KPMG

REUTERS

China's Trust Sector: The next chapter

FINANCIAL SERVICES

AUDIT ▪ TAX ▪ ADVISORY

Contents

Acknowledgments

This report was written principally by Jason Bedford, Manager, Financial Services, KPMG China.

We would also like to thank Reuters for their valuable assistance and industry executives who so generously contributed their time, knowledge, and insights to this report.

For any questions about the content of this report, please feel free to contact Jason Bedford at +86 (10) 8508 5851 or jason.bedford@kpmg.com.cn

For more information about KPMG China's thought leadership programme, please contact Michael Hurle at +852 2826 7292 or michael.hurle@kpmg.com.hk

Welcoming remarks by KPMG and Reuters

Welcome to our second report on the trust sector in China. Following the reforms undertaken by the China Banking Regulatory Commission (CBRC) in 2007, the nature and direction for trust companies has gradually taken shape and set the stage for the trust sector to become a much more significant player in China's booming wealth management sector and still nascent structured financial products market.

China's regulators have demonstrated that they are open to innovative ideas and new financial products and have given trust companies the tools they need to succeed and to become the engines for financial innovation. However, the significant differences that exist among trust companies because of variations in the licenses they hold have made trust companies one of the least understood financial institutions in the mainland financial services sector. Many challenges also still exist for trust companies. These include finding a niche in the asset management industry and being able to offer new products to distinguish themselves from competitors, particularly the retail-oriented fund management companies, in related sectors.

This latest paper by KPMG China and Reuters considers all of these challenges, as well as providing an analysis of how trust companies are developing in practice.

We hope you find this report insightful and we would welcome the opportunity to discuss our findings with you further. We would also like to thank the executives from Royal Bank of Scotland, CITIC Trust, China Credit Trust, Macquarie and Morgan Stanley who are featured as case studies within this report.

Simon Gleave
Partner in Charge
Financial Services
KPMG China

The rapid evolution of China's financial industry has captured the imagination of global investors. The country boasts the world's biggest banks by market capitalisation. The bond market is growing by leaps and bounds. Early in 2010, Beijing announced long-awaited plans to galvanise its stock market by introducing index futures, margin trading and short selling.

Somewhat neglected in this maelstrom is the trust sector. An industry with a chequered past, it is now being used as a testing ground by Chinese regulators eager to promote asset management as well as alternative methods of financing to reduce the economy's reliance on bank lending.

Given the significant potential of trust companies and the attention they are attracting, this comprehensive study by KPMG China is particularly timely.

The report, which was compiled with the help of Alan Wheatley and Langi Chiang from Reuters' Treasury reporting team in Beijing, will be welcomed by anyone with an interest or a stake in China's financial sector.

Phil Smith
Editor
North Asia
Reuters

What is a trust company?

What might be a mundane question in any other part of the financial services sector is quite difficult to answer in the context of a trust company. They are variously referred to as trust banks, trust companies, trust & investment companies and trust fund managers. All of these titles are accurate in their own way since these uniquely Chinese financial institutions combine characteristics from the private equity, asset management and banking sectors. They should not be confused with how the term trust is applied in the West. Further complicating an easy definition of trust companies is the fact that they are ever-evolving entities. The economic and regulatory environment can precipitate significant changes in their profit drivers and business models in the space of a year. They are very opportunistic in nature and will roll out new services in response to a market change or need.

In the past three years, the trust sector has increasingly become a target of both foreign and domestic investors seeking to obtain a stake in China's rapidly growing financial services sector. This shift has been primarily brought about by regulatory changes instituted in January 2007 that sought to clarify the future development of trusts and set out standards to reduce uncertainty and high levels of risk in the sector. While it is still too early to define a clear vision of what the future holds, a few patterns are becoming clearer. Most notably, many trust companies are becoming a vital source of financing for many privately-owned companies in China that for various reasons are unable to secure bank, or other types, of financing. The greater flexibility that trust companies enjoy in coming up with customised products is also a key differentiator.

The trust sector is still small compared with other areas of the finance industry, with assets under management (AUM) totalling approximately RMB 1.58 trillion[1] as at the end of November 2009 and RMB 1.24 trillion at the end of 2008. This compares to AUM of RMB 2.68 trillion for the fund management sector at the end of 2009.[2] Proprietary assets at the end of 2008 for 50 trust companies surveyed totalled 109 billion RMB, representing a decrease from 2007.

History of China's trust sector

The origins of China's trust sector stretch back to October 1979 with the establishment of China International Trust & Investment Co. (CITIC). From these beginnings, the sector developed rapidly and by the end of 1992 there were 1,000 such entities.[3] Without the same level of regulatory constraint placed on other players in the financial sector, trust companies thrived and were widely utilised by government bodies to invest in earmarked projects as well as to channel capital into promising areas of the Chinese economy. However, their most common function was lending to construction subsidiaries in which the trust and investment company (TIC), as trust companies were known back then, would play the dual role of both the overseas and domestic partner.

1 *This is an approximate number based on preliminary trust product volumes and the final number will be available on the release of 2009 financial statements*
2 Fund AUM nears USD400bn, 5 January 2010, *Z-Ben Advisors*
3 China Hand, March 2006, *Economist Intelligence Unit*

While generating substantial profits when property markets were booming, the companies incurred significant losses when China's real estate markets ran into trouble in the late 1990s.

During this period the problems and debt stemming from trust operations dealt a serious blow to the sector. A number of notable bankruptcies shook the sector in the following years, beginning with Guangdong ITIC (GITIC) in 1998 and followed by Hainan ITIC (HITIC), which defaulted on USD 370 million worth of Samurai bonds owed to Sumitomo Bank and other Japanese creditors, causing considerable tension among foreign investors.[4] In 2000, the International Monetary Fund (IMF) estimated that the debt of Chinese trust and investment companies totalled between USD 12 billion and USD 20 billion.[5]

Reforming the TICs

The People's Bank of China (PBOC), the central bank, served as the regulator of the trust industry until 2003, but attempts at reform did not have the desired results and in 2000 the bank ordered all trust companies to stop their business and resubmit applications to be certified.

The following years saw the implementation of a number of new laws and regulations to increase risk management and supervision of the sector. In October 2001, the *Trust Law* was released and a year later, in light of still unacceptable levels of risk, the PBOC released the *Provisional Rules on Entrusted Funds Management of Trust and Investment Companies*. These two laws attempted to reform the sector by first improving regulatory oversight and establishing a framework for punishing companies operating outside of the law, as well as to dramatically limit the business scope of TICs. In particular, TICs were no longer allowed to borrow from abroad, guarantee minimum returns, or take deposits of any sort. Despite their dramatically reduced operating scope, TICs quickly rebounded and by the end of 2004 the sector had assets totalling RMB 278.4 billion (equivalent to just under 1 percent of total bank assets) and managed wealth of RMB 204.2 billion.[6]

This rapid growth, driven by promises of high returns, drew the concern of the regulatory authorities and culminated in the CBRC taking over supervisory and regulatory oversight of the trust sector in 2003 and launching investigations into several TICs in early 2004. Three scandals emerged, with the default by Jinxin Trust and Investment on one of its trust products causing the biggest stir.[7]

The CBRC, using its mandate to reform the trust sector, issued numerous guidelines after 2004, including one requiring TICs to issue annual reports on their financial performance. By January 2005, the number of players had dropped

4 Japan sees no progress in China HITIC settlement, 27 July 2001, *Reuters*
5 China finance — Beijing to clean up the trust and investment sector, 8 November 2000, *Economist Intelligence Unit*
6 Trust industry: how far is the way to be 4 [sic] pillar of China's finance?, 1 March 2005, *Xinhua Finance*
7 Trust Association in the Works, 14 September 2004, *China Business Weekly*

sharply. Following continued reforms, in 2007 the CBRC succinctly described its aims for the sector as the following:

"[the] objective of the new regulations is to motivate trust companies to evolve from being a financial platform into truly professional institutions entrusted to manage third party wealth, and encourage trust companies to reorganise and innovate business based on the needs of the market and actual operational situations, in order to aim for trust companies to develop into risk-controlled, legally compliant, innovative and competitive professional financial institutions within three to five years."[8]

Key regulatory changes

While the 2007 reform still stands as the key regulatory overhaul of the trust sector, the past two years have also seen a number of wide-reaching regulatory changes. The key thinking behind the restructuring in 2007 was to make the trust sector once again a major force in China's financial industry. The most important step in the reform of the sector occurred with legislation passed by the CBRC in 2007, entitled *Measures on Administration of Trust Companies and Measures on Administration of Collective Fund Trust Schemes of Trust Companies*. This went further than any previous regulations in opening and restructuring the trust sector. The most symbolic change made by the CBRC was the renaming of Trust and Investment Companies as simply trust companies to place greater emphasis on their trust role (after re-certification most trust companies have made this name change) rather than the proprietary investment side of their business. The thrust of the regulations was to help trust companies compete with their investment management peers by carving out a niche serving higher net worth individuals and institutional investors while increasing risk management and corporate governance. Under the new regulations, greater limits have been placed on who may invest in a trust product, particularly with respect to requirements for individuals.

The message to take out of this is that retail investors may no longer invest in trust products and trust companies are expected to reorient themselves to institutional investors and, to a lesser extent, high-net-worth-individuals (HNWIs). Tellingly, the number of individual investors in a trust plan is capped at 50. However, new CBRC regulations in 2009, *Management of Combined Trust Plans Methodology (revised)*, have sought to relax this restriction somewhat and now allow individual investors with investments equal to, or in excess of, RMB 3 million to be regarded as institutional investors and thus not count towards the cap of 50. This has in turn prompted trust companies to offer their more exclusive, high-return products to individual investors who invest more than RMB 3 million.

Criteria for investors in a trust fund

Qualified investors must now fall into one of the following categories:

- Individuals or organisations whose investment in a trust plan exceeds RMB 1 million
- Individuals or families who can prove their total financial assets exceed RMB 1 million during the subscription period
- Individuals whose proven annual income was in excess of RMB 200,000 during the three years prior to the investment, or together with their spouse had a combined income greater than RMB 300,000 during the same period.

[8] CBRC website

The new law also clearly states which related-party transactions are prohibited. In particular, trust companies are no longer permitted to offer funding to shareholders. In another stipulation, it is now easier for trust companies to establish branch offices in other provinces (following CBRC approval), giving them a greater opportunity to expand geographically. In addition, promotional activities by trust companies are now permitted within financial institutions, whereas before they were prohibited. A final change relates to risk management. Proprietary investments by trust companies are now limited to investments in financial institutions, financial products or a trust company's own trust fund products. In all cases, though, such investments must not exceed 20 percent of the total assets of the trust company in question. Investments into a trust company's own trust products are also limited to 20 percent of the total invested amount. Investments in other sectors must be approved by the CBRC. The restrictions go a long way to reducing conflicts of interest between a trust company's on-balance-sheet business and its trust business. Loans and credit can also only be inter-bank and they must be below 20 percent of net assets unless the CBRC grants special approval.

Recent regulations have sought to limit the relationship between banks and trust companies and have reduced the capacity of trust companies to invest in the capital markets. This will be discussed later in further detail.

Liquidated and decertified trusts

In March 2007, the CBRC granted trust companies a three-year period in which to achieve compliance with the new regulations and risk management guidelines in order to be recertified. With the March 2010 deadline quickly approaching, it would appear that the CBRC is remaining true to its word and many trust companies are scrambling to be restructured and recertified. The question of what will happen to some of the companies is still an open one, although many of them have already been acquired and restructured (see Table 1 on next page). However, it would not be surprising if some trust companies are still permitted to undergo restructuring after the March 2010 deadline, particularly those in the less developed regions of China, where they often play a key role in infrastructure development as well as being a key source of tax revenue for local governments.

