STEP Society of Trust and Estate Practitioners

HKTA Hong Kong Trustees' Association Ltd 香港信託人公會

China and Hong Kong Tax and Regulatory Update

Newsletter Issue No. 1 - July 2010

Use of trust products in Wealth Management in China

History of Wealth Management business among Chinese banks

It all started in early 2004, and had much blossomed in the bullish markets during 2006-7 when banks' wealth management products mainly focused on A-share IPO issues. Bank-type QDII products were also developed around that period. With the cessation of A-share new listings in 2008, IPO-related wealth management products had lost much of its glamour. Banks started to collaborate with securities companies, fund houses and also trust companies etc to diversify their investment product range. Facing market uncertainty and volatility in 2008, banks also devised alternative products linked to gold, wine, tea leaves, carbon emission rights etc in a bid to tap new sources of fee incomes. At present, banks are on equal footing with securities companies and fund houses in terms of sharing the wealth management market in China.

Major types of wealth management trust products available

There are mainly two types:

1. Collective Trust Schemes launched by trust companies

- mostly at fixed rates of return, ranging from 6-8% per annum
- tenor for 1-2 years normally
- rather high subscription amounts are set, usually at RMB1 million or above
- cater to high net-worth or high income investors
- generate income through equity / debt investments into government infrastructure, real estate, premium enterprises etc

2. Trust Products jointly launched by banks and trust companies

- banks raise the funding from investors while trust companies design and manage the products
- average return is about 5% per annum
- minimum subscription amount usually set at RMB100,000
- cater to middle or low end investors

In this article, we would analyze the background for the remarkable growth of the latter type of products in recent years as well as their future outlook.

Partnership between banks and trust companies

There are lots of natural advantage for banks and trust companies to complement each other in the wealth management arena:

- The extensive branch networks and strong client base of banks make them powerful distributors of wealth management products. Bank clients, given their growing affluence, have ever-increasing demand for investment tools and products, and they naturally will resort to banks to get their needs fulfilled.

- Being constrained by the CBRC (China Banking Regulatory Commission, the regulator of more than 50 trust companies in the Mainland), trust companies cannot attract deposits but they can engage in a wide range of financial activities and services, including loans, mutual funds, investments (into private equity / securities / real estate / receivables / projects / infrastructure / money market instruments etc), portfolio management, asset securitization, pensions and even QDIIs.

- For Chinese banks to issue trust products through collaborating with trust companies, they mainly act as the bridge between affluent bank clients who possess excess funding and trust companies which are in need of funding. Capitalizing on their distribution capabilities and capital raising functions, banks are no doubt well-placed to add value between the “have” and the “have not”. They can also make use of the diverse business scope of trust companies to customize products to meet the needs of different target investor groups with different risk appetite or return expectation.

- To ensure the safety of trust funding, most trust products would have built-in hypothecation, guarantees, special structures etc in their design to mitigate investment risks. Issuing banks will also act as the custodian for the product assets to get them segregated from the trust company assets.

Given the above, cooperation between banks and trust companies has much strengthened in the last few years.

Latest Developments

With the tightened credit situation prevailing in China since early 2009, trust products should have offered an alternative source of funding for those in need. While a bank is in no position to issue trust products to buy into its own loan assets or trade bills issued, and investments into properties are also much constrained, there was however nothing to stop a bank trust product from (a) buying into the loan assets of a third-party bank or (b) directing the trust money to a borrowing client of the issuing bank.
There were also other forms of credit arrangements possible to push the bank trust product volumes to some RMB2 trillion by mid-2010. However, on 2 July 2010, the CBRC suddenly imposed a ban on all forms of collaboration between banks and trust companies with immediate effect. No more new joint product will be approved while existing ones would only allow redemption but not subscription.

Such a U-turn in the CBRC policy is said to have arisen from the concern of CBRC over the following :

- this kind of bank trust products would undermine the continuous effort of CBRC in controlling the overall credit scale; and
- there is also immense risk concerned when banks can literally move their loan assets off their balance sheets through trust products.

Future Outlook

Looking at the near term, it is uncertain as to whether and when the said ban will be lifted, and if a new form of collaboration would eventually emerge among banks and trust companies. However, it is likely for the CBRC to guide the trust companies to act not merely as product manufacturers but also to enhance their professional capabilities in relation to risk management, research, and product management. With diverse designs, investment focus, returns and so forth, it is optimistic that trust products will play a more prominent role in the wealth management market of China going forward.

Source: www.trust-one.com and www.anbound.com.cn
Editor: Fanny Wong
Date: July 2010

Changes in PRC tax practice enhance the Cayman and BVI advantage

International investors into China have traditionally favoured structuring their investments via holding companies or special purpose vehicles domiciled in jurisdictions outside China such as the Cayman Islands and the British Virgin Islands (BVI). The reasons for this include the ability to dispose of the investment indirectly by way of an international IPO or private sale of the shares in the Cayman/BVI company, the desire of international investors to invest in a corporate entity formed under familiar legal principles in an established international financial centre, administrative simplicity and the desirability of ring-fencing liabilities.

Some investors have, however, chosen jurisdictions such as Barbados and the Seychelles to take advantage of their respective Double Taxation Treaty (DTT) with China. The advantage of such DTT jurisdictions in taxation matters has been put in doubt by the issue of Circular 601 by the Chinese State Administration of Tax. The effect of Circular 601 is to introduce uncertainty in assessing a claim for DTT tax benefits for a typical vehicle established in an offshore jurisdiction such as Barbados or the Seychelles. As the likelihood of successfully claiming DTT benefits diminishes, Cayman and the BVI will find themselves on the same playing field with regard to taxation as the DTT jurisdictions.

(With authorisation to publish from Maples and Calder)

MAPLES
Author:
Maples and Calder
www.maplesandcalder.com

For details of this article, please log onto the website of Maples and Calder. If you have any question in relation thereto, you may contact:

Christine Chang
+852 2971 3002
christine.chang@maplesandcalder.com

Greg Knowles
+852 2971 3008
greg.knowles@maplesandcalder.com

This newsletter is contributed by the HKTA/STEP Joint Sub-Committee for China Development. Members include: