# BEYOND THE CHALLENGES
## THE STRENGTH OF SINO-EUROPEAN TIES

pwc

LuxembourgforFinance
Agency for the Development of the Financial Centre

# TABLE OF CONTENTS

# FOREWORD

We have observed more developments in the Sino-European financial relationship in the last couple of years than in the 10 previous years combined. While hardening tones on the political stage hint at a deterioration of diplomatic ties, the numbers tell another story altogether. Recent years have actually seen an unprecedented strengthening of financial collaboration and inter-dependence between the two blocs - with China overtaking the US as the EU's largest trading partner in 2020. A similar tightening of China-EU ties has emerged in the realm of Financial Services - with China recently implementing a range of deregulatory internationalisation efforts. Despite the majority of these regulations coming into play in the last year, they have ushered in an era of unparalleled Sino-European co-operation; as demonstrated by an exponential surge in bilateral portfolio investment.

This increased bilateralism represents a major shift in the global FS landscape and a watershed moment in Sino-European relations. The highly publicised differences between to two economic superpowers notwithstanding, there is a growing wealth of evidence to suggest that their respective financial services industries are strongly compatible and conducive to an increasingly symbiotic relationship. That being said, a number of structural, systemic and regulatory hurdles remain. As the title of the report suggests, we aim to move beyond the challenges in order to provide an objective overview of the Sino-European relationship in the Financial Services sphere. Rather than dwelling on political statements, we examine facts and figures to assess the extent to which the financial sectors of the two economic giants are intertwined.

In light of this, given the recent tonal shift on the geopolitical stage, we believe there is no time like the present to identify and reinforce the numerous benefits provided by the ongoing bilateralism between China and the EU. We would also like to take this opportunity to thank our partner Luxembourg for Finance for their support in the production of this report, which we hope will provide a foundation for a deeper understanding and further debate.

**Jörg Ackermann**
Partner,
PwC Luxembourg

Luxembourg for Finance
Agency for the Development of the Financial Centre

# FOREWORD

Humanity has always recognised the value of trading, from the earliest hunter gather groups to today's vast and interconnected global trading networks that stretch from one side of the world to the other. Arguably, one of the most crucial moments for global trade occurred in the early first century where goods from China appeared in Europe, transported via the ancient silk roads – perhaps the first instance of globalisation.

Since then, Europe and China have continued to, on the whole, strengthen ties – be it on a technological level, a supply chain level, or a financial services level. We are now, in what can be termed globalisation 4.0, more interconnected than ever. The digital economy thrives and China has emerged as the preeminent global trading power and the internationalisation of China's financial services has seen flows between Europe and China grow at a rapid clip.

Global challenges however are also growing at a rapid clip, be it the economic recovery to the Covid-19 or the climate crisis. In order to tackle the challenges that we face it is therefore critical that we look beyond the current situation. With this report we aim to contribute to developing a deeper understanding of the financial services relationship between China and the EU, as well as the China-US relationship. Strengthening these ties will be critical for the future of globalised financial services, which in turn are pivotal to tackling climate change and economic recovery.

It is important to understand, at a time when geopolitical tensions are high, that globalisation and it's benefits should not take a backseat. Allow me also to extend my thanks to PwC and their global Asset & Wealth Management Research Centre for their work and partnership in putting together this report.

**Nicolas Mackel**
CEO,
Luxembourg for Finance

# INTRODUCTION

Since the historic emergence of China as a global economic power, we have seen an unprecedented strengthening of Sino-European ties - with the two superpowers becoming entwined in an increasingly reciprocal relationship.

However, these bilateral relations have not been without strain. Despite recent mutual efforts to ease tension and rebalance the asymmetry of the EU-China relationship - namely through the ratification of the Comprehensive Agreement on Investment - political headwinds have led to a slowdown in diplomacy.

That being said, the hardening tone on the political stage notwithstanding, the bilateral economic relationship between the two superpowers has shown little sign of weakening. This perfectly characterises the ambiguous nature of the Sino-European relationship: while political and regulatory differences have often led to strains in diplomacy between the two nations, their strengthening ties are indicative of an increasingly symbiotic partnership.

Despite the differences between these economic powerhouses - in terms of their national agendas, Financial Services (FS) players on both sides have been investing in each other's markets through equity and debt as well as the ongoing investment banking and private market deals; albeit at lower levels. Moreover, given that the Chinese FS industry is relatively domestic in nature and FS players in China lack a truly globalised footprint, the financial relationship between the two regions could unlock massive financial investments under a more collaborative environment – boosting the respective FS industries. This notwithstanding, the increased calls to decouple from China and decreased dependency across major and strategic sectors presents a major hurdle which could restrain future collaborative efforts.

With this in mind, we aim to move beyond the immediate challenges - examining the current state of affairs from both a qualitative and quantitative standpoint in order to evaluate the extent to which the financial sectors of the two economic giants are intertwined. In light of our findings, we strongly believe that, should sufficient collaborative efforts be made, the quality of this collaboration has the potential to drive the growth of the financial industry.