Table 1 on the following page is not exhaustive and there are still a great many trust companies seeking to be restructured. In Sichuan alone, for example, Bohai Industrial Fund, a closed-end fund that counts among its investors China Postal Savings Bank, China Development Bank, China National Social Security Fund, Bank of China (International) and China Life Insurance Group, is seeking to invest in Sichuan Trust and Investment and Sichuan Construction Trust and Investment. The local government warmly welcomes its approach.[9]

9 Bohai Industrial Fund actively participating in reconstruction of Sichuan-based trust companies, 26 November 2009, *21st Century Business Herald*

Table 1: Trust companies undergoing restructuring

Trust company	Restructuring investor
COFCO Trust (Previously Islamic Trust)	COFCO
Sino-Australian International Trust Company (previously Kunming Trust)	Beijing Sanjili Energy Company Limited, Beijing Rongda Investment Limited & Macquarie
Kunlun Trust (previously Jingang Trust)	PetroChina
Aijian Trust	Shanghai International Group
Jiangnan Trust	China Aviation Industry Group and Oversea Chinese Banking Corporation
Huaxin Trust (previously Foshan Trust and Investment Company)	China Huadian Group
Jingu Trust	Cinda Asset Management Company
Sichuan Trust	Hongda Group
Jinxin Trust	Zhejiang International Trade Group
Huaneng Guicheng Trust (previously Qian Long trust)	China Huaneng Group

Source: Bridge Trust, Trust Sector Analysis report, 26 October 2009

Profitability

Overall the trust sector has seen dramatic profit growth since 2004, but there has been a significant drop in profit from 2007 to 2008. While 2009 figures were not available at the time of this publication, there are interesting trends that can be extrapolated from comparisons of the 2007 and 2008 financial statements of trust companies. Most notably, many suffered a large decline in profit due to equity-exposed products that fell sharply following the drop in the markets in late 2007. Only a small minority of trust companies, such as CITIC Trust, Beijing Trust, Zhong Rong International Trust, New China Trust and Suzhou Trust, experienced significant increases in profit from 2007 to 2008. However, it is notable that all of the 50 trust companies surveyed remained profitable, with one exception.

The factors behind this variance are complicated. Unlike with banks, where key profit drivers are largely the same across the sector as a whole, trust companies vary greatly in terms of business model and revenue sources. This is a key factor in understanding the nature of profit across the spectrum of trust companies. For example, some trust companies derive significant portions of their profit (up to 25 percent in some cases) from loans made using their own capital, while other trust companies have negligible or no lending operations whatsoever.[10] While

10 2008 Trust Company Annual Report Analysis, *Bridge Trust*

nearly every single company has losses associated with stock investments, those trust companies that had a more diversified business model and relied more on fee and commission income (as opposed to proprietary income) were able to cope much better and continue to increase profit. Clearly the impact on profit from proprietary investments on the domestic stock exchanges was negative for the majority of trust companies, albeit with a few notable exceptions such as CITIC Trust and Yunnan Trust. These both had significant stock investments in 2008 but nonetheless reaped high returns.

Despite the previously discussed limits set by the CBRC on trust companies' proprietary investments, in some instances these investments represented a large portion of their total revenue. Certain trust companies derived up to 94 percent of their total revenue from proprietary investments, while the proportion for others, such as Suzhou Trust, was only around 15 percent. The sector average was 49 percent for 2008 (compared with 78 percent in 2007), according to a survey by Bridge Trust of 51 trust companies. This drop is due to both losses related to the fall in the stock markets as well as the fact that, over the same period, fee and commission income grew by nearly 75 percent, far outpacing growth of proprietary investment income.

Also of note is the profit per person for the trust sector, which ranks among the highest in the financial services sector. For 2008, the average for 51 trust companies was RMB 2.54 million per person, although there were significant variances from one company to another.

Trust shareholders

The business model, capital base and strategies of various trust companies often depend on their key shareholders, which can play a role in dictating strategy and business focus. On this basis, trust companies can be broadly broken down into three types:

- State-owned trust companies controlled by national government enterprises and conglomerates. These trust companies tend to be larger in size and operate on a national scale.
- City government-controlled trust companies typically located in wealthier areas and most tend to have a regional focus.
- Trust companies with largely diversified shareholders comprising a mix of government, privately owned enterprises and smaller state-owned enterprises. These trusts tend to be more flexible and show no preference in terms of region of operation. They are also often smaller in size and tend to have an industry focus linked to their shareholders.

Please refer to Appendix 1 on page 36 for a full list of all shareholders in trust companies.

Morgan Stanley

Kai Yang, CEO
Hangzhou Trust

Morgan Stanley has been a player in the financial services sector in China for a long time and holds stakes in a wide variety of mainland financial institutions, including CICC and a fund management joint venture. Morgan Stanley Bank International is also one of the first locally incorporated foreign banks. In 2008, Morgan Stanley took this a step further and became one of the first of the batch of foreign investors to take a stake in a trust company, namely Hangzhou Trust. As part of the deal, they were given the right to appoint the CEO, Kai Yang, who helped to shed some light on the deal rationale and the benefits of their investment into this company.

"We see a great deal of strategic value, platform value and license value in trust companies," explains Kai Yang. "Globally, Morgan Stanley is very strong in wealth management and we view a trust company as the ideal platform to cater to high-net worth individuals here." A key feature of Morgan Stanley's strategy with Hangzhou Trust is the localized focus it has taken, which stands in contrast to the national approach adopted by many other trust companies in the market. "We are very clear on what we want to achieve here. Zhejiang province is home to perhaps one-third of China's wealthy individuals," says Kai Yang. "This ability to generate wealth makes Zhejiang an ideal place to develop a wealth management business focused on high net worth individuals and local enterprises by providing them alternative, customised investment opportunities. Moreover, when you are local, you can better manage risks, because you live in the community. Being local also gives us more scope to quickly address any problems that do arise."

Questioned about the importance of having a large distribution network, Kai Yang noted that for the type of business they are engaging in, it is far from being an important factor. "Every time we sell our trust products - every time - we get introduced to new potential clients. So we can build our client base every day of the week."

Kai Yang notes that it is vital not to marginalize the local management as they are critical to running a successful business. "We have a clear division of labour: the local team drives the business, while the management team oversees the strategy, the business definition and overall direction, as well as paying attention to building up an appropriate corporate and risk management culture. Having our own people in such senior management positions naturally gives us influence, but when we bought into this company, it was because we liked the management team – it would be crazy to sideline them, especially since it would take us years to develop the local expertise and connections they already have."

Kai Yang also acknowledges that trust companies could play a larger role in terms of financing SMEs. However, he notes with a smile, that SMEs do not constitute a sector. "We look for good companies. Full stop. If a small company is good, we support it. If a medium-sized company is good, we support it. The key thing holding us back though is the restriction on trust-invested companies listing. If this were removed, it would allow us to provide a lot more support to SMEs."

According to Kai Yang, the greatest risk for trust companies is their reputational risk. "At the end of day, if you define trusts as being in the asset management sector, they should have a limited proprietary business. Historically, a lot of problems have been caused by institutions basing their profitability on their own capital or on investing others' money in a highly irresponsible way for their own benefit." As a result, corporate governance is a key concern and Morgan Stanley has worked hard to nurture a culture of risk management while developing a strong internal compliance system. "Risk management is not completely or even primarily about skills or experience. It's about being a professional who is responsible for people's money. For us, even a minor breach would mean a collapse of this culture."

From a market point of view, an important way of mitigating risk is by focused only on areas where the trust can add true value. "We had a great deal of discussion 12 months ago about whether we should have an equity investment business. I asked one question: is our ability to pick stocks better than all the mutual funds? Nobody could give a satisfactory answer, so we gave it up. If we don't have a distinct capability to do something, we simply won't do it."

And herein lies another reason for Kai Yang's contention that the sector might benefit from having a more clearly defined role than at present.

"A trust company in China is ideally a combination of real estate funds, private equity business and alternative investments with private lending. There's a risk that the more the trust sector becomes merged with the banking sector, the less value the trust sector has. More clearly differentiating the trust sector from the banking sector can help develop a genuinely new channel for calculated risk taking and higher returns for clients."

Corporate Governance

Corporate governance in trust companies has dramatically improved in the last few years. The *Trust company governance guidelines* released by the CBRC shortly after the 2007 reform set out many of the corporate governance standards that trust companies must adhere to. Trust companies are required to set up corporate governance structures in line with their peers in the banking sector. This includes having a board of directors with some independent directors, audit committees, risk management committees and other features common to companies with high standards of corporate governance. A great deal of progress has been made in this respect. According to a study by the Renmin University Trust and Fund Research Institution, at the end of 2008 the majority of trust companies had independent directors on their boards and 28 had set up audit committees. Another seven had risk management committees in place. Growing oversight by the CBRC is no doubt a significant factor behind this trend as many trust companies are cognisant of the fact that better corporate governance is key to winning approval for new business as well as gaining a competitive advantage over their peers.

The CBRC has also implemented a ratings system to judge the performance of trust companies. Trust companies are rated on a scale of one to six, with six being the worst score and one being the best. These ratings are not publicly available and even the trust companies themselves aren't informed of what ratings their peers have received. According to discussions with trust companies though, the ratings are developed by performing on-site evaluations that focus on the corporate governance structures, risk controls, regulatory compliance, asset management capabilities and profitability of the trust company in question. Companies ranked one or two are subject to less regulatory oversight and they are encouraged to enter new markets and roll out new services. Companies ranked six have to undergo restructuring, while those ranked five must meet the CBRC on a quarterly basis, are subject to frequent site visits and are highly restricted in the services they can perform.

CITIC Trust

Pu Jian
President, CITIC Trust Co., Ltd.

Since the reform in 2002, CITIC Trust has earned a reputation as one of the leading trust companies in China and the pioneer of many of the new licenses that have been open to trust companies since 2007. A meeting with the president of CITIC Trust made clear why this company has maintained such a leading role in the industry.

While others may crave greater regulatory clarity, Pu Jian, President of CITIC Trust, believes that China's Trust Law provides ample scope. "The banking, insurance and securities laws are defined in such a way that they encourage homogeneity. The Trust Law though gives us much more flexibility. Since the law rarely sets specific limits on the scope of our operations, we have a lot of freedom to engage in an array of innovative and new services; essentially we can do whatever we can think of and whatever we are capable of. This allows us to synthesize various financial tools to provide highly customised solutions and generate value in a way that standardised products of banks, securities companies and insurance firms are unable to match."

Pu Jian believes that the success and business of a trust company is innovation. "We are focused on innovation every second of every day. If your product is duplicable, then competitive cost pressures reduce returns. Quite simply, the more innovative you are, the faster you will develop. This means we never say 'no' to our clients – our teams always have something to offer." In recent years, CITIC Trust has also pioneered products in the agricultural and creative sectors, as well as having set up private equity and securities funds. They have also engaged in the disposal of bad assets.

Such flexibility makes trust companies particularly opportunistic entities that are well placed to benefit in periods of uncertainty and market change. Even before the government's stimulus package, CITIC Trust was involved in helping companies facing the financial crisis. "The greater the uncertainty and imbalance there is in the market, the greater the opportunities for us. If a company successfully specializes in securitisation, they will face difficulties when the market shifts. Our diversity means that any change in policy generates new and unique demands."

This innovative approach also has positive implications for investment targets of trust companies as they can improve corporate governance. "Because we have thousands of stakeholders, any company we invest in acquires these influential stakeholders too. This is a great way to hold business leaders to account and drive corporate governance. We also use the strength of our culture to improve the acquired company by spreading our creative concepts. This breeds further success – you need look no further than Taikang Life Insurance, which following our strategic investment has enjoyed stellar growth."

With China now relatively cash-rich, Pu Jian sees CITIC Trust as somewhat similar to foreign private equity funds. "We started our QDII business two years ago, but we insist on handling investments ourselves rather than outsourcing to other firms. We're confident in the abilities of our coordinated teams to best manage these funds – and the market is confident too."

Commenting on the impact of having CITIC Group as the key shareholder, president Pu Jian plays this down, noting that CITIC Trust could not be successful without its independent management systems and anything limiting the innovative nature of their products. "We focus on driving client returns - we only work together with other CITIC group companies on an arm's length basis and only when all sides can benefit. This is not to say though that we don't benefit from the association with the highly regarded and recognized brand name of CITIC Group."

Questioned on foreign investment in trust companies, Pu Jian is very pragmatic and he does feel that there is an important role for foreign investors to play. "Foreign investment in trust firms is part of the authorities' desire for better risk management, which foreign investors are well positioned to deliver. As for ourselves though, we have no plans to introduce a foreign investor… that is, unless they can demonstrate that they can deliver something strategically unique which we don't possess." Pu Jian also notes that there is nothing regulatory that restricts trust companies from offering financing solutions to foreign companies in China.

CITIC Trust's impressive expansion has brought risks as well as rewards, but Vice President Daoyuan Wang is confident of continued success. "In 2007, our AUM increased from RMB 40 billion to RMB 190 billion, thanks to the expansion of our wealth management business, especially among high net worth individuals. This has brought challenges, but our approach has allowed us to deal with them effectively. We try to learn from the experiences of other sectors but we also bring a comprehensive range of financing alternatives and a matrix project control system to manage risks. Keep in mind as well that our services are largely tailor-made on a project by project basis. Thus risk isn't something we're afraid of or something we want to avoid. Rather it is something we simply want to manage. High risk, well-managed products also make for high-return products."

Trust fund products

Managing trust fund products is the mainstay of trust companies in terms of their fee and commission income. The nature of products under management can vary greatly from one company to another, and it doesn't help that there is no standardised classification for the industry. However, there have been efforts to categorise different types of products. These categorisations take two approaches: a breakdown by structure of the trust product and a breakdown by industry or type of investment target.

The first category of trust products breaks them down by the nature of their structure and investor profile into *single unit trusts*, *combined trusts*, and *property management trusts*. Single unit trusts are defined as having one investor while combined trusts have two or more investors.[11] While this may seem like a mundane difference, it is key to the nature of the service being offered.

Single unit trusts

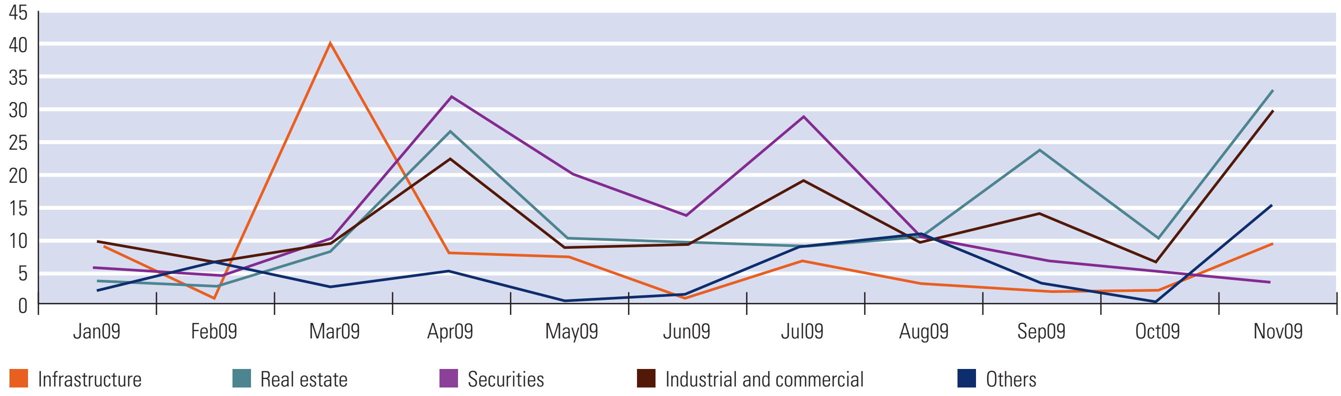
A single unit trust is typically one in which the client sets out its requirements and the trust company creates a product based on those criteria. This is a relatively low return product mainly driven by banking clients, which is explained further in the section on cooperation between trust companies and banks.

Combined trusts

Combined trusts are by and far self-developed products and financial solutions. Unlike single unit trusts, which are developed according to criteria set out by the client, a combined unit trust is developed by the trust company itself, which then seeks to promote it and draw in investors. Obviously there is a flight to quality, and competition can be fierce in this space. By the same token, fees are also significantly higher. These classifications do not differentiate according to the target or industry of the investment funds. Financial innovation in these products, compared with that of single unit trust products, tends to be much higher and the growth of these products over the past three years has been very high. A new CBRC regulation in January 2009 relaxed the ratio of loans permitted in a combined trust product from 30 percent to 50 percent.

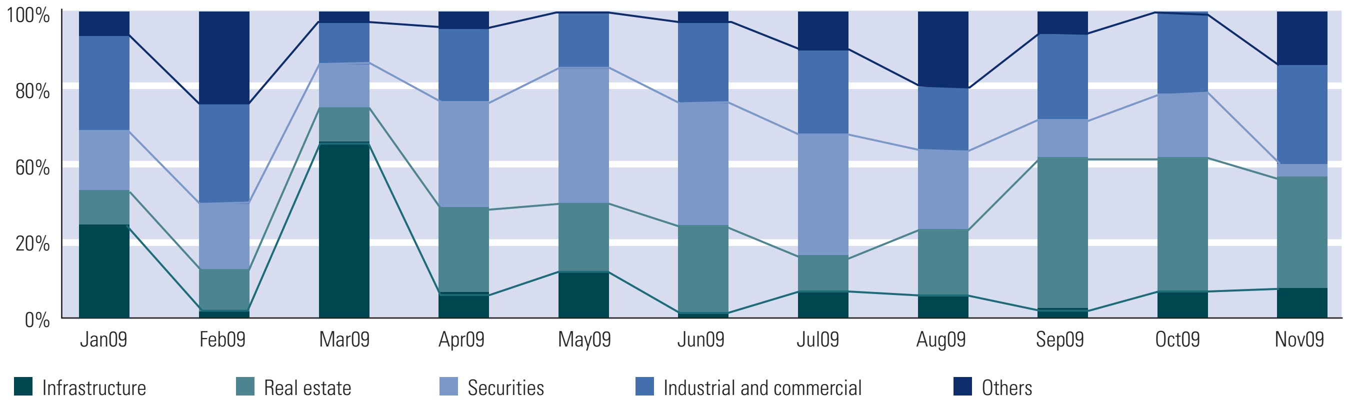
[11] Trust company QDII investment management guidelines, 12 March 2007, *CBRC*

Figure 1: Combined trust investments by industry for the first 11 months of 2009 (in 100 million RMB)



Source: Industrial Securities

Figure 2: Combined trust investments by industry for the first 11 months of 2009 (As a percentage of volume)



Source: Industrial Securities

Property management trusts

Property management trusts are a relatively smaller part of the market and represent the management of non-monetary assets on behalf of clients. This could include any number of assets, such as physical assets, intangible assets or stocks and bonds. Various structures and methods could then be used to drive revenue, such as assets purchased under a resale agreement, asset backed securities (ABS), improving the management efficiency of a property (for example, the charging rights for a toll road), or holding stocks for a client and then selling them at an agreed-upon price to earn a higher return. This form of trust product rarely accounts for a majority of trust assets under management, with one exception being Gansu Trust.

China Credit Trust

Dr. Wang Yuguo
Senior Analyst, China Credit Trust Company

China Credit Trust stands out as one of the more unique trust companies for the size of its property management trust business and also because it is a pioneer in many of the new lines of business that trust companies have been permitted to perform after the 2007 reform, such as securitisation and enterprise annuity plans. In October 2008, the Ministry of Finance transferred its 32.35 percent stake in China Credit Trust to People's Insurance Company of China (PICC), which is now the largest shareholder, followed by Guohua Energy Investment Co., Ltd.

Securitisation in particular has been a strong area of growth for them. "We lead the industry in terms of credit asset-backed securitisation," explains Wang Yuguo, Senior Analyst at China Credit Trust. "Our first project was China Development Bank's Kai Yuan Issue. In 2008 we closed four deals, accounting for half of all securitisations at the time. The largest one was ICBC's securitisation program, which alone was over RMB 8 billion." However, Dr. Wang also adds that "securitisation is still quite a low profit margin business for trust companies and is subject to high levels of regulation. For 2009, the central bank did not approve any new securitisations projects."

A significant portion of China Credit Trust's total income stems from proprietary income. Dr. Wang explained that this primarily stems from equity investments in certain very large financial institutions, such as Harvest Fund Management and Guodu Securities in 2008. In terms of other investments, Wang Yu Guo notes, "we are cautious about making securities investments. We prefer to focus on low risk lending with stable income."

China Credit Trust places a great deal of emphasis on ensuring high levels of risk management, but Dr. Wang points out that this is not always consistent throughout the trust sector. Many of the infrastructure investments take place between trust companies and local governments and there is concern in the market about the solvency and implicit debt of some local governments. Commenting on China Credit Trust's role in these products, Dr. Wang says, "we have kept a tight rein on it, restricting our business to cooperation with financially sound local governments or those with which we have a long-term investment relationship with."

China Credit Trust is a significant investor in real estate property though, which some analysts regard as risky going into 2010. Asked for his thoughts on this, Dr. Wang notes "the regulation in the property sector is continuing, and the market performance for 2010 is uncertain. This is obviously a risk we bear in mind and we have adjusted our investment practice from a single investment approach to mixed investments in the form of both debt and equity. Our trust schemes now invest in a number of projects to diversify risk."

For the second category of trust products, there is a relatively consistent grouping in terms of classification types by industry (see Table 2). But, these classifications are not set in stone and significant differences in interpretation arise from company to company. For example, some trust companies group mining sector investments as Industrial and Commercial, while others put them under Others. The financial statements of trust companies also rarely offer any sort of explanation as to the nature of these groupings. Even more confounding is that some trust companies categorise over 90 percent of their investments under Others, with no further explanation given.

Table 2: Classification of trust products by industry

Industrial and commercial funds	Covers trust funds with industrial and commercial enterprise investments
Infrastructure funds	Generally focused on city infrastructure investments in sectors such as water treatment plants, power plants and public transportation, but also covers public services, environmental protection, research and development, tourist facilities and education
Real estate	Covers investments in commercial and retail real estate
Financial	Generally refers to capital market investments
Others	Perhaps the least defined and the most open to manipulation of all the categories, Others covers the widest range of investments, including those in the mining sector, health care and all other areas

Source: Trust Company Rating Report, Soderberg & Partners, 2 April 2009

Infrastructure trusts

Infrastructure still represents one of the largest investment areas for trusts, which, given the historical role of trust companies in this field, is not particularly surprising. In light of the government's RMB 4 trillion stimulus package launched in November 2008, this growth has accelerated greatly and 2009 saw record growth in trust infrastructure investments. Comparing the volume of infrastructure investment of combined trust products for the first eleven months of 2009 with the same period of 2008, growth was roughly 148 percent.[12] The majority of trust infrastructure investments are focused on city infrastructure, particularly second-tier and third-tier cities, which in some cases is due to the inability of infrastructure enterprises in those cities to secure other forms of financing.

While the government has identified trust companies as vital players in the development of infrastructure in China, there are concerns about the risk profile of some of these funds. The Ministry of Finance is particularly concerned about the risks associated with trust fund products supported by local (particularly municipal) government guarantees. In 2009, the ministry released a circular, *Notice on the prevention of public project financing with illegal government guarantees*, strongly re-emphasising that such products are strictly forbidden.[13]

12 Use Trust Studio, www.use-trust.com
13 Ministry of Finance website

Financial trusts

Financial investments, primarily investments in stocks and, to a lesser extent, bonds, led to significant losses in 2008. However, there has been renewed interest in equity trust products with the recovery of the markets. The growth of equity products in first three quarters of 2009 is testament to this fact. But the last quarter of the year saw a pronounced decrease in equity investments, which was largely due to what was initially an informal, temporary ban by the China Securities Regulatory Commission (CSRC) in July 2009 on the opening of new stock trading accounts by trust companies. This has now been formalised by the CBRC and allows trust companies to open new trading accounts only if they have closed an existing account.[14] It is not clear when, or even if, this limit will be removed.

Real Estate trusts

As with the pick-up in equities, the real estate property markets in China in 2009 also enjoyed a stellar year. The government took various steps to prevent a property bubble from emerging and implemented measures to cool banks' real estate lending, but no such limits were placed on trust companies. The local Shanghai CBRC specifically singled out real estate investments in Shanghai by trust companies as an area where greater risk management should be exercised.[15] These products differ from real estate investment trusts (REITS) as the trust product invests in the actual physical assets of the real estate properties and takes ownership of them — unlike REITs, which simply purchases the beneficial rights to a real estate property (i.e. the stream of mortgage or rental payments).

Real Estate Investment Trusts (REITs)

Listed REITs have yet to gain significant traction in the mainland market, but many trusts are already engaging in unlisted REITs while others are excitedly preparing for new regulations to fully introduce REITs in China, particularly ones that can list on the domestic exchanges. This appears to be more a question of when rather than if, as very high level support for REITs is growing quickly. On 31 December 2009 the State Council released a notice to promote the development of Hainan, *Notice on the development of Hainan as an international tourist island*, which specifically ear-marked REITs as a method to develop the real estate market there.[16]

Nonetheless, the obstacles facing the development of a REITs market in China are considerable. In particular, there are no specific laws on the taxation of revenue from REITs. The question of how such regulations could be rolled out

REITs are collective investment schemes (normally in the form of a unit trust) that aim to deliver a source of recurring income from a portfolio of real estate such as shopping malls, industrial and office buildings, hotels and service apartments. REITs are becoming popular vehicles both for fund raising as well as providing investment opportunities in Hong Kong SAR, China and overseas property markets.

REITs are attractive to investors as rental income is relatively stable. In contrast to direct real estate investments, REITs provide investors with portfolio diversification and professional management and exposure to overseas markets including China.

14 关于信托公司信托产品专用证券账户有关事项风险提示的通知, 28 August 2009, *Trust Laws Web (www.trustlaws.net)*
15 Real Estate Trust Risk Potentials, 1 December 2009, *Shanghai Financial News*
16 State Council website

uniformly is also a difficult one since the tax bureaus of individual provinces and cities often interpret tax rulings differently. Likewise, the very nature of property rights and property rights registration in China make any transfer of beneficial rights out of a real estate property very complex — as opposed to buying a property straight out. It must also be kept in mind that China published its property laws only a short time ago, so in many ways they are still a work in progress.

However, listed REITs invested in mainland real estate are already a fact of life, although the listings have all taken place on overseas exchanges. A good example is that of a REIT product from CITIC Trust. In 2007, CITIC Trust partnered with Capitaland of Singapore to roll out a REIT investing in domestic business parks. A company was set up (CITIC Capitaland Management Consulting Company) specifically to manage the fund, and the REIT later went on to list on the Singapore stock exchange. It was a remarkably resilient and profitable fund that provided satisfactory returns even during the height of the financial crisis. However, the role of a trust company in a domestically listed REIT is far from clear as there has been no regulatory clarification on this topic. Likewise, there needs to be greater clarity on the range of real estate assets that could be included in a REIT. For example, certain countries do not allow investments in hotels and recreation parks to be packaged into REITs.

The benefits of REITs in this market are clear. They allow greater participation by more investors in the real estate market since they provide easier access to property investments. Traditionally real estate investments require significant capital commitments and would not be readily accessible to smaller investors. As a result, REITs permit an increase in the investor base while allowing investors to obtain the benefits of property ownership. REITs are also highly liquid as they are listed marketable investments, notwithstanding the illiquid nature of the underlying real estate assets. Another issue to be addressed before REITs can be rolled out is which regulator should be in charge of them. Clearly both the CSRC and the CBRC have competing claims.

Figure 3: The path to REIT listing

Key issues to consider

	Key issues to consider
Identifying the portfolio	• Asset valuation • Financial analysis on future income stream projection • Financial, legal and tax due diligence
Structuring the portfolio from acquisition, holding and exit	• Operating and running costs' assessment of each structure • Cash flow assessment • Income support arrangements • Repatriation of income • Tax planning to minimise tax leakage
Preparing the portfolio for REITs	• Controlling interest in REITs • Tax efficient management fee structure • Financial modelling and determination of optimal financing structure • Fair value assessment
Submitting the listing application and obtaining regulatory approval	• Determining time and place of listing • Preparation of the listing documents • Resolving comments raised by the regulators • Accountants report, comfort letters
Roadshow	• Investors' relations • Yield forecasts • Future funding • Post-listing strategy
Listing	• Compliance with the Code, Listing Rules and trust deed • Risk management and operational control • Corporate governance • Ongoing audit and tax compliance • Subsequent acquisitions

Innovation

Many of the financial innovations that make their way onto the market in China have their origins in trust companies. Each year, new and highly creative products are released. This can in some instances lead to a cyclical situation all too familiar to regulators in the U.S., whereby a trust company introduces an innovative service or product, which is later restricted or forbidden by the regulators. They then move on to something else, only to repeat the cycle all over again. An example is trust loans to enterprises to help them meet the minimum capital threshold for bank loans — a practice the CBRC prohibited in 2009.

Innovation in trust companies can take many forms, ranging from arbitrage trust funds to highly structured financing solutions to portfolio products invested in wine or art. While these innovations can take place across all trust product types, it is mainly in the combined unit trusts where creativity is the greatest. Trust companies are also very pragmatic when it comes to understanding where their strengths lay — and where they need help. For example, in a real estate investment project, CITIC Trust engaged the services of various law firms, financial advisors, and the global real estate consultancy DTZ.[17] With their greater level of flexibility, trusts are increasingly expanding their business scope and entering other areas of the market. A number of trust companies have begun to actively manage their own pure equity funds, putting them into direct competition with the retail fund management sector. Mezzanine financing, REITs structures and products with different investor tranches are all being rolled out by trust companies. Ping An Trust even came up with a *trust of trusts* product in 2009.[18]

The specialised services offered by trusts also necessitate a need for higher-educated and more financially savvy, creative staff, which in turn has led to significant wage inflation. A study conducted by Renmin University Trust and Fund Research Institution of 47 trust companies showed that 27 percent of employees at trust companies had a post-graduate education in 2008, which is an unusually high figure for the financial services sector. While the majority of trust companies do not disclose staff salary figures, certain high level information can be extrapolated from the four trust companies that do release such information (Sha'anxi Trust, Northern International Trust, Suzhou Trust and Tianjin Trust). For 2008, the average annual salary per employee for these companies (including bonus and benefits) was RMB 376,000, up from RMB 219,000 in 2007. Again, this is a relatively high number compared with their peers in other areas of the financial services sector.

17 中信天泰不动产投资信托基金集合资金信托计划, 7 August 2009, *Land 163 (www.land163.com)*
18 China Trust Wealth Management Net, www.trust518.com

Macquarie

Andrew Low
Board Member, Sino-Australian International Trust Co. (SATC)

Macquarie partnered with two highly influential local partners to acquire Kunming International Trust, which had been suspended from operating. The new joint venture is headquartered in Shanghai and has received all the necessary approvals. The company will initially focus on helping raise financing for companies and local government, while providing RMB investment products to high net worth and institutional investors. The joint venture will have an initial capital base of RMB 300 million.

"We had to go through a long process of firstly acquiring the company, renewing the operating license and then moving the company to Shanghai, but we think there will be significant benefits over the medium to long term," said Andrew Low, Board Director of SATC and Head of Macquarie Capital for Asia. Moving the company to Shanghai also had its advantages resulting from the formal announcement that Shanghai is to become China's international finance centre by 2020.

Macquarie's partners in the venture are Beijing Sanjili Energy Company Limited (Sanjili) and Beijing Rongda Investment Limited (Rongda), which are both controlled by several state owned companies including the State Development and Investment Company (SDIC), one of China's largest investment holding companies. Interestingly, neither of these two companies are financial institutions but nor are they passive partners in the joint venture.

Reflecting on the challenges that some joint ventures face in China, Low believes these can be avoided if you choose the right partner. "In a way it's the best of both worlds for us," adds Low. "Macquarie brings structuring skills, corporate finance skills, asset management skills, and risk management skills – effectively best-of-breed international financial experience – to the market. You have to operate in the local space with local partners though. Our partners have the local relationships and the ability to identify opportunities as we go forward and widen the scope of our business. They are very sensible, commercial people who, on matters of financial services, are very much profit-focused and open-minded."

Macquarie is and was very actively involved with establishing the risk management framework at SATC, including structuring the various committees, models and procedures – a key element in an industry where effective risk management plays an important role.

Commenting on how the trust platform fits with the overall strategy of Macquarie in China, Low points out that a trust platform complements Macquarie's existing operations very well, particularly the group's investment banking business. "The ability to provide clients with RMB solutions is very powerful when combined with the structuring expertise we bring to situations globally."

And in the future, "when you've got credibility as a fund manager your scale goes up in terms of assets under management," said Low. He sees over time Macquarie "wants to be able to do more sophisticated PE-style trust plans and possibly get involved in REITs," and move beyond solely creating products for high net-worth individuals. "The Holy Grail for trust companies is complementary to the tradition of creating products for HNWIs. It's having the credibility within the local financial services system and the management infrastructure in place to encourage institutional investors to put money into trust products. The minute you can tap into insurance money, corporate pension money and the SOE money, then you've got the credibility as an asset and fund manager and your scale goes up." Low expects a three to five year time lag before this trend really begins to come into effect.

Commenting on the future of the trust sector, Low believes that there will be more innovation in the financial services sector in China and trust companies are the ideal channel for that innovation to emerge given their relatively small size and existing hybrid licenses. He adds; "If you want to be successful, you're going to have to build distribution and create innovative products."

Cooperation between banks and trust companies

As with the fund management sector and the banking sector, the relationship between banks and trust companies is very close. Many trust companies are highly reliant on their banking partners as a source of both income and single unit products. However, the nature of the ties can be quite complicated and can vary from company to company.

A key driver behind this relationship is the increasing sophistication of Chinese investors as banks seek to boost their wealth management operations and competitiveness by distributing higher return trust products. They are also engaging trust companies to structure more complicated financial products. However, wealth management is the main impetus. The numbers speak for themselves. Some banks experienced a tenfold increase in the number of trust products distributed from 2007 to 2009. Of more than 60 banks surveyed, there was a five-fold increase overall in the number of trust products distributed through banks over that period, from roughly 630 in 2007 to 3520 in the first eleven months of 2009.[19] However, high fees charged by banks and fierce competition among trust companies have meant that profit margins for this line of business have been quite low for trust companies.[20]

There has also been a great deal of speculation in the media as to the real nature of these wealth management products. Various news reports have suggested that banks' real purpose in creating these wealth management products is to take loans off the balance sheet to overcome lending quotas.

