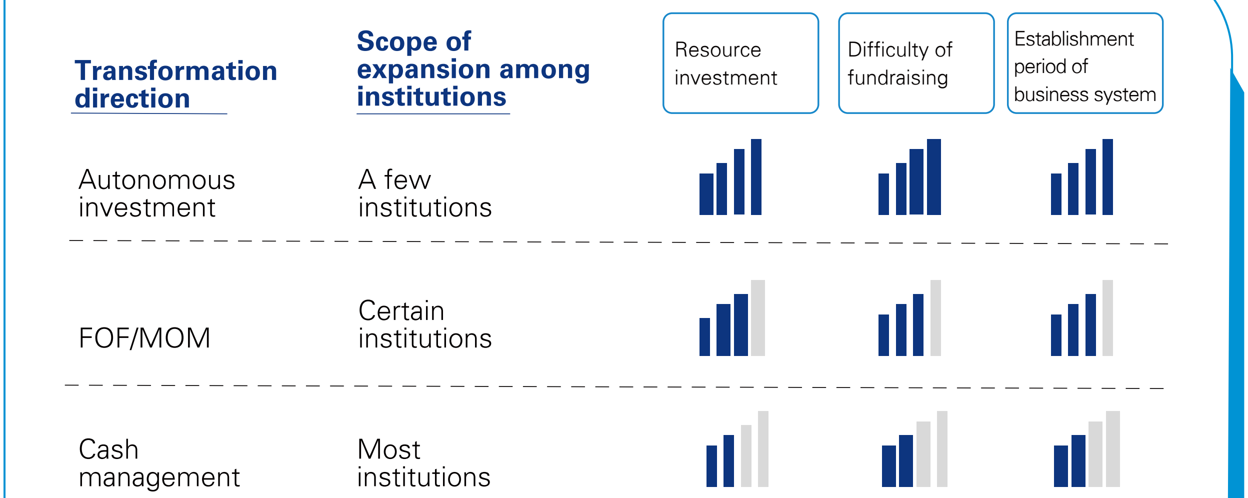
Most trust companies conduct cash management as a part of their securities trust business. However, this business needs to be carried out on a large scale in order to be profitable. The product scale typically has to exceed a certain level (about RMB30 billion) to ensure normal input and output; as a result, only a few leading institutions in the market can achieve profitability in this area.

Most trust companies choose to develop FOF/MOM-type businesses first, as these types of businesses enable trust companies to transform and actively manage their securities investments based on their past transaction management experience in 'Sunshine' private equity. For this business, the trust company collects product management fees and excess shares by setting up major asset allocation plans, selecting high-quality sub-funds, establishing a fund evaluation system, and dynamically managing its investment portfolios.

The autonomous investment business has very high requirements with respect to investment talent and investment research systems. Due to the general lack of a secondary investment market, it is difficult for trust companies to build the necessary capabilities from scratch. In order to succeed in this area, trust institutions need to invest significantly in operations, technology capabilities, as well as in talent recruitment and incentive programmes.

In addition, trust companies can also consider taking advantage of the flexibility of their private equity to explore the development of differentiated securities investment models (such as those that focus on the market between the primary and secondary market).

Figure 18: Analysis of business expansion challenges for three main directions of active management businesses



Source: KPMG analysis based on publicly available data

Case Study: Pioneer Fund

Pioneer Fund was initially small in scale and weak in its active management capabilities. It developed a FOF business early and gradually improved its active management capabilities, ultimately achieving great success. Its development process can be used as a valuable reference for China's trust companies facing the challenge of insufficient active management capabilities.

Figure 19: Development history of Vanguard

Vanguard started as an index fund with a low fee rate and FOF business, and gradually developed its active management capabilities.

90s – Now
Professional investment stage

- In 1994, 2003 and 2008, Vanguard issued the "Lifestyle Series Funds", "Life Cycle Series Funds" and "Regular Payment Pension Funds", **all of which were active management products of internal managers.**

80s~90s
Active investment stage

- Vanguard gradually expanded its investment scope. The underlying assets include domestic and overseas stocks and bonds, REIT products and commodity assets that are not closely related to the capital market (such as agricultural products and energy products).
- **The advantage of customer resources becomes greater** ,and bargaining power grows on the asset side.

1985
FOF stage

- After 10 years of development, Vanguard accumulated lots of loyal investors.
- Due to the lack of active investment capabilitiesy, **Vanguard launched the first FOF product in US history,** and used outstanding fund managers in the market to make investments.

1975
Index fund stage

- Vanguard was established, its business mode is the index funds with low fee rates.
- **Attracted investors with low fee rates and accumulated customer resources.**

Source: KPMG analysis based on publicly available data

Fund business: Favourable policies will help trusts transform and upgrade to "functional asset managers"

China has increased its support for private equity firms in recent years to ease the pressure of fundraising, increase exit channels and reducing the tax burdens associated with investing. Developing private equity business has become an important means for trusts to transform and upgrade from providing "supplemental financing" to "asset management" services. However, trusts are facing challenges as they build their capabilities in the four key areas of the fund business: funding, investment, management and withdrawal. At present, the scale of the trust fund business is still small. As of 2019, only Ping An Trust, Zhongrong Trust and CCB Trust were managing assets of more than RMB10 billion. In terms of investment strategy, trust companies have made different choices according to their own resource endowments. In addition to traditional real estate, they are mainly investing in national strategic emerging industries and in industries in which their shareholders are involved.

Figure 20: Layout of trust private equity investments

Institution name	New energy	New material	New energy automobile	Intelligent manu-facturing	Health-care	Energy conservation and environ-mental protection	Modern technol-ogy	Big con-sumption	Modern agriculture	Culture and media	Real estate	Reform of state-owned enterprise
L					✓			✓				
M	✓	✓	✓	✓	✓					✓		
N	✓			✓	✓					✓	✓	✓
O				✓	✓		✓			✓		
P				✓	✓		✓			✓	✓	✓
Q	✓					✓					✓	
R	✓	✓	✓		✓	✓			✓	✓		
S									✓			
T	✓	✓	✓		✓	✓						
U	✓				✓		✓					
V					✓			✓			✓	
W				✓	✓		✓	✓				
X					✓			✓		✓		

Note: Institution names have been anonymised to provide a cross-section of investment trends
Source: KPMG analysis based on publicly available data

Trust companies engaging in fund businesses can consider the following three models:

Acting only as a fund investor or only participating in part of the equity of management companies: Some trust companies still lack active management capabilities. To address this shortcoming, they can invite professional investment institutions to serve as general partners (GPs). The main goal of this model is to accumulate equity investment experience by acting as an investor or gaining equity in certain management companies.

Dominating the management of funds: Trust companies with certain active management capabilities can use project-driven capital funds to conduct business, which will mitigate fundraising difficulties to a certain extent and help trust companies build equity investment track records. However, companies should note that trust plans and contractual models cannot be designed for the purposes of listing and exit due to shareholder issues.

Fund-of-funds (FOF) model: Alternatively, trust companies can become a fund-of-funds (FOF) GP, invest in a FOF or use a FOF to invest in various sub-funds in order to quickly place investments in various sub-sectors. However, FOF usually have a longer closed period, and they tend to face the same challenges that affect traditional trust funds, such as fundraising difficulties and high capital costs.

Wealth management: “returning to the industry’s origins”

The total investable financial assets of high-net-worth clients in China have grown rapidly. Individual investment requirements have become increasingly diverse, and the country's high-end wealth management market has become more mature. Regulators have imposed stricter requirements on trust companies in recent years in terms of net worth management, product sales thresholds and restrictions on the number of purchasers. These regulations have placed significant pressure on various institutions to transform their wealth management businesses. In the future, the target client groups of trust companies, private banks and wealth managers will continue to expand, and competition among institutions will intensify.

Figure 21: Comparison of trust companies and other wealth management institutions

Entity type	Evaluation indicator: Customer base	Evaluation indicator: Assets allocation	Evaluation indicator: Channel resources	Evaluation indicator: Product attraction	Core profit model	Core barriers to competition
Trust companies	◔	◔	◔	◕	▪ **Receive trust revenue from the product side.**	▪ License advantage; ▪ Stable, high yield, nonstandard products.
Private banks	●	◕	●	◔	▪ **Domestic private banks generally do not charge management fees and focus on selling self-owned wealth management products.** ▪ **Account for private banking income through Internal Funds Transfer Pricing (FTP).**	▪ Strong customer base; ▪ Rich channel resources; ▪ Strong assetss allocation; ▪ Experienced in financial planning.
Securities companies	◑	◔	◑	◑	▪ **Performance-based revenue, fees from sales on a commission basis, fees from margin trading and short selling.**	▪ Professional investment advisory and research team; ▪ Leverage investment services; ▪ Brokerage customer base.
Third party wealth management institutions	◔	◕	◔	◑	▪ **Receive management fees and fees from sales on a commission basis.**	▪ Strong assets allocation; ▪ Experienced in financial planning; ▪ Experienced in domestic and international financial products.

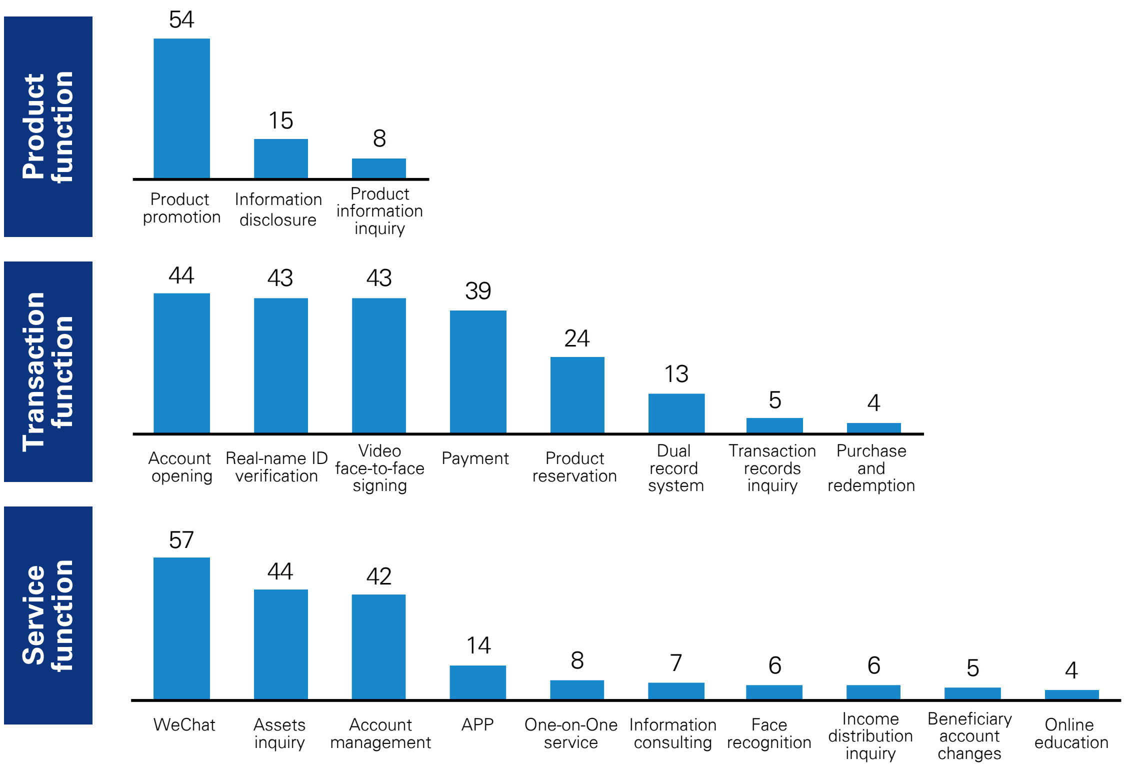
Keys: ● Strong competitive advantage ◔ Weak competitive advantage