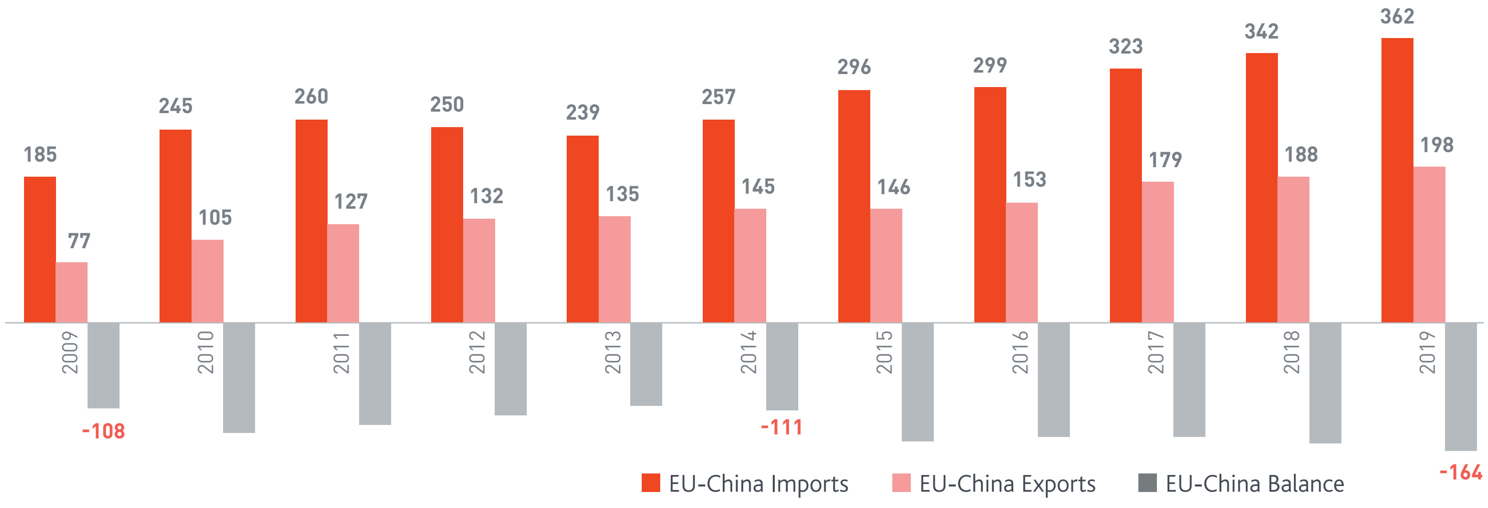
# 1 A DEEPENING ECONOMIC RELATIONSHIP

## TRADE

Sustained economic growth and a dominance of global supply chains has seen China quickly emerge as the world's largest trading nation and its largest economy in terms of purchasing power parity. Following the establishment of diplomatic ties in 1975, Sino-European relations and cooperation have continued to strengthen, notably through the EU-China Trade and Cooperation Agreement of 1985 and the establishment of the China-EU Comprehensive Strategic Partnership in 2003. The EU has since surpassed the U.S as China's largest trading partner in 2006. This in turn bolstered a surge in diplomacy between the two regions, with the jointly-ratified EU–China 2020 Strategic Agenda for Cooperation of 2013 renewing and reaffirming the commitment of both parties to broaden cooperation with one another.

However, it is clear that the goals of this agreement are still some way off, as trade data highlights a notable imbalance in Sino-European trade relations. According to Eurostat figures, the EU currently holds an approximate EUR -164.0bn goods trade deficit with China (cf. exhibit 1). This rising trade deficit has given rise to a degree of apprehension from the West, who have cited concerns surrounding the bloc's overreliance on China. The tonal shift exacerbated further in May 2020, with several EU states joining the D10 initiative seeking to establish alternative suppliers of 5G equipment. The challenges, however, have largely been limited to the political sphere and have had little impact on trade flows – with China overtaking the US as the EU's largest trading partner in 2020.

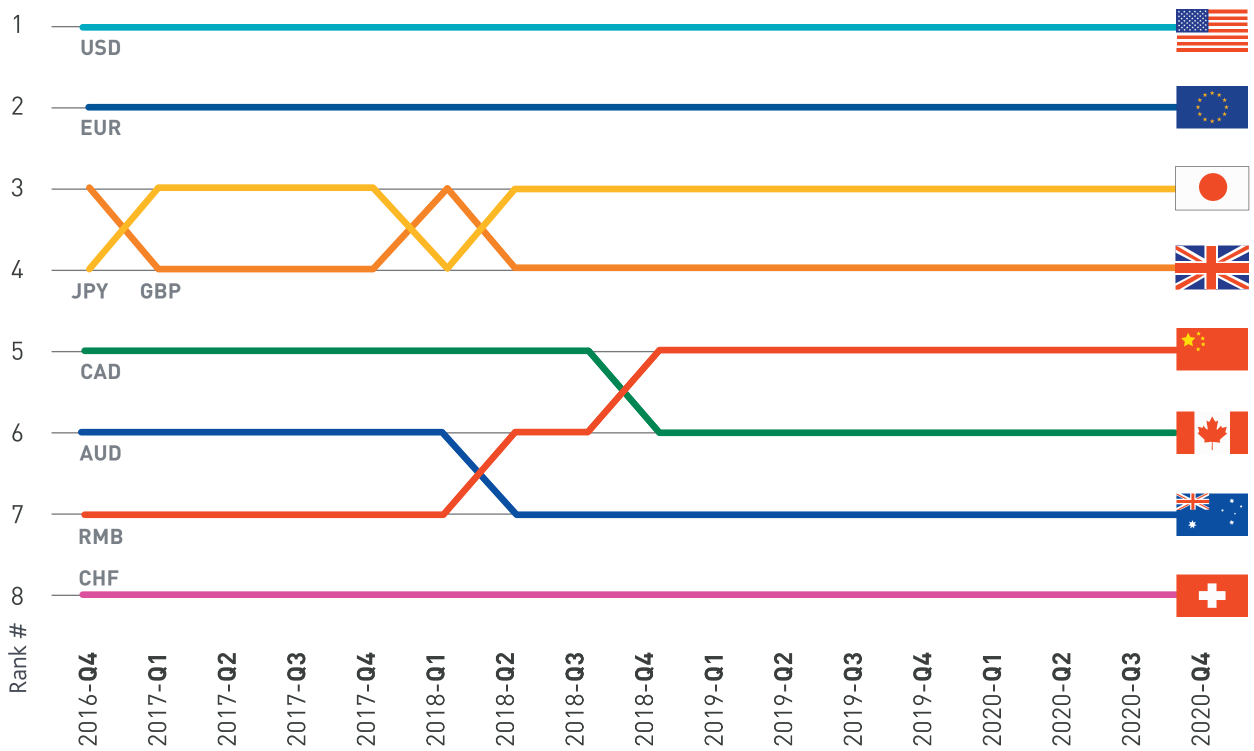
**EXHIBIT 1:** EU-CHINA TRADE IN GOODS (EUR BN)




*Source: PwC Global AWM Research Centre, European Commission*

China's increasing role in global trade has seen the prominence of its currency skyrocket over the years, with sovereign institutions and investors increasing their RMB stockpiles for use in trade and investment, with the daily foreign exchange turnover exceeding USD 285bn as of April 2019 [1]. Specifically, China's cooperation with the EU has led to a marked increase in the prominence and value of the RMB in the global currency basket. Following the decision of the European Central Bank to include RMB into its foreign exchange reserves and the development of offshore RMB markets, European countries increasingly gave up their IMF shares to support RMB's inclusion into the SDR (special drawing rights) currency basket of the IMF (International Monetary Fund). Their efforts were successful, as the RMB now represents the fifth largest reserve currency in the 'currency basket' (cf. exhibit 2). That being said, the volume of RMB held in foreign currency reserves has increased far more rapidly than its counterparts, posting a YoY increase of 8.3% between Q2 2019 and Q2 2020; while the US dollar and Euro rose by 2.2% and 0.8%, respectively [2]. However, the use of the RMB remains marginal with respect to other major currencies.

**EXHIBIT 2:** FOREIGN EXCHANGE RESERVES, TOP 8 CURRENCIES



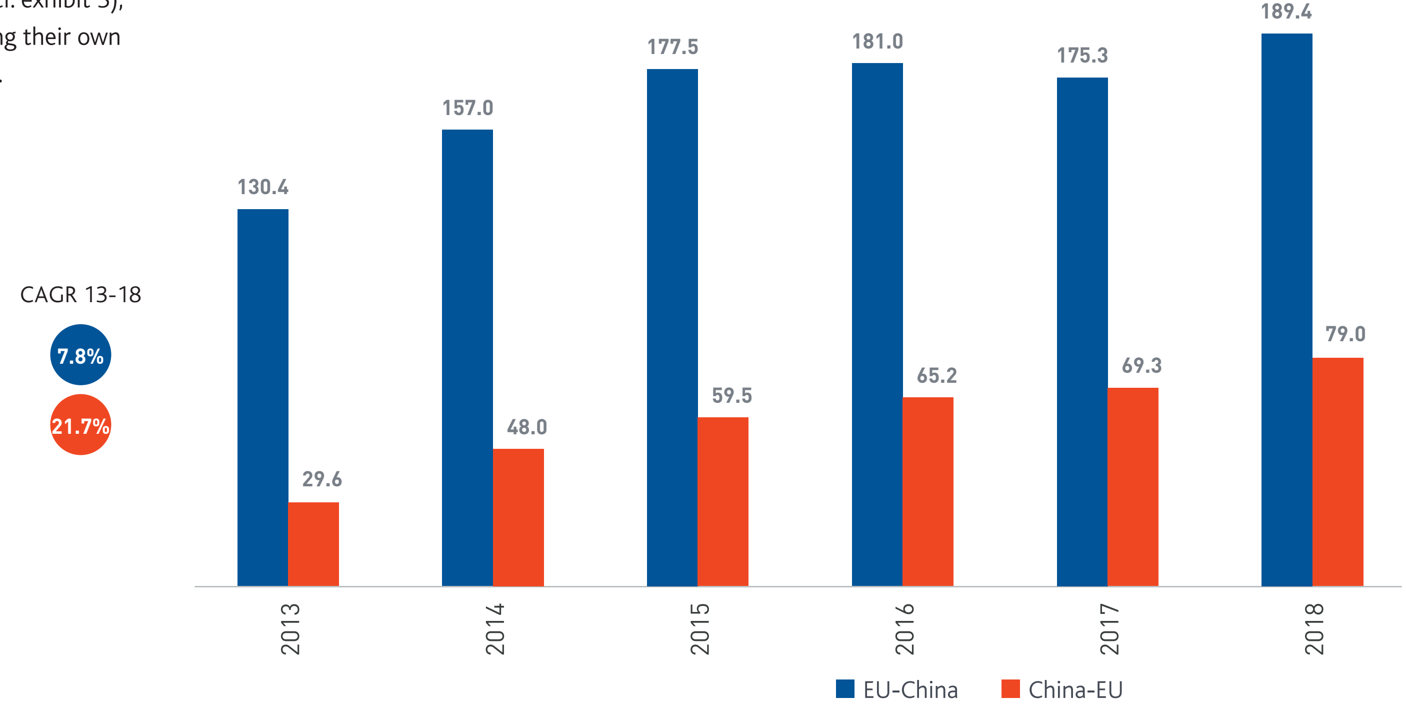

*Source: IMF*

[1] Triennial Central Bank Survey of Foreign Exchange and Over the counter (OTC) Derivatives
[2] IMF

## INVESTMENT

While bilateral trade has always represented the cornerstone of the Sino-European relationship, recent years have seen the proliferation of an increasingly fruitful investment rapport between both parties. In order to ascertain the strength of this rapport, one need look no further than the exponential increase Foreign Direct Investment (FDI) flows between China and the European Union in recent years (cf. exhibit 3), with virtually all EU member states holding their own respective investment treaties with China.

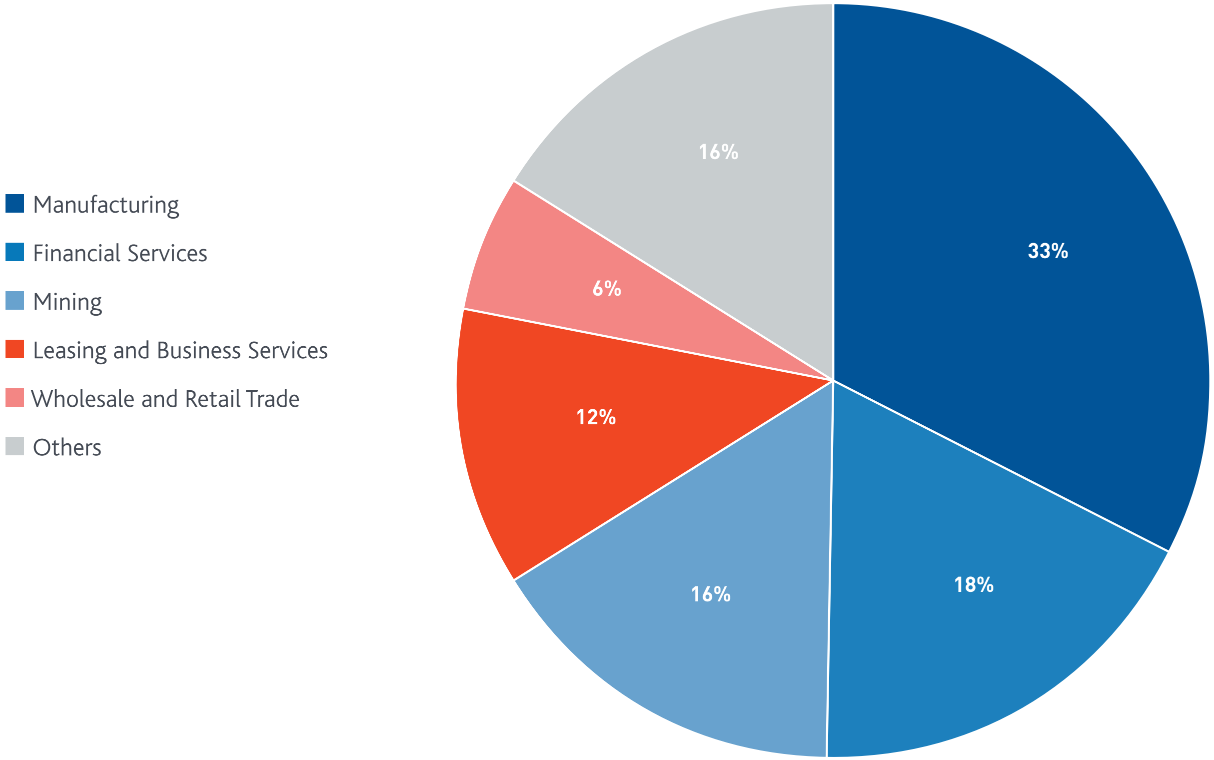
**EXHIBIT 3:** EU-CHINA BILATERAL FDI STOCKS (EUR BN)