The numbers quoted in the news media reflect the total volume of wealth management products packaged from bank loans. However, it must be kept in mind that the banks themselves are under intense pressure to improve their competitiveness, particularly by offering higher interest rate products for large depositors. The demand deposit rate in China is very low and offers a strong disincentive to deposit large sums of money in a bank account. Hence, to retain clients and deposits, banks need the capability to offer higher-rate products. Packaging their own high-quality loans into a wealth management product is a means to that end, while also conferring the benefit of first-hand knowledge of the risk profile of the loans. Thus, creating wealth management products based on a bank's own loans may very well take those loans off the balance sheet, but this does not mean that the bank is doing anything other than responding to market demand.

Another product originated through trust and bank cooperation is bank-originated trust loans. Here, the bank identifies a borrower and structures a loan, which is then packaged by the trust company into a wealth management product that is sold to bank clients. However, the bank still retains a role in the management

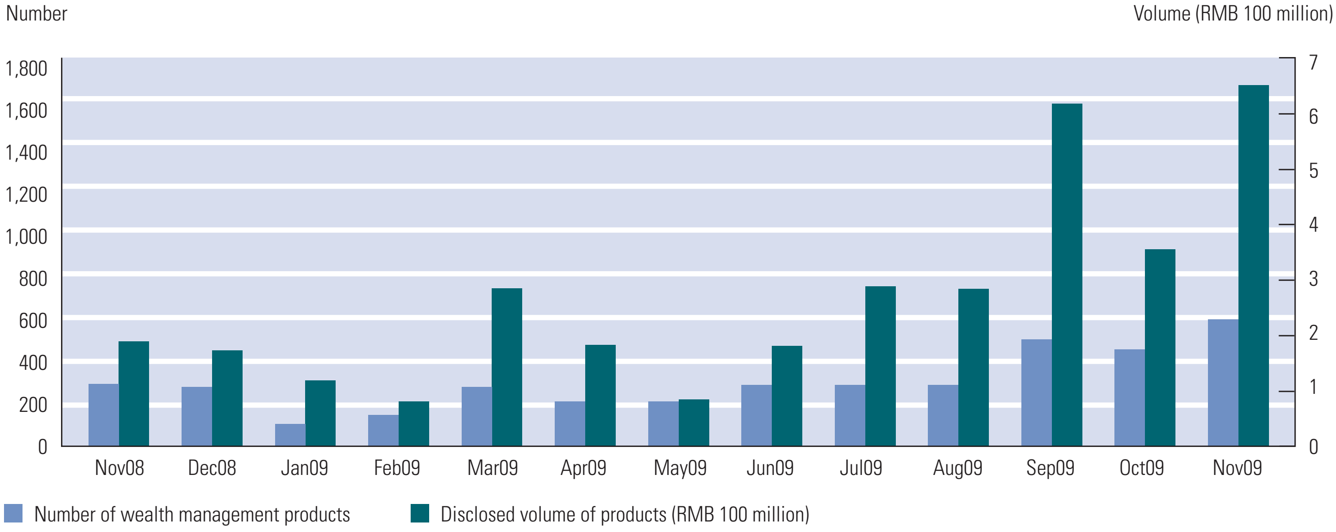
19 Use Trust Studio; *www.use-trust.com*
20 Bank and trust company cooperation guidelines, 4 December 2008, *CBRC*

and servicing of the loan. Such products are not without problems, though, as in many cases there is not a clear transfer of credit risk, leaving the banks with too much residual risk. Such a structure also poses a significant reputational risk to the bank should such a product suffer losses as it would appear as though the bank was offloading bad loans to its customers. The CBRC recognised these risks and on 14 December 2009 implemented regulations that have in effect brought this business to an end in its current form.

The key effect of the new regulations will be to change the way in which banks' wealth management products can be originated and distributed. They will also introduce a greater transparency to how effectively risk is transferred. This will dramatically change both the way wealth management products are developed and the role of the various participants. This will likely lead to an increase in combined trust products, but these regulations will by no means bring an end to the packaging of loans into wealth management products. Rather, the process will have to become fully independent of the bank, with the issuing bank no longer playing any role in the management of these loans nor distributing its own loan-based wealth management products to its own customers.

For the trust sector, these new regulations will have a negative impact on a large number of trust companies that have relied to a great extent on the fee income from such products. Despite wafer thin profit margins, the sheer volume of this line of business has made it a key revenue driver for many trust companies. However, the long-term effect should largely be positive as the trust companies will play a more active role in the management of these products. They will also be forced to compete more on product quality rather than on price, which should ultimately drive fees higher.

Figure 4: Number and volume of wealth management products between banks and trust companies



Source: Xinan Caida Trust and Wealth Management Research Institute

RBS

Charles Li
Head of RBS China

RBS was one of the earlier foreign entrants in to the trust sector in China and completed its investment of 20 percent into Suzhou Trust in mid 2008. They applied a tried and tested strategy to find a trust company that could complement their existing wholesale banking model and overall China strategy. The flexibility of the trust structure – and RBS's targeted approach – allows for a greater range of options in packaging products and in creating the ideal financing solutions for its clients. "It offers more choices to our customers both in terms of financing and investment solutions," says Charles Li, head of RBS China. "For foreign banks in China, having a trust company as a partner means we can expand the scope of our services to our customers, boosting our commitment in what is an increasingly important market."

Suzhou Trust is around 70 percent owned by Suzhou International Development Group (SIDG) and the other 10 percent of shares is owned by Legend Holding. "We are lucky that our co-investors in the joint ventures share the same vision of developing Suzhou Trust into a domestic industry leader offering world-class products and services. We found the experience of working with SIDG and Legend particularly satisfying and want to deepen the cooperation by contributing more to the development of Suzhou Trust and China's financial industry as a whole," commented Li.

While many foreign banks see the question of management control as their main issue, this has not been the case for RBS. Charles attributes this to RBS's careful partner selection, "The quality of the management team at Suzhou Trust was key. The company itself is also a great fit. For example, RBS has considerable experience and expertise in real estate and infrastructure financing, while our partner, Suzhou Trust, has extensive experience in infrastructure and real estate development-related trust plans. This level of synergy and cooperation means we can advise and promote shared ideas without the need to insist on management control."

For Charles, one instance in particular stands out the most in terms of highlighting the complementary nature of a trust company to an existing financial services platform. An energy company in Xinjiang turned to RBS to help meet financing requirements for a project. Realizing a bank solution was not ideal, RBS referred the client to their leasing subsidiary which created a leasing receivable. "We then leveraged Suzhou trust to work with RBS Leasing to structure the deal and package this into a trust plan. To add a final layer of credit enhancement, Sinosure was introduced into the equation to add a credit guarantee to the product. This resulted in the client getting a competitively priced, off-balance sheet financial solution customised every step of the way. We couldn't have done this on our own."

RBS is also positive about the role of Suzhou Trust in enhancing RBS' ability to provide wealth management products and solutions in China. Working together with Suzhou Trust they can create highly tailored products to meet the needs of high net worth individual clients in China. The ability of a trust company to customise a product makes them an excellent vehicle for wealth management.

Suzhou Trust remains an independent company, but RBS's experience and knowledge have played an important role in creating a new risk culture to face the changing financial climate. "Regulators across the globe have become more sensitive in the last two years, and China is no exception. Risk is at the top of all shareholders' priority lists. We've brought our experience to the joint venture, and played a key role in recruiting the chief risk officer. Our input remains purely from a shareholder's perspective though – ensuring the company has an independent and effective risk management framework. It's in all of our interests to develop and protect this and this is recognised by both parties. I think it's telling that the regulator has been very positive about the progress Suzhou Trust has made."

Recent developments, including the new trust law, have solidified the industry's place within the overall financial industry framework, but Charles cautions that these are still early days. The supervisory framework is much improved, and definitions on the types of customers the trust industry should be focused on are much clearer now but there are still pockets of uncertainty.

While he notes the lack of explicit regulatory obstacles to the sector's growth, Charles looks forward to when the current phase of understandably high risk aversion may pass. "One of the major attractions of the trust industry is that it is so flexible. So, while the regulator should absolutely adopt a capital risk-weighted basis in managing the sector, at the same time it should allow trust companies to use this flexibility to help develop and nurture financial innovation in China."

Opportunities for trust companies

Trust IPOs?

The listing of trust companies, or rather the lack thereof, has been a notable feature of the sector. In comparison to other areas of the financial services sector, particularly insurance and banking, there have been remarkably few IPOs of trust companies. The last one occurred in 1994. Only two trust companies, Anxin Trust and Sha'anxi Trust, are listed.

This should not be interpreted as a blanket ban on the listings of trust companies. The regulators are no doubt aware of the very positive impact of stock exchange listings on the banking sector. However, the listing of financial institutions in China has always been met with a healthy dose of caution. While the first listing of a Chinese bank was in 1991, it was not until 2005 when a significant number of bank IPOs occurred. Trust companies may follow a similar path. A number of trust companies have applied for approval for an IPO while others are seeking a backdoor listing.[21]

However, when considering the possibility of a listing, it is important to keep in mind that the very nature of trust companies would likely lead to them being labelled with an inherently higher risk profile. For instance, the level of proprietary investment by many trust companies would probably pose a stumbling block to their listing plans. Another issue is the risks associated with transparency as to how the proceeds from an IPO would be used — particularly whether they would fund proprietary investments. Thus, new regulations may have to come into effect to make trust IPOs a reality.

21 Second investor to pay dividends through the restructuring of ST Jade Resources, 24 December 2009, *21st Century Business Herald*

Small and Medium Sized Enterprise (SME) Finance

SME finance has been a thorny issue in China for quite some time. Despite an easing up of restrictions on bank lending, SMEs are largely underserved by the banks. The importance of SMEs — defined as entities with annual revenues of less than USD 250 million — to the Chinese economy is undisputed; they contribute nearly 60 percent of GDP, 50 percent of tax revenues and over 70 percent of China's employment.[22] Their ability to secure finance, however, continues to be a challenge, exacerbated by the difficulties suffered by exporters in eastern and southern China in 2008 and 2009. Banks have come under the greatest pressure to ease the lending bottleneck to SMEs, although the CBRC has also encouraged trust companies to do more.

However, the inherent nature of bank lending in China makes it difficult for SMEs to secure bank financing. First and foremost, for historical reasons banks are partial to loans secured by real estate. However, many SMEs lack firm land use rights or have insufficient property or real estate to put up as collateral. This is especially the case for SMEs in rural areas as they are located on land that was previously farmed and is thus collectively owned, meaning it can not be used as collateral. Lastly, banks in China are quite conservative and are averse to making high-risk loans, particularly given limits on pricing to take account of risk. Some banks have made serious efforts to embrace SME lending and are gradually introducing SME credit rating models. Nonetheless, many SMEs are still left facing financing difficulties.

To some extent, SMEs themselves also bear responsibility for the difficulties they face in securing bank financing. There are issues with the quality of financial information provided by SMEs. Many lack a credit record. However, trust companies are perhaps in a stronger position to work around these difficulties and help meet the shortfall in SME financing since they are better able to price for risk and assess hard-to-value assets such as machinery and intangibles. Moreover, they do not fear taking risks as long as they can manage those risks. Most importantly, though, trusts can provide customised financial solutions rather than a simple loan package to an SME. This financing could come in a variety of forms from pure or modified debt to a combination of equity and debt or a debt-to-equity swap. While the financing solutions provided by trust companies are almost certainly not going to be as cheap as bank loans, the SMEs in the end may find themselves better served by the customised nature of trust offerings.

While trust companies are unlikely to be the key lender for SMEs in the future, their role in financing SMEs is growing rapidly with the explicit encouragement of the CBRC. According to a number of trust companies, they perceive the biggest impediment to financing SMEs to be the implicit restriction on the listing of trust-

22 Chinese SMEs warned of hard times ahead, October 28, 2008, *Xinhua*

invested companies on domestic or foreign stock exchanges. Normal practice has been for trust companies to exit their investments prior to the IPO. However, this creates a very strong disincentive to make private equity-style investments since China's private equity market is still largely driven by IPO exits. Unlike markets such as in the US and Europe, other exit avenues are very limited here. The reasoning behind this is not entirely clear, but it could be related to the lack of transparency of investors in a trust fund product — which would in turn be an issue when it comes to disclosing the shareholders in a listed company's financial statements. Clearly, though, the SME financing capabilities of trust companies and the number of SMEs financed by trust companies would be much higher were this restriction relaxed. Moreover, equity financing tends to be a more effective driver of corporate governance in investment targets than debt financing.