Source: KPMG analysis based on publicly available data

In light of sales channel weaknesses, trust companies will intensify their efforts to establish regional wealth management outlets in order to increase the headcounts of their trust product sales forces and expand direct sales. In terms of goals, wealth management trusts are mainly working to strengthen their sales forces, build wealth management brands, and empower their operations using technology.

More and more investors are realising that the professional capabilities of an investment team are directly linked to investment yield and asset safety. In addition to improving professionalism, increasing team headcounts is also a top priority. Although the number of wealth managers in the trust industry exceeds 5,000, the average team still consists of fewer than 100 individuals. In the context of online financial services, trust companies also need to strengthen their construction of online platforms, increase technological investments, expand online customer acquisition, improve customer service capabilities and customer experience, and enhance customer stickiness.

Figure 22: Functional applications of trust companies' customer service information



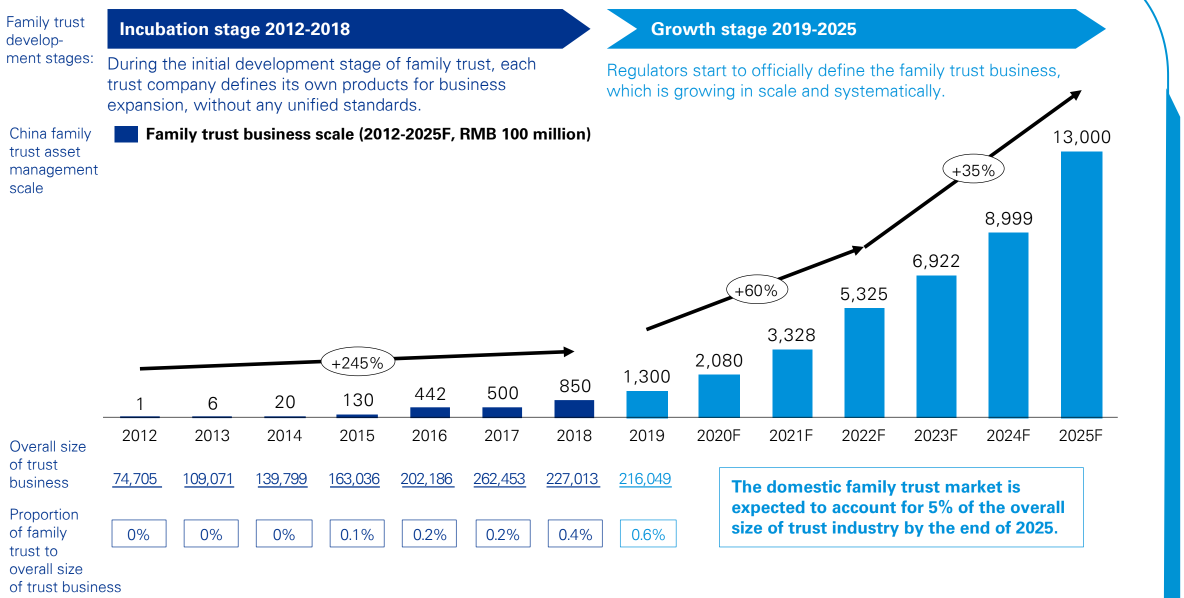
Note: 2018 data

Source: KPMG analysis based on publicly available data

Family trusts: Patiently accumulate resources to build core competitiveness over the medium- to long-term

Survey data shows that ultra-high-net-worth individuals are increasingly recognising the importance of family trusts. After six years of continuous supervision and encouraging regulatory policies, domestic family trusts are entering a growth stage. As of the end of 2019, the scale of family trust assets had reached RMB 130 billion, but this amount still accounts for only about 0.6% of total trust assets. Overall, China's family trust sector is still in its infancy compared with mature family trust systems overseas.

Figure 23: Domestic family trust market size and development process



Source: KPMG analysis based on publicly available data

About 36 domestic trust companies have launched family trusts, but they are all in the very early stages. Only three trust companies have family trusts with more than RMB 10 billion in assets. At the same time, due to limitations related to sales channels, services and product capabilities, domestic trust companies are mainly developing their family trust businesses by working with external parties, usually private banks.

Figure 24: Family trust business development models

Business development models and features

Private-bank-led

Trust companies rely on the customer base, assets allocation and service systems of private banks to break into the family trust market, mainly acting as a role of transaction management, and receiving fixed management fees.

Cooperation with insurance companies

Trust companies may take over the insurance benefits as a beneficiary of insurance relationship or participate deeply in the family trust as both the policyholder and the beneficiary. It has a lower product threshold and becomes a product akin to family trust.

Self-led

Trust companies use their own customer accumulation for independent marketing, design and implementation of family trust, collect management fees and excess returns.

Cooperation with banks

Trust companies strategically cooperate with banks, negotiating the division of responsibilities, management of trust assets, and receive management fees or excess returns according to the division of responsibilities. It has a lower product threshold.

Cooperation with third party organisations

As family trust requires a high degree of comprehensive competence, trust companies also work with law firms, accounting firms, professional wealth management firms and other organisations to develop family trust business.