*Source: PwC Global AWM Research Centre, National Bureau of Statistics of China, Eurostat*

The scale of Chinese investment into Europe skyrocketed in the years following the Global Financial Crisis – surging from EUR 6.1bn in 2010 to EUR 79.0bn in 2018. The bulk of this investment is allocated to Europe's manufacturing industry, which accounted for one third of overall outward FDI in 2019 (cf. exhibit 4). Europe's financial services industry represented the second largest investment sector, accounting for 18% of China's total investment into the EU that same year. However, we have observed a decrease in China's FDI allocation to Europe's financial services sector in recent years, dropping from 22% in 2013 to 17.6% in 2019 as a result of the country's investment pullback.

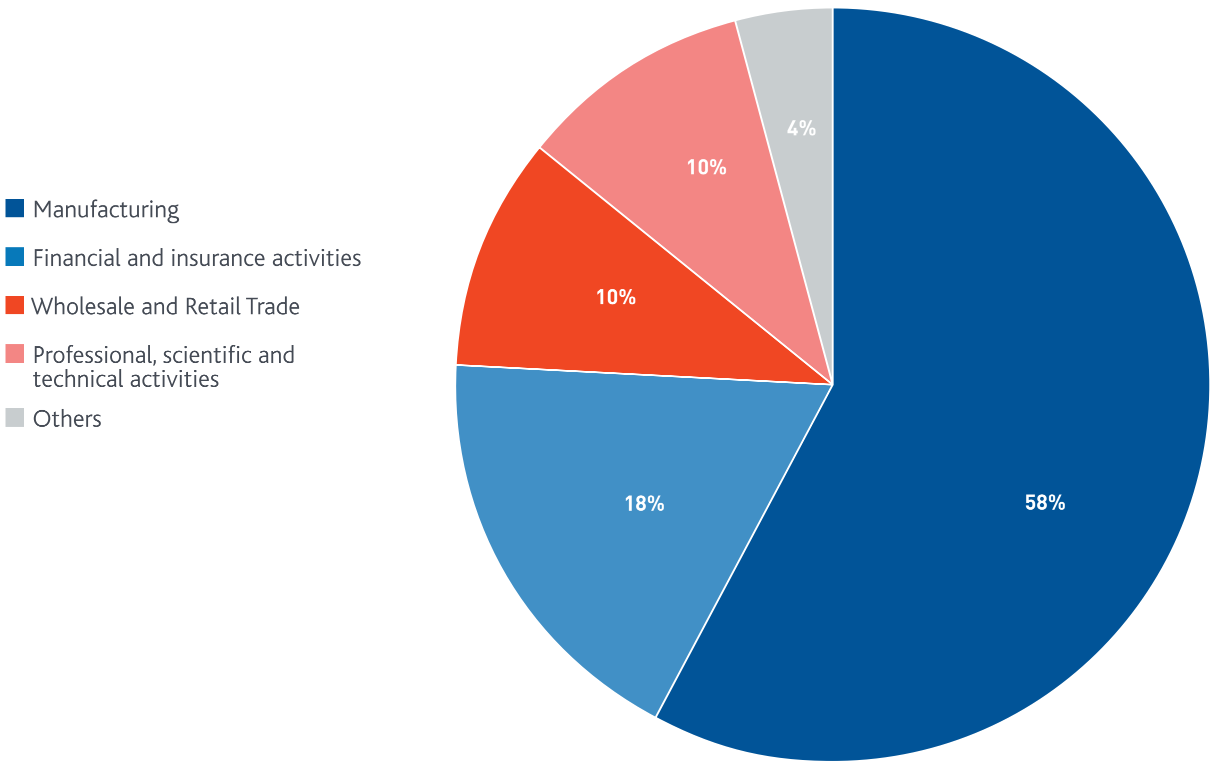
**EXHIBIT 4:** CHINA-EU FDI PERCENTAGE ALLOCATION BY SECTOR (2019)




*Source: PwC Global AWM Research Centre, Eurostat*

The volume of EU outward FDI allocated towards China far exceeds China's investments into the EU. EU outward FDI has grown at an annual compound rate of 6.7% since 2002, reaching EUR 189.4bn in 2018. These investments have primarily been directed towards China's manufacturing sector, which alone accounted for 58% of the EU's outward investment allocated towards China in 2017 [3] (cf. exhibit 5). That being said, a noticeable increase in the EU's FDI allocation to China's financial and insurance activities sector, which represents the second largest target for EU investment, points to growing synergies between both regions within the financial services space.