The launch of the GEM Board last year in Shenzhen, which specifically targets the listing of SMEs, may offer a significant boost to both the SMEs themselves and to the PE business of trust companies as the criteria for IPO listings are less onerous than on the major exchanges.

Additional business lines for trust companies

Table 3: Specific capital requirements for different business licenses

Type of Business	Minimum Registered Capital (RMB)	Minimum Net Asset (RMB)
Standard	300 million	300 million
Insurance Infrastructure Funds	1.2 billion	1.2 billion*
Special Purpose Trusts/Securitisation	500 million	500 million
Enterprise Annuity Plans (EAP)	1 billion	1 billion
QDII	1 billion	Not less than registered capital post loss provisions

* in addition to having minimum net assets of RMB 1.2 billion at the time of applications, minimum net assets must not have gone below RMB 500 million for the preceding three years

Insurance infrastructure funds

In light of a desire to promote investment diversification, the China Insurance Regulatory Commission (CIRC) released a regulation in 2006 permitting insurance companies to invest premiums in infrastructure-invested trust products. This was a significant opening up of the investment channels for insurance companies, which, considering their excessive exposure to equity investments in 2007 and 2008, is no doubt a positive development for the sector. The relatively strict criteria and minimum capital thresholds required for approval to engage in such a business line would seem to indicate that there are sensitivities in opening trust infrastructure products to insurance investment. Other financial institutions, such as the asset management subsidiaries of insurance companies and certain industrial funds, can also be approved to direct insurance investment into infrastructure funds. However, given the history of infrastructure investments by trust companies, they are clearly well placed to be a primary beneficiary of such an opening up. On the other side of the equation, only the major national insurance companies have been approved to make these kinds of investments.

The first trust company to engage in this line of business was Ping An Trust, which developed an infrastructure fund focused on highway development in Shanxi. However, this is likely to become a major driver of revenue only for a select few trust companies given the restricted scope, participation of other competitors, and the high approval criteria. New regulations in October 2009 also permit insurance funds to be invested in real estate funds.

Security underwriting

Trust companies can also engage in a wide range of financial services, including the underwriting and distributing of bonds. Theoretically they could also underwrite stock offerings, but it is highly unlikely that the CSRC would give its approval since the stock market is already more than sufficiently served by securities companies. Certain areas of the bond market are open to trust companies, although to date their penetration has been quite limited. The areas are:

- Enterprise bonds: Bonds normally issued by state-owned, non-financial institutions that are under the regulatory oversight of the National Development and Reform Commission. There has been a fair amount of participation in this market by trust companies, although only in a distribution capacity, not as underwriters.
- Government bonds: As non-deposit-taking institutions, trust companies may seek approval to underwrite and distribute book-entry government bonds under a B-type license, although no trust companies are on the 2009-2011 approved list for bond issuance. Any company that applies needs registered capital of at least RMB 800 million.

- Financial bonds, medium-term bonds and commercial paper are issued and traded in the inter-bank market and regulated by the PBOC: For a trust company to be considered as an underwriter or distributor, it must be a member of the inter-bank market, of which a number of trust companies are.
- Asset-backed and mortgage-backed securities: These are largely the domain of commercial banks, although there is nothing explicit to prevent trusts from underwriting such products.

Enterprise Annuity Plans (EAPs)

Trust companies can hold two of the four licenses – for asset managers, trustees, custodians and administrators – related to the management of Enterprise Annuity Plans. As of 1 January 2009, only a small number of trust companies have received the go ahead to act as trustees for EAPs (including CITIC Trust, Fortune Trust, SDIC Trust, and China Credit Trust). Fortune Trust and CITIC Trust have also obtained approval to administer EAPs. Application criteria are particularly onerous for EAP licenses. In addition to high capital and net asset requirements, trust companies must have a clean track record over the preceding three years and have put in place a stringent risk management system.

The EAP market is beset by significant uncertainty and fierce competition. Initially trust companies and specialised pension services companies were the only entities permitted to act as trustees; however, in 2008 approved commercial banks also got the go ahead, which has dramatically affected the competitive landscape. Certain trust companies have exited this line of business since they cannot compete with the branch networks of banks (which can better serve the needs of a client with a nationwide presence) or the fees being charged by banks. In some cases these are zero as the end game of the banks is to secure as many mandates as possible for a single EAP.

Securitisation

Securitisation has been both a boon and a bane to the financial services sector in the rest of the world. While China has tentatively embraced securitisation and understands the benefits it can bring, the recent financial crisis has clearly made regulators hesitate about promoting it more widely. This is not to say there will be a ban on securitisation, but it will surely be rolled out more slowly than anticipated. Likewise, some securitisations, particularly those of non-performing housing loans, are strictly prohibited.[23] The most likely outcome is that securitisation will come about when the market needs it. To date over ten

23 2008 CBRC Annual Report

trust companies have obtained the license to act as a trustee for these special purpose trusts, including China Credit Trust, Yingda International Trust, Zhongtie Trust, China Foreign Trade Trust and Investment, Zhonghai Trust, Shanghai International Trust, Zhongyuan Trust, Fortune Trust, CITIC Trust and Ping An Trust.

New regulations released in early 2008 by the CBRC, *Notice on Further Strengthening the Management of Credit Assets Securitisation*, set out guidelines for the development of the market. In particular, they emphasised that only assets of high quality should be securitised and the requirement for full disclosure of the level of diversification as well as all related operational, credit and default risks. They also reiterated the need for robust internal risk management systems and encouraged trust companies to employ intermediaries, such as accounting firms, law firms and credit rating agencies to audit credit assets related to their asset-backed securities business.

Despite the more stringent requirements set out in these regulations, the volume of securitised assets has been quite considerable although there have been no securitisations in 2009. The quality of the underlying assets has generally improved, the average tenor of the products has decreased and stricter controls aimed at reducing liquidity and default risk have generally been adhered to. As uncertainty and caution increased with the onset of the financial crisis in 2008, the basis of bank-issued securitisation products largely switched from floating interest rates to fixed rates, due to a combination of investor demand and regulatory pressure.[24]

Securitisations of NPLs have been few and far between. However, there has been an increase in the amount of collateral backing such loans as the CBRC and investors alike have become more sensitive to the risk profile of these products.

The outlook for securitisation is not easy to predict, as these products are still regarded as being in the pilot phase of their development. The widespread use of securitisation as a financial tool is far from being a reality in this market.

24 China Trust Development Report 2008, *Renmin University Trust and Fund Research Institution*

Table 4: Pilot asset securitisation program of China's banking institutions (For 2007 and 2008)

Securitisation programme / name	Sponsor	Trustee
2008 GMAC-SAIC Tongyuan personal automobile mortgage securitisation trust (issue No.1)	SAIC FC	Fortune Trust Co., Ltd.
CCB 2008-1 restructured asset securitisation trust (issue No.1)	CCB	China Credit Trust Co. Ltd.
2008 ICBC Gongyuan credit asset securitisation trust (issue No.1)	ICBC	China Credit Trust Co. Ltd.
2008 CDB Kaiyuan credit asset securitisation trust (issue No.1)	CDB	China Ping An Trust Co., Ltd.
2008 Citic Bank Xinyin credit asset securitisation trust (issue No.1)	China Citic Bank (CITIC)	China Credit Trust Co., Ltd.
2008 CMB Zhaoyuan credit asset securitisation trust (issue No.1)	CMB	CITIC Trust Co., Ltd.
2008 Zheshang Bank Zheyuan SME credit asset securitisation trust (issue No.1)	China Zheshang Bank	China Foreign Trade Trust and Investment Company
Cinda 2008-1 restructured asset securitisation trust (issue No.1)	China Cinda Asset Management Corporation	China Credit Trust Co., Ltd.
2007 ICBC Gongyuan credit asset securitisation (issue No.1)	ICBC	Fortune Trust
CCB jianyuan individual home mortgage securitisation (issue No.2)	CCB	China Credit Trust
CCB 2007-1 restructured asset securitisation	CCB	China Credit Trust
2007 SPDB Credit asset securitisation (issue No.1)	Shanghai Pudong Development Bank	Fortune Trust
CIB Credit asset securitisation (issue No.1)	China Industrial Bank	China Foreign Economy and Trade Trust
GMAC-SAIC Tongyuan automobile mortgage securitisation (issue No.1)	SAIC FC	Fortune Trust

Source: 2008 CBRC Annual Report, 2007 CBRC Annual Report

QDII

CITIC Trust, Shanghai International Trust, Ping An Trust, Zhonghai Trust and China Credit Trust are the only trust companies to have obtained QDII licenses. These are among the most difficult licenses to secure given the higher risk profile of overseas investments. Shanghai International Trust became the first trust company to launch an actual QDII trust fund product on 28 December 2009. This fund is primarily focused on stock and bonds listed on the Hong Kong Stock Exchange.[25]

A QDII license is one of the licenses most sought by trust companies and the application criteria are particularly rigorous. Trusts are required to have not less than RMB 1 billion in registered capital, or the equivalent in convertible foreign currency. They must also have enjoyed two years of good ratings by the CBRC and have made a profit over the previous two years.

Strategic investors

The attraction of investing in trust companies, and the attraction for trust companies of bringing in strategic investors, depends on the needs of the various parties and raises complicated issues.

For a major state-owned enterprise (SOE), investing in a trust company gives it a financing platform to develop its own financing solutions in house as well as to raise project and other finance more easily and potentially more cheaply. Buying into a trust company also provides an SOE with an investment channel so it can switch out of low-interest paying bank accounts into higher-yielding trust products while still maintaining a low risk profile.

For financial institutions, both foreign and domestic, the logic is also quite clear. The licenses of trust companies give them access to a wide selection of asset classes, including hard- to-access sectors such as private equity, real estate and alternative investments. They also have the flexibility to offer a much wider range of financial services and products than other domestic financial institutions. The refocusing of trust companies on high net worth individuals and institutional investors is also particularly appealing as these two customer segments represent a market with untapped potential.

25 First overseas QDII product launched, 28 December 2009, *21st Century Business Herald*

Table 5: Domestic financial institution investments into trust companies

Company name	Acquirer / Investor	Stake size
Bank of Communications Trust (previously Hebei International Trust and Investment)	Bank of Communications	85%
Tibet Autonomous Region Trust	China Merchants Bank	60.5%
CCB Trust (previously Hefei Xingtai Trust)	China Construction Bank	67%
Huaxin Trust	China Huadian Financial	n/a
COFCO Trust	COFCO Financial Services	100%
Huaneng Guicheng Trust	Huaneng Capital Services	62.2%
Jingu Trust	China Cinda Asset Management Corporation	92.3%
Kunlun Trust	Petro China Financial Services	82.2%
Yunnan Trust	Everbright Holdings	Pending approval
China Credit Trust	PICC	32%
Bridge Trust	Haitong Securities	Pending approval
Union Trust	Industrial Bank	Pending approval

Source: Publicly available information

Table 6: Foreign investments into trust companies

Company name	Acquirer / Investor	Stake size
Hangzhou Industrial & Commercial Trust	Morgan Stanley	19.9%
New China Trust	Barclays Capital	19.5%
Suzhou Trust	The Royal Bank of Scotland	19.9%
Union Trust & Investment	National Australia Bank	20%
Beijing International Trust	Ashmore Investment Management	19.9%
South China Trust	Overseas Chinese Banking Corporation	Pending approval
Kunming Trust	Macquarie	19.9%

Source: Publicly available information

For trust companies, a strategic partner can bring much needed risk management technology and know-how as well as valuable capital. Some trust companies have successfully used their relationship with their strategic investor to develop new client bases as well as specialised industry knowledge. For example, a trust company in which a major mining or energy conglomerate has taken a stake can build up the strategic knowledge to invest in those industries by working with its investor and tapping into its related party network. Trust companies that have a financial institution as an investor stand to reap significant benefits by being able to distribute their products through an expanded network, particularly if the investor is a bank. Financial institutions are also in a better position to help their trust partners with financial innovation and to match them with skilled staff.