Source: KPMG analysis based on publicly available data

Family trusts are geared towards ultra-high-net-worth individuals after their wealth reaches a certain scale, and is also one of the few lines of business specifically licensed to trust companies by regulators. As supporting laws and regulations are improved and trust companies enhance their service capabilities, family trust businesses will become more developed. Analysts expect total assets in family trusts to reach RMB 1.3 trillion in 5 years, which would account for about 5% of total assets managed by trusts. For trust companies, the most effective way to differentiate their family trusts from those of other wealth management institutions such as brokers and banks is to maximise the functions of trust licences, such as risk isolation and transaction management, in conjunction with building a trustworthy brand image and professional service team.

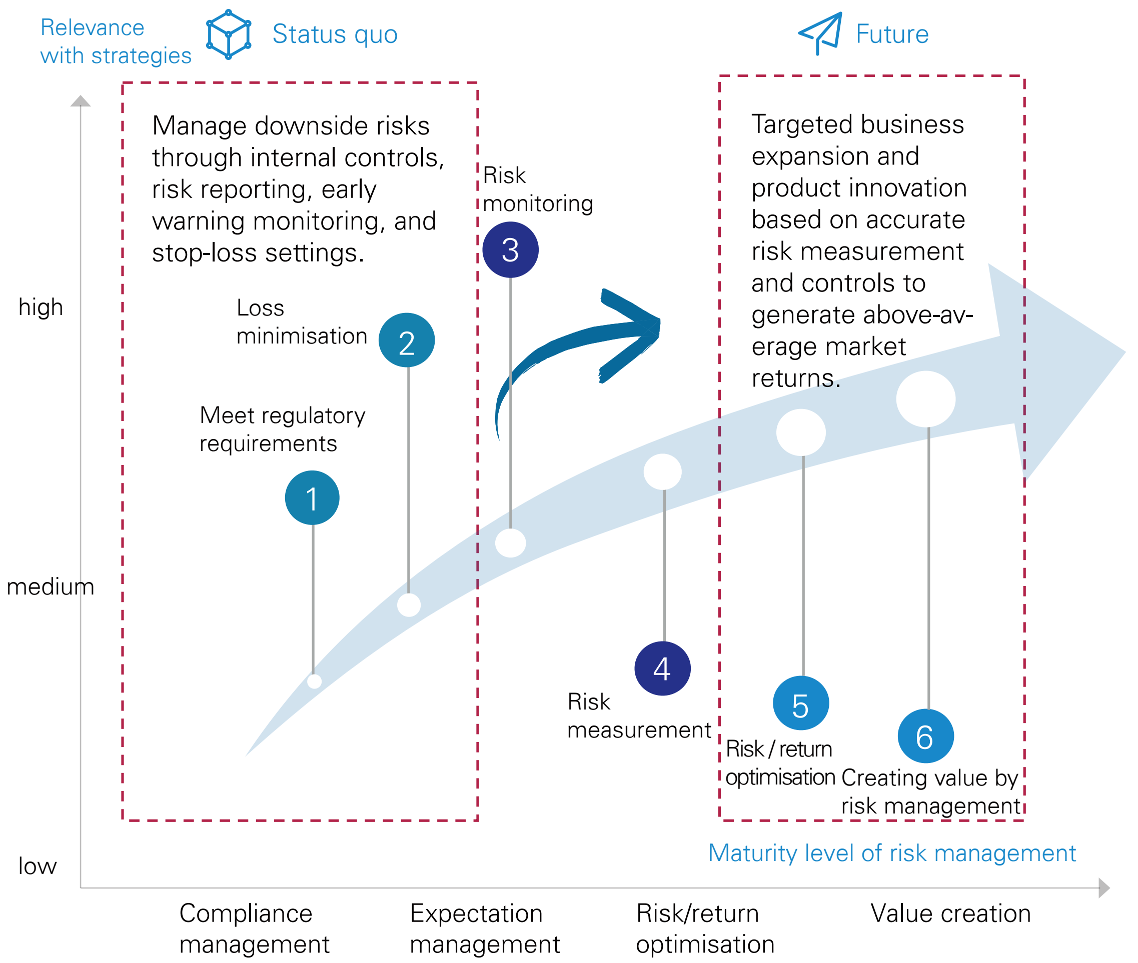
Optimisation of support systems

The trust industry is currently facing the need for strategic transformation. Against this backdrop, many trust companies are acutely aware that their companies' business transformations will depend on their ability to optimise and upgrade their internal support systems. This transformation will require strategic vision, determination, and effective implementation of their strategies. We believe that trust companies urgently need to make advances in four key areas: risk management, human resources, information technology, and brand building in order to quickly enhance their capabilities and support business development.

Risk management: From "controlling losses" to "creating value"

Traditionally, trust companies' risk management systems focus on project approval, and their primary aims are to strictly control risks and minimise losses. However, as the diversity of equity investments has grown, the complexity of risk management has greatly increased. For this reason, the risk management capabilities of trust companies urgently need to be fully upgraded, and they need to transform from "passive risk control" to "active risk management."

Figure 25: Development process of trust companies' risk management systems



Source: KPMG analysis based on publicly available data

Human resources: From "partnership" to "system building"

Trust companies have always been renowned in the financial industry for their streamlined workforces, which drive a high per capita performance compared to other types of financial institutions. On the other hand, lack of marketisation, low employee loyalty and high turnover are issues that have always plagued trust companies from a human resources (HR) perspective.

As China's trust industry has developed over the years, more and more trust companies are realising the strategic importance of constructing effective HR management systems. To this end, they are revamping remuneration, assessment, and incentive mechanisms to consolidate their advantages. At the same time they are actively cultivating motivated workforces and improving their organisational effectiveness.