**EXHIBIT 5:** EU-CHINA FDI PERCENTAGE ALLOCATION BY SECTOR (2017)

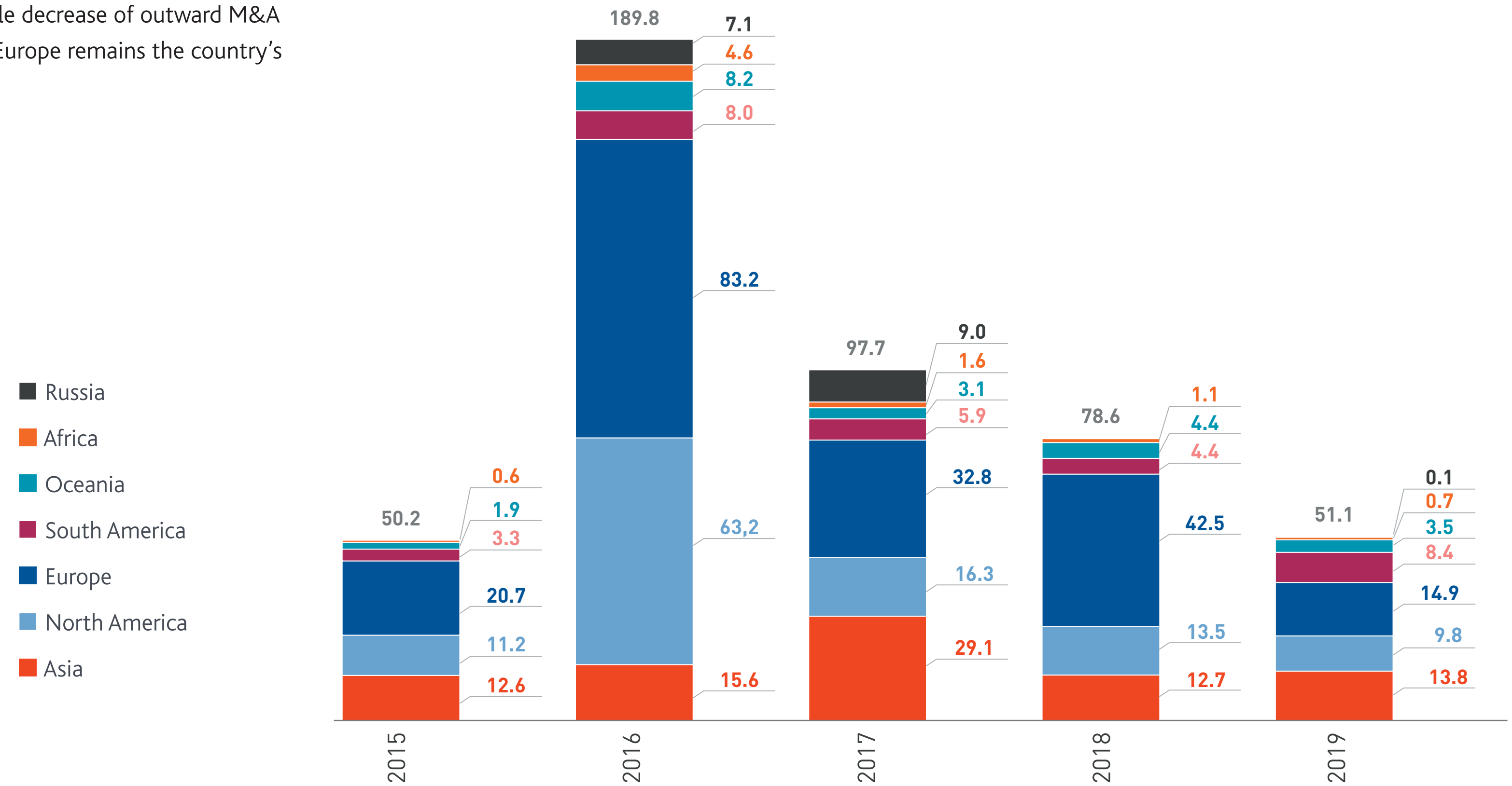



*Source: PwC Global AWM Research Centre, Eurostat*

[3] Latest available data

Recent years have also shown an influx of M&A activity from China amid growing domestic business growth needs; with inbound deal value into Europe increasing four-fold in 2016 alone (cf. exhibit 6) and Chinese ownership of EU companies increasing from 2.5% in 2007 to 9.5% in 2017. Several factors underscore Europe's appeal, such as attractive enterprise valuations, low interest rates, the open business environment and lower degree of competition in the European M&A market. Despite a widescale decrease of outward M&A deals from the Mainland, Europe remains the country's destination of choice.

**EXHIBIT 6:** CHINA'S MAINLAND OUTBOUND DEALS BY REGION-VALUE (EUR BN)

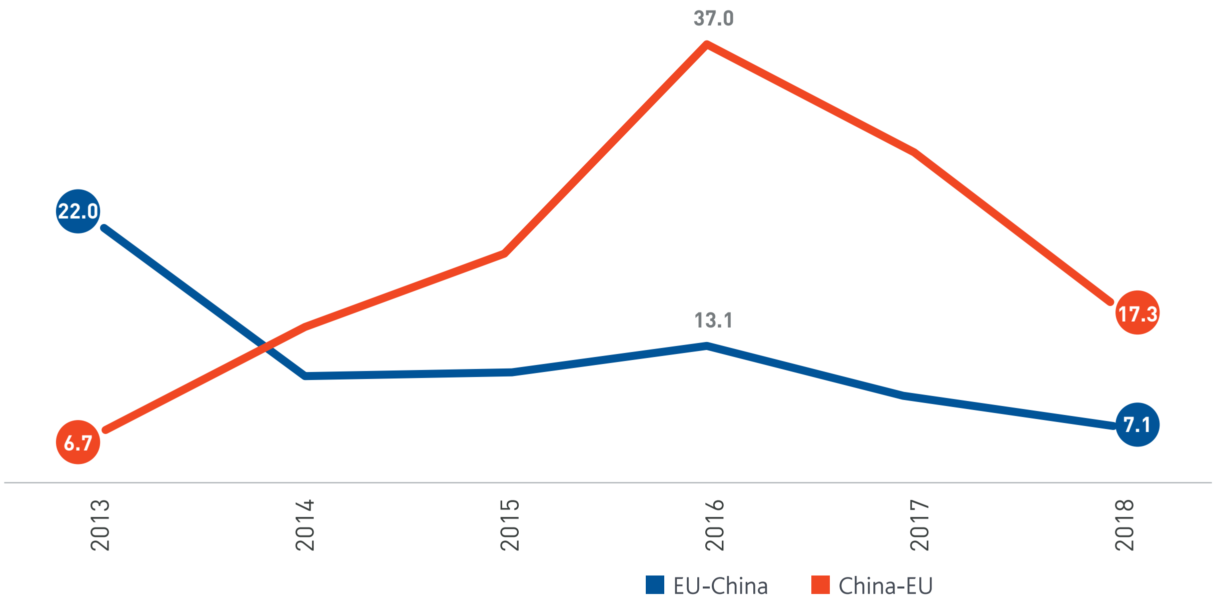



*Source: PwC China "PwC M&A 2019 Review and 2020 Outlook"*

However, while investment flows are substantial, and have increased in absolute terms, the overall Sino-European FDI value remains relatively low considering the economic magnitude of the two nations. In addition, China's outbound investment trajectory has faced an abrupt slowdown since 2016 due to rising governmental concerns surrounding the country's widening financial account. The succeeding rigidifying capital controls led to a sharp drop in outward FDI flows into Europe, which fell by over 50% from EUR 36.7bn in 2016 to EUR 17.3bn in 2018 (cf. exhibit 7). That being said, it must be noted that the EU was less impacted by China's rigidifying capital flight restrictions than its economic counterparts, with the US seeing its share of inward investment drop by 82% during this period according to Rhodium Group.