China opened the trust sector to foreign investment in 2007, albeit with significant restrictions. The relevant CBRC regulations, *Implementation Measures on Administrative Allowances for Non-bank Financial Institutions*, explicitly permit overseas financial institutions to buy up to 20 percent of a trust company, which is allowed to have two foreign investors. Furthermore, a single overseas institution, including its related companies, may not invest in more than two trust companies — a regulation that also applies to domestic institutions. Foreign investors are also required to have total assets over USD 1 billion and must hold their investment, once it has been made, for at least three years.

Valuations of trust companies

Establishing benchmarks in order to value a trust company is remarkably difficult. Differences in revenue streams, actual and projected, and the presence of investment properties complicate industry and inter-industry comparisons. Normal techniques employed to value other financial institutions such as banks, securities companies and leasing companies are less relevant in the case of trust companies. Price- to-book ratios for investments in trust companies, for example, have varied from 0.2 to 16.8 times, while deal sizes for 20 percent stakes in trust companies have ranged between RMB 100 million and RMB 2 billion. Certain characteristics peculiar to trust companies also make them very hard to assess without undertaking in-depth due diligence. For example, credit risk may or may not exist depending on the contractual terms of each trust product. Another complication is that assets under management are not split between actively managed, high–fee-paying assets and passive, low-fee entrusted loans.

Common obstacles in investing in trust companies

Choice of valuation methodologies
Gaps between the valuation of investors and existing shareholders – the balance between up-front consideration and future economic benefit requires painstaking analysis and negotiation
Revenue projections — i.e. how to exploit a license and how quickly this can be accomplished
Management control
Board composition
CBRC approval

Conclusion

The reforms of 2007 have dramatically changed the operating scope and market landscape for trust companies. Looking at overall growth in the industry since then, it becomes clear that the reform has gone a long way to achieving its goals. It is expected that in 2010 a number of new players, namely newly-restructured trust companies, will join this market.

The attraction to partner with and invest in these entities will likely remain strong given the unique role they play in the financial services sector. However, investors, foreign and domestic alike, will have to temper their expectations with the understanding that this is still a sector facing a great deal of obstacles. Limits on IPO exits for PE investments, the ban on opening new stock trading accounts and new restrictions on the scope of cooperation between banks and trusts all pose considerable challenges.

This last restriction in particular will have an immediate, direct impact as it will reduce the income related to single unit trust products. While major trust companies will still manage to do well, smaller trusts that have not yet been able to develop the capacity to produce combined trusts with high returns and acceptable risk profiles will face a daunting task. As a result, trust companies in the future will have to place a greater emphasis on innovation and differentiation, for example by offering investors personalised products. They will also have to move towards higher-fee-paying combined unit products while fully embracing financial innovations as they emerge. A better balance between proprietary income and fee and commission income would also lead to more stable earnings.

Significant risk management and corporate governance issues remain and will also have to be addressed in the near future. It is to be hoped that the trust sector will come up with innovative solutions to these and other problems, as it has in the past.

Appendix 1

Trust company shareholders (as of year end 2008)

Type one trust companies   Type two trust companies   Type three trust companies

Name	First shareholder	Share holding
Bohai International Trust	Haikou Meilan International Airport	42.74%
SDIC Trust	State Development Investment Corporation (SDIC)	95.45%
Fortune Trust	Baosteel Group	98.00%
Huachen Trust	Hunan Valin Iron & Steel Group	48.95%
China Resources SZITIC Trust	China Resources Company	51.00%
Bank of Communications International Trust	Bank of Communications	85.00%
Ping An Trust and Investment	China Ping An Insurance (Group)	99.88%
China Foreign Economy and Trade Trust	Sinochem Corporation	93.07%
Yingda International Trust	State Grid	51.00%
China Credit Trust	Chinese People's Insurance Group (PICC)	32.35%
Zhonghai Trust	China National Offshore Oil Corporation	95.00%
Zhongtai Trust	China Huawen Investment Holdings	31.57%
China Railway Trust	China Railway	78.91%
China Zhongtou Trust	China Construction Bank Corporation	100.00%
CITIC Trust	CITIC Group	80.00%
Northern International Trust	TEDA Investment Holdings	32.33%
Beijing International Trust	Beijing State-Owned Assets Management Company	34.30%
Dongguan Trust	Dongguan City Finance Development Company	40.00%
Guangdong Finance Trust	Guangdong Finance Holdings Company	98.14%
Guolian Trust	Wuxi Guolian Development Group	65.85%
Anhui Guoyuan Trust	Anhui Guoyuan Holdings	49.69%
Hangzhou Industrial and Commercial Trust	Hangzhou Investment Holdings Limited	52.99%
Dalian Huaxin Trust	Dalian Huaxin Trust	49.18%
Jiangsu International Trust	Jiangsu Guoxin Investment Group	98.00%
Union Trust	Fujian Overseas Chinese Investment (Holdings) Company	31.96%
Shandong International Trust Corporation	Luxin Group	85.94%
Shanghai International Trust	Shanghai International Group	66.33%
Suzhou Trust	Suzhou International Development Group	70.01%
Tianjin Trust	Treasury Bureau of Tianjin	23.16%
Xiamen International Trust	Xiamen C&D Corporation Limited	51.00%
New China Trust	New Industrial Investment Company	89.34%
Chongqing International Trust	Chongqing Guoxin Investment Holdings	100.00%
Bridge Trust	Zhengzhou Municipal Finance Bureau	22.05%
Gansu Trust	Gansu Provincial Department of Finance	78.85%
Hunan Trust	Hunan Caixin Investment Company	96.00%
Huarong International Trust	China Huarong Asset Management	97.50%
Jilin Province Trust	Jilin Provincial Department of Finance	97.50%
Jiangxi International Trust	Jiangxi Provincial Department of Finance	79.10%
Golden Harbor (Jingang) Trust	Tianjin Economic Development Asset management Company	75.43%
Shanxi International Trust	Shanxi Guoxin Investment (Group)	90.70%
Shanxi Trust	Shaanxi Provincial Expressway Construction Group	44.34%
Xi'an International Trust	Xi'an Municipal Finance Bureau	39.67%
Western Trust and Investment	Shaanxi Provincial Electric Power Construction Investment	57.78%
New Times Trust and Investment	Baotou Lvyuan Holdings	58.54%
Hefei Xingtai Trust	Hefei Xingtai Holdings Group	83.33%
Yunnan International Trust	Yunnan Provincial Department of Finance	25.00%
Zhongrong International Trust	Zhongzhi Enterprise Group	67.70%
Zhongyuan Trust	Henan Investment Group	48.42%

Source: Publicly available information

Second Shareholder	Share holding	Third Shareholder	Share holding
HNA Hotels Holding Group	39.14%	Yangtze River Real Estate Group	11.44%
SDIC Electric Power Company	4.55%	n/a	n/a
Treasury Bureau of Zhoushan	2.00%	n/a	n/a
Inner Mongolia State-owned Assets Supervision and Administration Commission	41.96%	Treasury Bureau of Hohhot	8.74%
Shenzhen Municipal People's Government State-owned Assets Supervision and Administration Commission	49.00%	n/a	n/a
Hubei Provincial Finance Department	15.00%	n/a	n/a
Shanghai Yan Tan (Group)	0.12%	n/a	n/a
Far East International Leasing	6.93%	n/a	n/a
Shandong Xinyuan Holdings Limited	14.94%	China Power Finance	6.33%
Shenhua Guohua Energy Investment	20.00%	Yankuang Group	10.00%
CITIC Group	5.00%	n/a	n/a
Shanghai New Huangpu Real Estate	29.97%	Canton Union (Nanning) Investment	20.00%
n/a	n/a	n/a	n/a
n/a	n/a	n/a	n/a
CITIC East China (Group) Corporation	20.00%	n/a	n/a
Tianjin United Group	11.21%	Treasury Bureau of Tianjin	6.24%
Win Eagle Investments Limited	19.99%	Sinopec Beijing Oil Products Company	14.29%
Treasury Bureau of Dongguan	30.00%	Donta Group	n/a
Guangdong Provincial Science and Technology Venture Capital Company	1.86%	n/a	n/a
Wuxi Guolian Environmental Energy Group	9.76%	Local Power Company in Wuxi City	8.13%
Shenzhen City Zhonghai Investment Management Company	40.38%	Capital Airports Holding Company	9.00%
Morgan Stanley International Holdings Inc.	19.90%	Zhejiang Xinan Chemical Industry Group	6.26%
Dalian Port Group	4.96%	Beijing Yueda Investment Company	4.96%
Jiangsu Province Investment Management	1.00%	Jiangsu Real Estate Investment Company	1.00%
Southern Hopes Industrial	25.49%	National Australia Bank	19.99%
Shandong Province High-Tech Investment Company	6.25%	Shandong Gold Group	3.13%
Shanghai Jiushi Company	20.00%	Shenergy Group	5.00%
Royal Bank of Scotland public limited Company	19.99%	Legend Holdings Ltd.	10.00%
China Energy Conservation Investment Corporation	23.16%	Tianjing Hi-Tech Holding Group	14.21%
Xiamen International Port Holdings Limited	49.00%	n/a	n/a
n/a	n/a	n/a	n/a
n/a	n/a	n/a	n/a
Shenzhen Yi Jian Technology	21.49%	Red Lion Coatings International Company	19.83%
Tianshui Municipal Finance Bureau	11.40%	Baiyin Municipal Finance Bureau	9.75%
Hunan Provincial State-owned Assets Management	4.00%	n/a	n/a
Xinjiang Kaidi Investment	1.48%	n/a	n/a
Jilin Grain Group	0.63%	Jilin Chemical Fiber Group	0.63%
Zhangzhou Municipal Finance Bureau	10.20%	Xingang Group	1.32%
Ningbo City Southern Metro Properties Limited	14.74%	Ningbo Guangbo Investment Holdings Company	9.83%
Taiyuan Haixin Asset Management	8.30%	Shanxi International Electricity Group	1.00%
n/a	n/a	n/a	n/a
Shanghai Zendai Investment Management	39.33%	Shenzhen Chunda Investment Company	11.67%
Shaanxi Provincial Industry Investment Company	8.48%	Chongqing Sino-Overseas Chinese Properties Limited	6.36%
Shenzhen Jin Ruifeng Industrial Development	14.63%	Chongqing Swell Porcelain (Group)	14.63%
Hefei State-owned Assets Holdings Limited	16.67%	n/a	n/a
Yongjin Industry (Group)	24.50%	Shanghai Nano Venture Capital	23.00%
Harbin Economic Development Investment Corporation	24.61%	Dalian Xinxing Real Estate Development Group Ltd.	7.69%
Henan Zhongyuan Expressway	33.28%	Henan Sheng Run Venture Capital Management	18.30%

Appendix 2

Trust Company Summary Financials (in RMB million)