From an HR perspective there are several areas trust companies in China should be paying attention to:

First, trust companies with insufficiently marketised human resource systems and mechanisms should make investments to improve both their software and hardware; reform their performance management and evaluation systems; and consider providing equity (including virtual equity) incentives to staff. These changes will help them attract talented individuals and enrich their talent pools. As regulations have become clearer, state-owned financial institutions have increasingly established market-oriented talent selection processes.

Second, trust companies should make professional training, especially in business innovation, a top priority. The transformation needs of trust companies are very significant, and companies cannot rely only on external talent to meet their requirements in this regard. In the future, to succeed in innovative business areas such as securities investment and private equity, trust companies need to build professional teams, establish internal training systems, and cultivate professional teams to shore up core competencies.

Third, trust companies need to retain talent by continuously improving their performance incentive mechanisms and talent development systems. To do this, companies should consider developing a performance appraisal system that provides both short- and long-term incentives and opportunities for career development. They also need to design differentiated incentive mechanisms that match the needs and characteristics of different business lines within the organisation.

Information technology: From "business support" to "technology empowerment"

At present, financial technology ("fintech") utilised by most trust companies serves the basic operational needs of the business. Compared with banks, insurance institutions, and other financial institutions, trust companies have historically had comparably lower technology requirements. However, in our view, the role of technology in the development of the trust industry is becoming more prominent.

Figure 26: IT positioning of trust companies

Upgrading of positioning

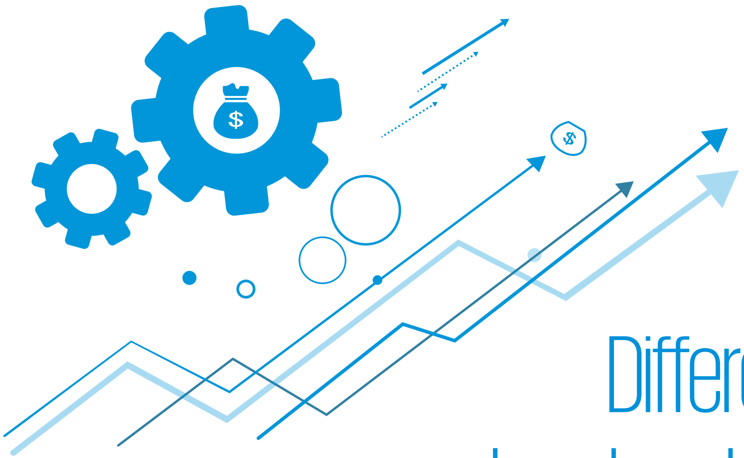
	Business–led	Technology–led	Key features of the Technology-positioned work
Strategy-driven	· Participate in the IT-led ideation stage.	· The technology line guides the business sector through the new ideas creation process, while the business sector carries out marketing based on the products and services offered by the system.	· Innovation-driven: Perform prediction and analysis on the company's growth, so as to create more space for business innovation.
Busness partner-ship	· Generate ideas and describe initial requirements to the IT department.	· Take on more business design and guidance in addition to application-oriented work; · Lead system conceptualisation and carry out validation.	· Integration of business, technology and strategies; · Focus on business needs and customer service; · Optimise project and cost management, improve service performance and promote collaborative development.
Applica-tionori-ented	· Develop a system building concept · Organise relevant departments for demonstration; · Develop requirements/programs · Organise relevant personnel for UAT testing;	· System design and development, production preparation and release, production operation and maintenance; · Complete follow-up assessments based on demand response from individual application systems.	· Provides single application-oriented system optimisation in a "tightly coupled" system environment.
Technolgy supported	· Develop a system-building concept · Organise relevant departments for demonstration; · Seek external vendors for system implementation and application maintenance.	· Cooperate with the system deployment; · Responsible for production, operation and maintenance after system transfer.	· Basic information construction; · Operation and maintenance of information system environment.

Source: KPMG analysis based on publicly available data

With the rapid development of fintech in recent years, customers' demands for services are constantly growing. In the future, trust companies will need to comprehensively transform their technology systems so that they can serve as strategic business partners for their clients. For example, some trust companies have built wealth management business apps that serve as one-stop, self-service platforms. The apps may include account-opening services, facial recognition technology, designated online financial advisors, electronic contracts, and other features. With these apps, trust companies are aiming to satisfy customers’ online service needs and act as comprehensive financial advisors to investors. With regards to emerging technology, companies also need to consider how to use data analytics to create unique competitive advantages through efficient operations (such as intelligent operational analysis and project monitoring), intelligent risk management (such as big data risk control modelling), and innovative product technology (such as blockchain confirmation).

Brand building: From "product-driven" to "customer-driven"