European FDI flows into China experienced a similar decrease, falling 45.4% from 2016 to reach EUR 7.1bn in 2018. This drop is largely attributed to heightened investor cynicism and apprehension surrounding poor investor protection and highly uneven market access. This drop is likely to persist in the coming years, given the EU FDI screening mechanism implemented in October 2020 is expected to place approximately 83% of Chinese M&A transactions in the EU under scrutiny.

**EXHIBIT 7:** CHINA-EU BILATERAL FDI FLOWS (EUR BN)




*Source: PwC Global AWM Research Centre, National Bureau of Statistics of China, Eurostat*

This highlights the inherent complexity and ambivalent nature of the Sino-European financial relationship — on the one hand, there is a clear appetite from both parties to strive towards a fruitful and mutually beneficial inter-regional investment rapport; but the current extent of this relationship continues to be hindered by regulatory, structural and systemic roadblocks. This notwithstanding, cooperation between China and the EU is materialising, driven by the desire of both sides to bring their trade and investment relationship to its fullest potential.

# 2 CREATING SHARED VALUE IN FINANCIAL SERVICES

China's financial cooperation with the EU has historically been hampered by its internally focused regulatory framework, with the country's financial sector having been largely closed to both inward and outward foreign investment.

Until recently, the China Securities Regulation Commission (CSRC) forbade foreign insurers, asset managers and banks from providing their services in the Chinese market without establishing a 49/51 partnership or joint venture with a Chinese firm. In a similar vein, strict QFII/RQFII quotas largely represented the sole option for European investors looking to allocate their assets into Chinese securities.

Similar regulatory restrictions applied to Chinese investors seeking to allocate their assets overseas. The country's strict capital flight restrictions and closed capital account policy have significantly limited the investment opportunities for domestic investors, largely keeping Chinese money within the country's borders. While the 2006 Qualified Domestic Institutional Investor (QDII) scheme granted Chinese investors access to offshore financial markets, strict quotas were implemented to slow capital outflows following China's 2015 stock market crash.

However, change is underway, and we have seen a recent wave of deregulation triggering of what the Governor of the People's Bank of China referred to as a "prudent, cautious, gradualist" liberalisation and internationalisation of the country's financial sector; significantly facilitating inward investment.

First, a revision of China's approach towards inbound foreign investment has ramped up global investors' exposure to the Chinese market - namely through a number of cross-border investment initiatives such as QFII/RQFII quotas, Stock Connect (2014), Mutual Fund Recognition (2015) and Bond Connect (2016). These efforts came to a head in 2020, with China removing the QFII and RQFII quotas altogether, making Chinese securities more accessible than ever. Second, the removal of all joint venture requirements in early 2020 has motivated foreign players to set up wholly owned asset and wealth management firms, currency brokerages and pension management companies in the country.

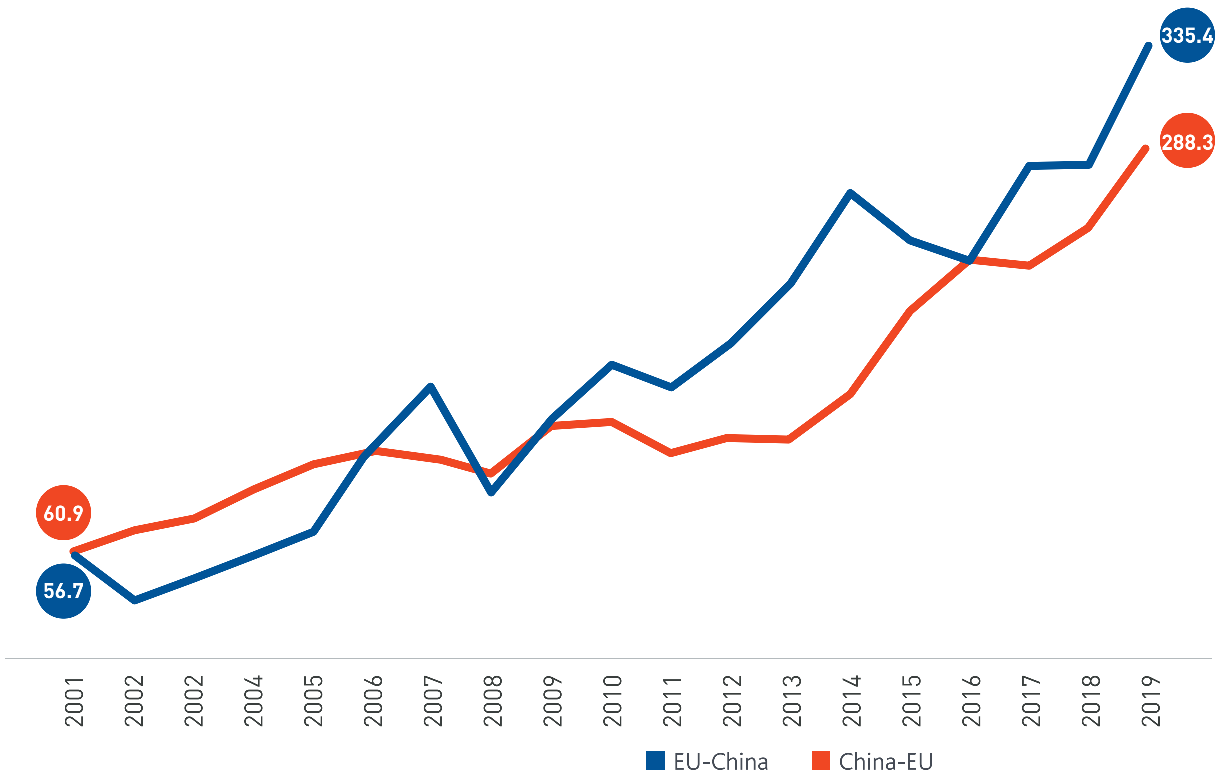
Similarly, China has recently increased its efforts to stimulate outward investment from the Mainland overseas. Namely, the QDII quota scheme was revived in September 2020, allowing 171 Chinese institutions to invest overseas; while the QDLP has facilitated the expansion of Chinese FS participants into international territories. This deregulation wave promises to have a massive impact on the financial sector for China and the EU's respective financial landscapes.

## ASSET AND WEALTH MANAGEMENT

The Chinese Asset and Wealth Management (AWM) industry has shown impressive growth. Our analysis underscores the sheer scale of this growth, with mutual fund assets having increased at a 23.9% CAGR from 2010 to reach EUR 2.44tn in 2020. This growth trajectory has accelerated remarkably in the last year, with AuM growing by 36% YoY in 2020 alone.