Trust Company	Total Assets		Assets Under Management	
	2008	2007	2008	2007
China Ping An Trust and Investment	27,872.26	37,862.63	48,643.81	47,591.38
China Resources SZITIC Trust	5,353.83	7,391.70	49,521.00	22,523.91
Shanghai International Trust	5,264.69	5,479.73	20,931.23	22,854.36
China Credit Trust	4,380.44	4,353.63	92,562.49	66,434.65
CITIC Trust	4,338.07	4,014.20	160,779.30	196,193.27
Fortune Trust	4,141.32	6,594.18	31,111.16	33,633.53
Jiangsu International Trust	2,997.50	3,419.81	11,852.99	12,915.61
Chongqing International Trust	2,792.74	2,469.53	26,405.82	27,091.72
Zhongtai Trust	2,489.19	2,387.17	4,621.01	7,459.41
SDIC Trust	2,417.36	2,543.86	4,227.39	6,033.82
Beijing International Trust	2,225.03	1,935.96	62,579.83	38,161.69
Guolian Trust	1,989.56	2,292.26	7,329.85	4,728.90
Zhonghai Trust	1,962.09	2,101.01	75,897.95	61,723.59
Tianjin Trust	1,865.37	1,982.44	15,660.79	11,269.94
China Foreign Economy and Trade Trust	1,854.00	2,898.45	57,217.55	59,684.98
Jilin Province Trust	1,824.21	2,518.78	10,100.86	697.17
Shandong International Trust Corporation	1,822.36	1,649.45	30,493.49	20,405.78
Dalian Huaxin Trust	1,736.12	1,837.64	30,534.79	11,798.16
China Railway Trust	1,728.26	1,039.81	21,172.68	20,027.15
Huachen Trust	1,700.44	854.24	15,311.32	7,383.15
Yingda International Trust	1,668.18	1,715.86	104,066.42	51,614.34
Anhui Guoyuan Trust	1,621.08	2,191.17	12,343.66	4,666.54
Shanxi Trust	1,546.54	1,389.61	4,920.70	3,413.28
The Trust Investment Corporation of Tibet Autonomous Region	1,511.11	1,338.06	75.10	74.15
Northern International Trust	1,341.98	1,665.11	9,467.39	3,594.22
Xiamen International Trust	1,312.20	1,264.76	10,412.91	9,382.15
Zhongyuan Trust	1,285.65	1,033.06	8,375.66	6,476.69
Bank of Communications International Trust	1,260.41	1,275.44	23,118.65	440.03
Shanxi International Trust	1,240.26	1,461.70	8,293.88	7,045.65
Hangzhou Industrial and Commercial Trust	1,131.90	1,403.49	4,353.76	4,159.84
National Trust Ltd.	1,125.72	1,023.64	1,881.78	4,146.86
Guangdong Finance Trust	1,067.04	1,073.55	8,401.38	5,187.55
Bridge Trust	839.82	804.39	8,244.80	4,745.56
Yunnan International Trust	817.28	727.76	4,570.04	10,158.31
New China Trust	781.30	653.85	23,110.12	19,705.62
Dongguan Trust	781.15	771.37	10,288.70	11,014.18
Suzhou Trust	773.11	428.86	8,004.07	6,211.33
China Zhongtou Trust	763.46	1,153.50	9,668.26	2,528.93
Hefei Xingtai Trust Co.	760.43	670.22	4,893.70	1,642.97
Western Trust	752.80	690.55	4,058.78	2,777.21
Union Trust	740.12	722.05	2,966.83	5,397.72
Jiangxi International Trust	736.91	559.78	23,009.39	15,599.28
Hunan Trust	691.23	666.88	3,660.86	2,952.89
Kunlun Trust	628.18	675.33	38,736.34	5,826.02
Bohai International Trust	608.31	598.42	5,457.75	345.71
Zhongrong International Trust	511.29	454.70	70,323.31	65,975.48
Anxin Trust	502.35	504.99	9,768.27	11,128.46
Gansu Trust	409.42	1,237.09	2,655.63	1,889.89
Xi'an International Trust	366.14	338.87	6,500.64	2,409.70
Qingdao Hisyn Trust and Investment	274.57	309.48	140.52	767.04
New Times Trust and Investment	n/a	702.39	n/a	6,412.33
Xinjiang International Trust and Investment	n/a	354.53	n/a	n/a

Source: Publicly available information

	Operating Revenue		Profit Total		Net Profit	
	2008	2007	2008	2007	2008	2007
	3,423.01	4,857.49	1,934.10	2,833.60	1,585.90	2,256.26
	948.44	2,626.34	864.01	2,445.92	822.67	2,420.49
	1,550.03	2,578.26	870.69	2,071.71	700.71	1,632.47
	526.65	467.74	806.32	1,242.05	670.57	993.52
	2,004.81	1,466.28	1,226.58	1,068.78	933.10	658.03
	2,145.32	1,381.26	1,272.69	1,517.94	962.59	1,058.20
	309.93	370.58	268.26	325.27	258.31	263.13
	719.59	588.06	652.92	534.68	510.66	503.38
	1,509.22	1,476.76	704.05	571.47	590.01	500.08
	778.11	971.63	479.41	638.39	411.80	483.49
	695.36	359.42	590.70	301.73	478.12	203.88
	207.69	616.00	175.31	594.94	132.91	526.71
	846.96	789.62	751.86	726.09	592.77	493.70
	535.27	498.14	205.43	200.81	147.23	131.88
	250.78	188.25	424.58	698.00	356.84	541.64
	151.85	108.24	7.24	624.45	16.88	401.37
	452.14	360.49	255.24	136.71	213.56	80.89
	419.11	532.20	363.67	450.04	281.52	336.89
	480.30	492.17	291.36	242.09	236.93	169.08
	161.07	157.12	110.88	111.18	94.76	72.67
	226.50	181.10	127.72	82.66	94.60	40.78
	231.10	832.25	136.91	729.44	133.74	706.52
	222.20	282.72	69.84	94.72	68.42	72.91
	81.50	241.43	22.53	166.96	22.49	147.34
	207.25	108.01	163.76	259.35	119.79	184.70
	298.34	321.26	243.40	194.47	218.26	109.00
	88.91	619.72	40.01	477.87	42.68	301.54
	64.14	23.47	9.81	10.11	6.78	6.01
	194.41	476.77	28.79	216.68	17.79	134.50
	144.43	201.61	85.91	161.02	62.64	114.31
	101.07	56.82	60.36	25.70	47.80	25.70
	127.39	375.67	123.78	322.07	130.35	288.80
	145.87	144.01	99.37	122.94	74.28	102.73
	427.00	377.24	336.75	301.91	252.96	222.67
	184.05	76.43	90.84	18.77	61.07	3.07
	201.46	234.96	140.59	196.08	135.69	145.37
	160.44	144.12	126.88	110.81	99.16	73.01
	85.67	87.08	41.86	51.52	41.86	51.52
	35.00	115.54	26.12	98.42	33.30	66.09
	226.74	164.74	199.82	130.70	193.77	111.27
	99.18	126.97	65.58	83.56	51.07	61.79
	154.80	137.57	83.99	94.18	75.26	73.47
	93.89	85.80	45.94	53.98	36.46	43.96
	122.37	315.40	54.13	236.18	38.23	168.01
	24.45	31.83	16.64	50.91	15.66	42.88
	353.79	161.08	131.66	118.38	122.30	76.67
	132.33	130.16	34.40	22.26	31.23	17.67
	67.15	149.19	40.14	46.35	11.98	29.98
	63.03	36.25	39.36	37.17	38.42	28.02
	3.95	7.85	-47.58	-2.06	-35.73	-1.81
	n/a	80.45	n/a	162.46	n/a	161.17
	n/a	27.69	n/a	26.47	n/a	21.29

Contact us

KPMG China has over 9,000 staff, working in 12 offices; Beijing, Shenyang, Qingdao, Nanjing, Shanghai, Chengdu, Hangzhou, Fuzhou, Guangzhou, Shenzhen, Hong Kong and Macau.

Our dedicated financial services team brings together partners from audit, tax and advisory practices and is linked closely to other member firms in the KPMG network.

For more information, contact one of the financial services partners listed below.

Simon Gleave
Partner in charge, Financial Services
Beijing
Tel: +86 (10) 8508 7007
simon.gleave@kpmg.com.cn

Thomas Chan
Partner, Financial Services
Beijing
Tel: +86 (10) 8508 7014
thomas.chan@kpmg.com.cn

Babak Nikzad
Partner, Financial Services
Shanghai
Tel: +86 (21) 2212 2268
babak.nikzad@kpmg.com.cn

Edwina Li
Partner, Financial Services
Shanghai
Tel: +86 (21) 2212 3806
edwina.li@kpmg.com.cn

Tony Cheung
Partner, Financial Services
Shanghai
Tel: +86 (21) 2212 2705
tony.cheung@kpmg.com.cn

Jasmine Lee
Partner, Financial Services
Guangzhou
Tel: +86 (20) 3813 7790
jasmine.sy.lee@kpmg.com.cn

Ivan Li
Partner, Financial Services
Shenzhen
Tel: +86 (755) 2547 1218
ivan.li@kpmg.com.cn

Joan Ho
Partner, Financial Services
Hong Kong
Tel: +852 2826 7104
joan.ho@kpmg.com.hk

Andrew Weir
Partner, Audit
Hong Kong
Tel: +852 2826 7243
andrew.weir@kpmg.com.hk

Danny Le
Partner, IT Advisory
Beijing
Tel: +86 (10) 8508 7091
danny.le@kpmg.com.cn

Tracy Zhang
Partner, Tax
Beijing
Tel: +86 (10) 8508 7509
tracy.h.zhang@kpmg.com.cn

Publication number: HK-FS10 0004

Publication date: March 2010

www.kpmg.com.cn
www.kpmg.com.hk

Beijing
8th Floor, Tower E2, Oriental Plaza
1 East Chang An Avenue
Beijing 100738, China
Tel : +86 (10) 8508 5000
Fax : +86 (10) 8518 5111

Qingdao
4th Floor, Inter Royal Building
15 Donghai West Road
Qingdao 266071, China
Tel : +86 (532) 8907 1688
Fax : +86 (532) 8907 1689

Shenyang
27th Floor, Tower E, Fortune Plaza
59 Beizhan Road
Shenyang 110013, China
Tel : +86 (24) 3128 3888
Fax : +86 (24) 3128 3899

Shanghai
50th Floor, Plaza 66
1266 Nanjing West Road
Shanghai 200040, China
Tel : +86 (21) 2212 2888
Fax : +86 (21) 6288 1889

Nanjing
46th Floor, Zhujiang No.1 Plaza
1 Zhujiang Road
Nanjing 210008, China
Tel : +86 (25) 8691 2888
Fax : +86 (25) 8691 2828

Chengdu
18th Floor, Tower 1, Plaza Central
8 Shuncheng Avenue
Chengdu 610016, China
Tel : +86 (28) 8673 3888
Fax : +86 (28) 8673 3838

Hangzhou
8th Floor, West Tower, Julong Building
9 Hangda Road
Hangzhou 310007, China
Tel : +86 (571) 2803 8000
Fax : +86 (571) 2803 8111

Guangzhou
38th Floor, Teem Tower
208 Tianhe Road
Guangzhou 510620, China
Tel : +86 (20) 3813 8000
Fax : +86 (20) 3813 7000

Fuzhou
25th Floor, Fujian BOC Building
136 Wu Si Road
Fuzhou 350003, China
Tel : +86 (591) 8833 1000
Fax : +86 (591) 8833 1188

Shenzhen
9th Floor, China Resources Building
5001 Shennan East Road
Shenzhen 518001, China
Tel : +86 (755) 2547 1000
Fax : +86 (755) 8266 8930

Hong Kong
8th Floor, Prince s Building
10 Chater Road
Central, Hong Kong
Tel : +852 2522 6022
Fax : +852 2845 2588

Macau
24th Floor, B&C, Bank of China Building
Avenida Doutor Mario Soares
Macau
Tel : +853 2878 1092
Fax : +853 2878 1096