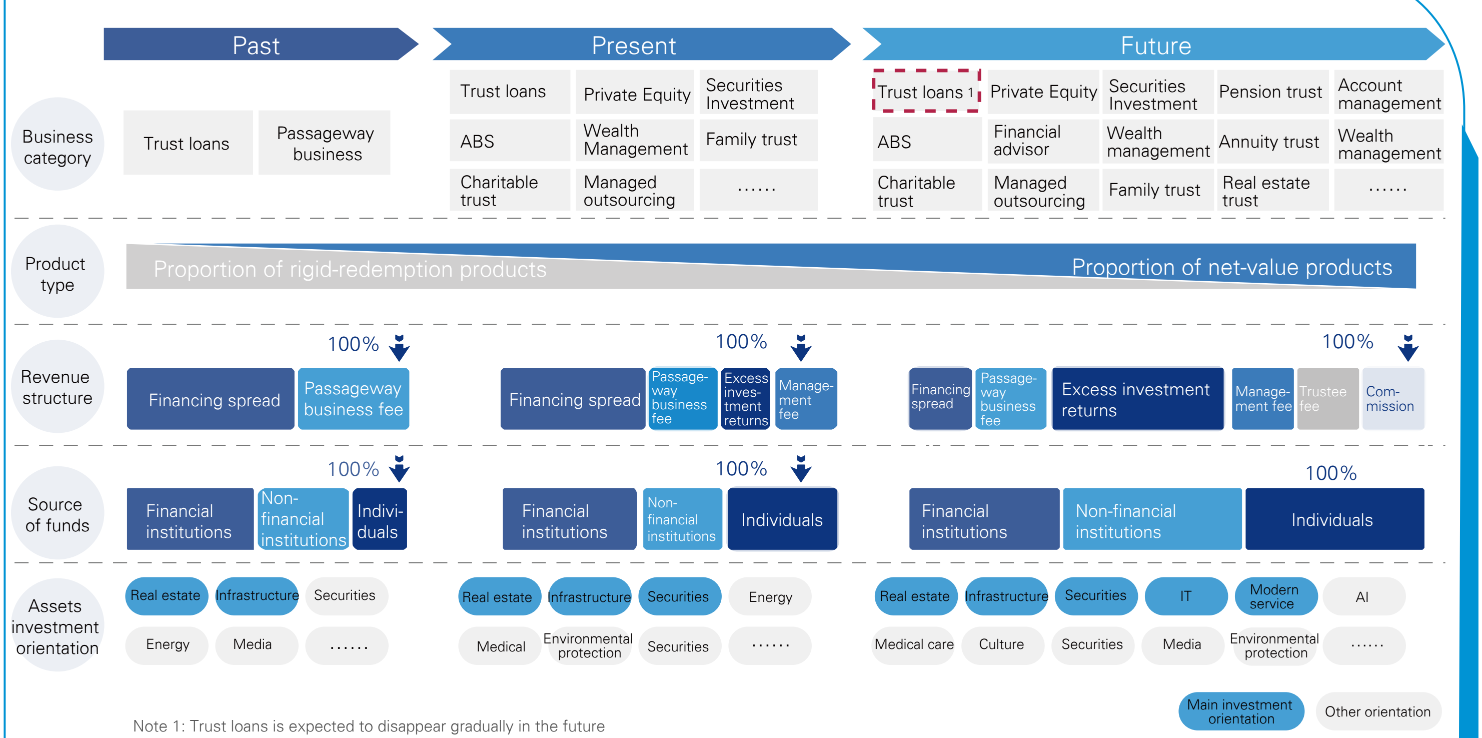
Fund-side customers, especially high-net-worth customers, are becoming more and more important to trust companies. Factors such as net-worth management, the imminent end of rigid redemption, and market crashes have made customers pay more attention to the reputation of trust companies when choosing which products and services to purchase. In addition, as the rate of return on trust products continues to decline and products and services become more homogeneous, trust companies urgently need to improve their brand positioning so that they can acquire and retain customers and avoid excessive price competition.



Outlook: Differentiated development and a return to the industry's origins

China is deepening its economic transformation and steadily upgrading its industries. As this transition continues, the demand for financial services within the trust industry will depend on the level of flexibility of the trust system, and the extent to which trust companies can meet the investment and financing needs of the real economy. However, taking into account international developments within the trust industry as well as the gradual improvement of China's financial regulatory system, we expect the professional capabilities of financial institutions to strengthen while the financing function of trust companies continues to weaken. In the future, we expect trust companies to focus on their original "core functions" that other types of financial institutions cannot truly perform. Going forward, we believe that as China's trust industry modernises, it will develop a wider variety of products and services, diversified investments and comprehensive functions.

Figure 28: Development evolution course of trust companies

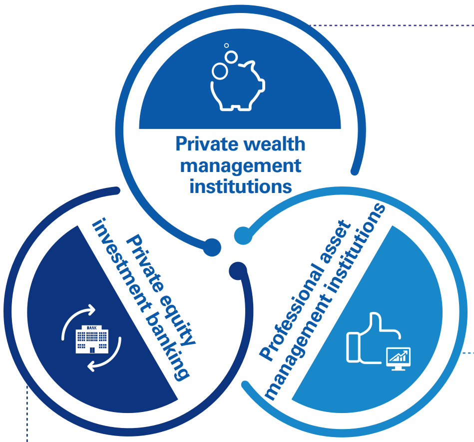


Note 1: Trust loans is expected to disappear gradually in the future

Source: Engagement team analysis

In view of the developmental path of the trust industry, changes in domestic regulatory policies, and the development status of domestic trust companies, we believe that trust companies can leverage their resource endowments to explore transformation in three areas: wealth management, professional asset management, and private equity investment.

Figure 29: Transformation direction of trust companies



Private wealth management institutions

- Based on the clients' needs, return expectations, risk appetite, term requirements and other characteristics, provide asset allocation and wealth planning that is client-centred (rather than product-focused).
- It is necessary to perform segmentation and refinement management to retain clients through customer experience and service quality, instead of relying on high-yield rigid-redemption products.
- Open product platform through which products may stem from both internal and third-party suppliers

Professional asset management institutions

- The originator of business is the client with investment needs, not the counterparties with financing needs. Maximise the maintenance and creation of assets value through one or more investment strategies.
- In terms of business development, usually consider the investment needs of clients on the capital side before structuring the product, setting the investment scope, product type and strategy.
- Investment targets may be standardised assets such as bonds, stocks, funds, etc., or non-standardised assets such as non-public equity.