There is strong evidence to suggest a growing relationship between the EU and China in relation to the Asset and Wealth Management industry, with bilateral portfolio investment from Europe into China and vice versa undergoing a respective 10.4% and 9.0% annual increase since 2001 - despite overall FDI flows slowing substantially (cf. exhibit 8).

**EXHIBIT 8:** EU-CHINA PORTFOLIO INVESTMENT STOCK (EUR BN)

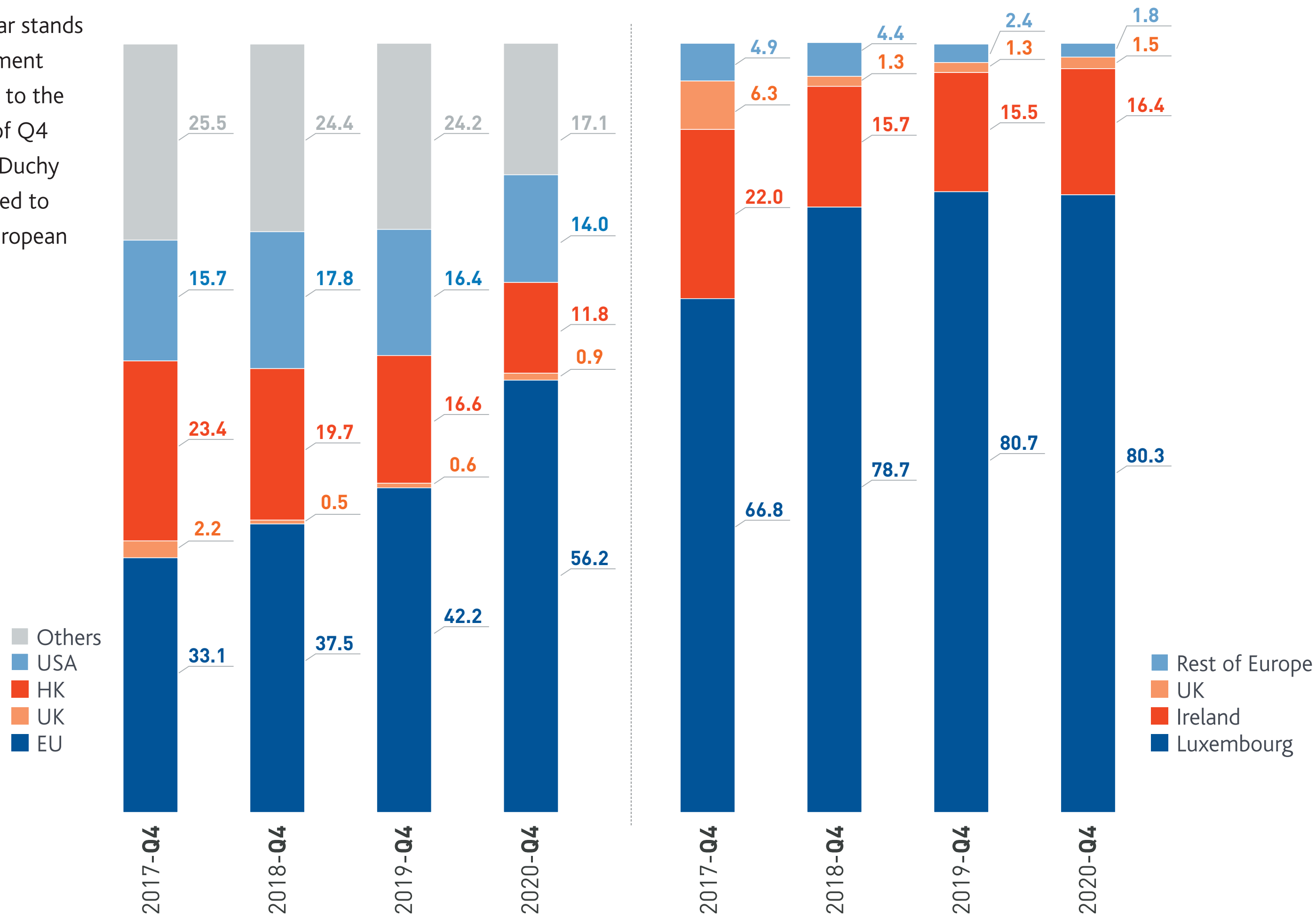



*Source: PwC Global AWM Research Centre analysis based in Lipper and AMAC data*

Back to contents

In addition, our analysis shows that European-domiciled investment funds account for an increasing proportion of inward investment into China - rising from 33.1% to 56.2% in the four-year period between end-2017 and end-2020 (cf. exhibit 9). Luxembourg in particular stands out as the primary proponent of Chinese investment globally, attesting to the country's commitment to the preservation of its collaboration with China. As of Q4 2020, investment funds domiciled in the Grand Duchy account for 45.8% of global investments allocated to China and over 80% of investments made by European investment funds.