Private equity investment banking

- Taking the financing needs of counterparties as the starting point, it is required to deeply understand the rules of industry chain, proactively identify the financing needs of different sections and participants in the industry chain, and perform in-depth risk assessment.
- As the transaction structure is not simply trust loans, it requires the flexibility to use a variety of methods such as debt or equity, standardised or non-standardised financing, provision of funds or property management to establish financial instruments and meet clients' various needs.

Source: Engagement team analysis

Direction #1: Transformation into private wealth management institutions that are driven by funds. To accomplish this transformation, trust companies will rely mainly on their wealth management and family trust businesses. They will leverage advantages associated with trust licences, such as property protection, risk isolation and fully entrusted account management. Based on client needs, companies will provide asset allocation solutions and value-added services around the core demands of private wealth management.

Case study: American Trust has developed a "refined, customised, and high-end" wealth management business. The company is focused on providing individual customers with comprehensive wealth management services that span multiple categories. The keys to its success include its precise segmentation of customer groups and the provision of differentiated services. For example, for customers with assets of USD 250,000 or more, the company uses technology to improve the design efficiency of its programmes; and for high-net-worth and ultra-high-net-worth individuals with assets of more than USD 10 million, it provides customised strategies and more complex investment solutions, with a focus on improving customer experience.

Direction #2: Transformation into professional asset management institutions that are driven by investment. In order to transform into professional asset management institutions, trust companies need to improve their investment, research and risk control capabilities, and they need to focus on the securities investment trust and fund businesses. To achieve their goals, trust companies will need to rely on their understanding of the industry to solve "last mile" problems between the fund end and the asset end.

Case study: US Capital Group is renowned for its "low-key but high-quality" investment style. It adopts a model whereby multiple investment managers manage one fund. The company focuses on strategic long-term products, emphasises the long-term interests of investors, pursues long-term returns, carefully introduces new projects, and provides long-term investors with consistently excellent investment results. Since its establishment, it has issued fewer than 50 products.

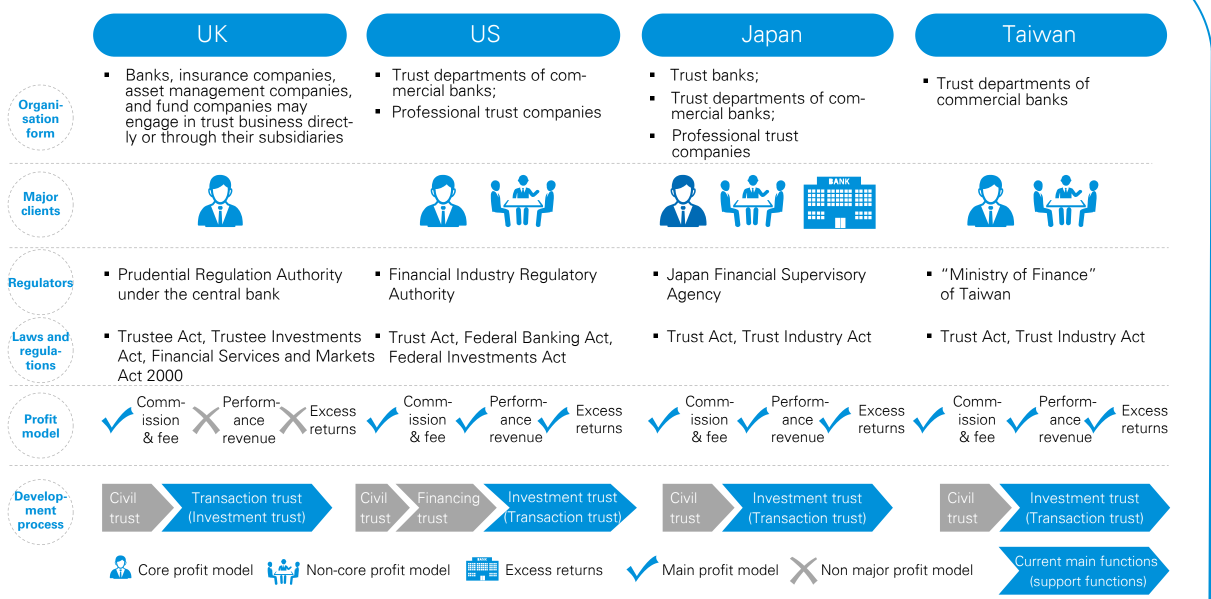
Direction #3: Transformation into private equity investment banks that are driven by leading industries. In order to expand their private equity investment capabilities, trust companies will need to leverage their own resources and industry experience to specialise in certain industries and drive business development. Trust companies can use legal functions such as cross-market configuration, flexible investment and financing mechanisms, and entrusted asset management to focus on asset securitisation, real estate trusts, government trusts and other businesses.

Case study: Huaxing Capital focuses on the "new economy" and positions itself as a "boutique investment bank". In its early days, the company insisted on using the "subtracting method," and only provided private equity financing services for "new economy" companies.

History and lessons from the development of the international trust industry

By looking at the development path of trust business in different developed markets, we can see that over time the trust industry has shifted from serving a financing function towards asset management and related services.

Figure 30: A comparison of trust industry development characteristics across four markets



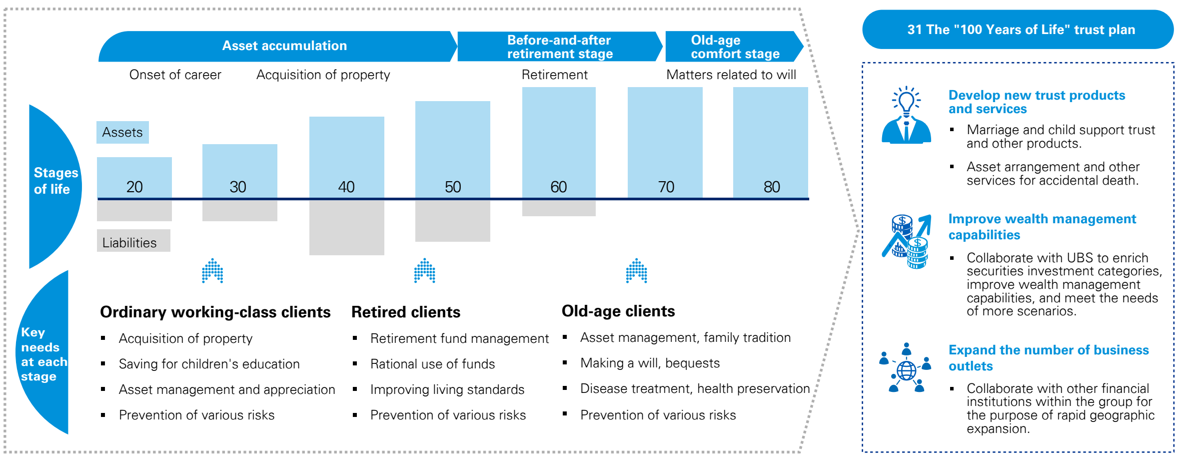
Source: KPMG analysis based on publicly available data

The trust industry in the US started with personal civil trusts, and the US was the first country to develop financial trusts. With the development of the US economy and its capital markets, the trust industry went through a period of explosive growth in which it mainly served a financing function, before finally returning to its original function under a supervisory system characterised by mixed operations. At present, the US trust industry is trending towards the fields of wealth management, family trusts, securities investment, real estate investment, corporate annuities, and employee stock ownership.

As Japan's economic development has slowed over the past few decades, the Japanese trust industry has transitioned from a focus on loan trusts towards investment and wealth management. Its customers are mainly individuals, households, and companies that require management and services for their various assets.

Case study: A leading trust bank in Japan has made personal business its strategic focus. In 2017, it launched a "100 Years of Life" trust plan to provide individual clients with comprehensive wealth management solutions at different stages of life.

Figure 31: The "100 Years of Life" trust plan of a leading trust bank in Japan



Source: KPMG analysis based on publicly available data

In Taiwan, the "Tenth Credit Cooperative Incident" in 1985 was a critical moment in the development of the jurisdiction's trust industry. After the incident, independent trust investment companies ceased to exist. Their businesses, which mainly covered wealth management and transaction management, were taken over and subsequently run by banks and securities companies. Today, trust services have penetrated into all aspects of society, with pension insurance, family wealth inheritance services, employee service trusts, real estate securitisation trusts, and charitable trusts being provided to various individuals, families and enterprises.

Conclusion

As China continues to reform its financial services sector, it is clear that the "transformation and development" of trust companies is no longer empty talk, but rather an urgent imperative for all players in China's trust industry. This road to transformation will be difficult, bumpy and long, and every single step counts. We hope that this report will strengthen the industry's determination to transform, help it make adequate preparations, and encourage it to explore a development path that leverages the advantages of trusts and makes the industry more competitive.

Looking to the future, we believe that the industry's original goal of serving the real economy remains unchanged; and the industry's culture of integrity and conviction remains fundamentally unchanged as well. With the guidance of regulators, the current generation of trust industry professionals must work together as they collectively strive for a better future for the industry.

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Beijing International Trust Co., Ltd. (Beijing Trust or the Company) is a large non-bank financial institution affiliated with Beijing with a registered capital of RMB 2.2 billion. It is a sponsor and director of the China Trustee Association, a member of the Securities Association of China, and a member of the Banking Industry Association of Beijing.

As one of the first trust companies established after the restoration of China's trust industry, the Company has always adhered to the Party's leadership over state-owned enterprises throughout its more than 40-year history, and it has carefully implemented various decisions and financial supervisory requirements issued by the Party's Central Committee, the State Council, and the Beijing Municipal Party Committee and City Government. In line with its mission of "dedicated to trust and benefiting the people," and adhering to the concept of "honouring credibility, being prudent, and acting with due diligence and integrity," the Company has established a sound corporate governance structure. By relying on its professional management team, effective risk management system, strong financial service strength and a large number of loyal, high-end customer groups, the Company has developed into a modern financial institution with high-quality assets, solid liquidity and strong risk mitigation capabilities. The Company's active management capability, which is the core competitiveness of trust companies, ranks in the forefront of the industry. In addition, Beijing Trust has maintained the industry's highest A-level rating for many years. The Company has also won the "Excellent Company Award," "Outstanding Trust Company Award," "Annual Gold Market Influential Financial Product" award, "Investment Return Award," "Excellent Enterprise with Comprehensive Capabilities in Respect of China Real Estate Trusts" award, and "Best Charity Award" from various authoritative industrial organisations on numerous occasions. The Company is trusted by investors and highly regarded by its cooperative partners.

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About KPMG China's Financial Strategy Advisory Services

KPMG's Advisory service team has been focused on the development of the financial and trust industries for a long time. The team has provided strategic planning services for many domestic trust and asset management institutions, and it has established a leading position in the financial services field. KPMG's Advisory professionals assist clients in addressing their strategic needs in terms of growth (creating value), performance (enhancing value) and governance (managing value). Relying on KPMG's experience in the global financial industry and local expertise in the China market, the team provides strategic services for a number of major players in the Chinese financial industry, such as banks, insurance companies, asset management companies, trust companies, and financial holding groups, to help them meet and respond to industry challenges. KPMG strives to effectively execute strategic planning by providing a range of value-added services such as management consulting, risk management consulting, IT consulting and financial consulting.

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