**EXHIBIT 9:** ORIGIN OF GLOBAL AND EUROPEAN INVESTMENT FUNDS INVESTED IN MAINLAND CHINA (% OF AUM)

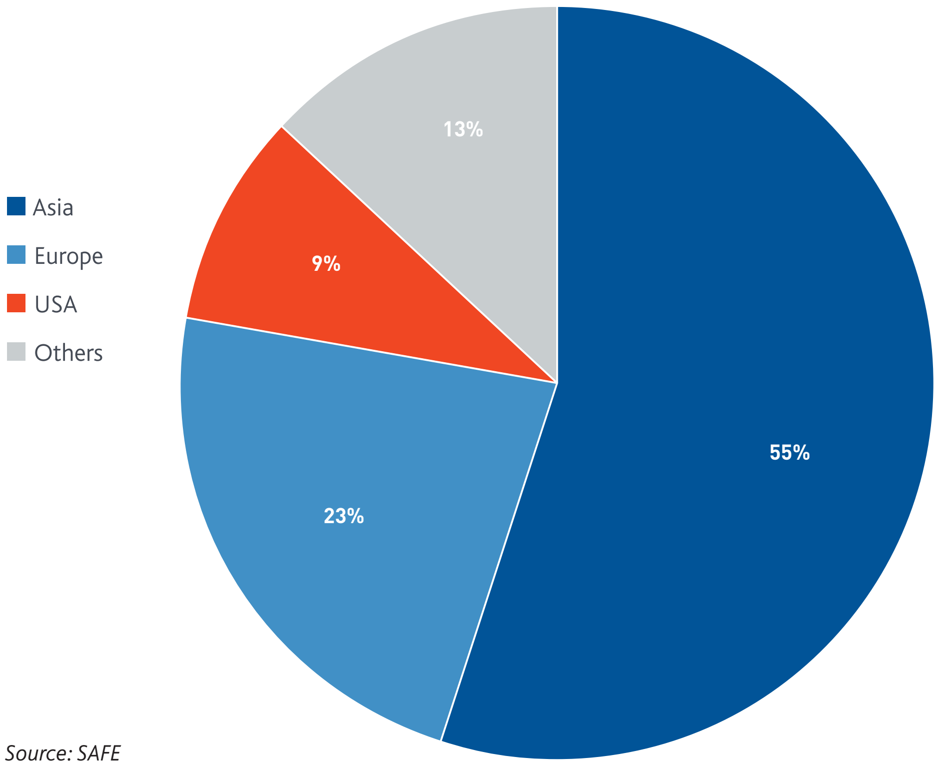



*Sources: PwC Market Research Centre based on Lipper*

On the flipside, the fact that the EU represents approximately one quarter of the QFII quota allotted to foreign investors as of May 2020 (cf. exhibit 10) further underscores the attractiveness of the region's AWM industry to China's financial sector.

The long-running trend of Chinese players establishing operations in Europe and vice versa further exemplifies the long-standing financial Sino-European relationship. Under the Qualified Domestic Limited Partnership (QDLP) [4] scheme, we have seen a number of strategic partnerships between Chinese asset managers and European third-party management companies such as FundRock and Lemanik Asset Management. Since 2015, Chinese fund managers such as Value Partners, Ping An of China Asset Management, Harvest Global Investments and GF International have leveraged such collaborations to explore the European market by launching China-focused UCITS funds. In a similar vein, European players such as AXA, Invesco, Credit Suisse and UBS have been operating in Chinese markets since the turn of the century, although the extent of their ownership has been restricted by the foreign ownership cap until recently.

**EXHIBIT 10:** QFII QUOTA BREAKDOWN BY REGION




*Source: SAFE*

[4] Which allows wholly foreign-owned enterprises to raise funds from Chinese investors for offshore investments.

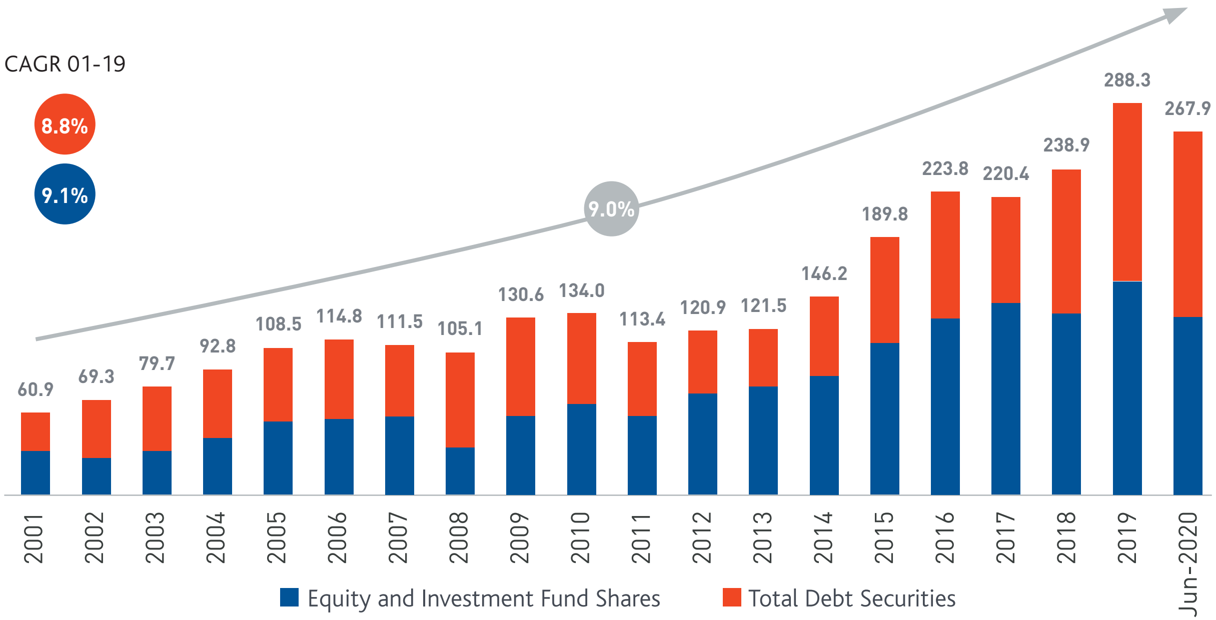
Looking into the future, we strongly expect this collaboration to strengthen despite growing diplomatic strains; with the aforementioned liberalisation and internationalisation of China's financial landscape bringing in an era of unparalleled collaboration between the two nations' respective AWM industries. The easing of China's capital flight restrictions is poised to catalyse Chinese investments into European-domiciled financial products, amid the ramp-up in government measures to boost domestic investors' exposure to foreign capital markets.

Already, we have seen these deregulatory efforts stimulate a veritable surge of assets into European securities, with EUR 130.9 bn and EUR 137.0 bn of Chinese investor assets flowing into European equities and bonds respectively as of June 2020 (cf. exhibit 11). We expect to see Chinese investment into European securities continue along an accelerating trajectory - given that the Chinese foreign exchange regulator has begun to further ease outbound investment limits through the issuance of increased QDII quotas as of September 2020, with approved quotas amounting to EUR 114.7bn by March 2021. The FS sector stands to see the biggest impact from this increase, with securities companies alone making up 50% of allocations.

In a similar vein, recent regulatory developments – namely the ratification of the QDLP in Beijing in 2020 – stand to stimulate an accelerated surge of Chinese-owned investment managers establishing operations in Europe. Recently, Hong-Kong based FountainCap Asset Management launched a Chinese-equity UCITS fund in Ireland with asset value of about USD1.3bn.

Similarly, FullGoal Asset Management and Red Gate Asset Management have made significant headways into the European market through Luxembourg, with FullGoal reporting a 111% increase in their Small-Mid Cap Growth Fund value as of end-2020 [5], bolstered by inflows from Europe.

**EXHIBIT 11:** CHINA-EU PORTFOLIO INVESTMENT STOCK (EUR BN)



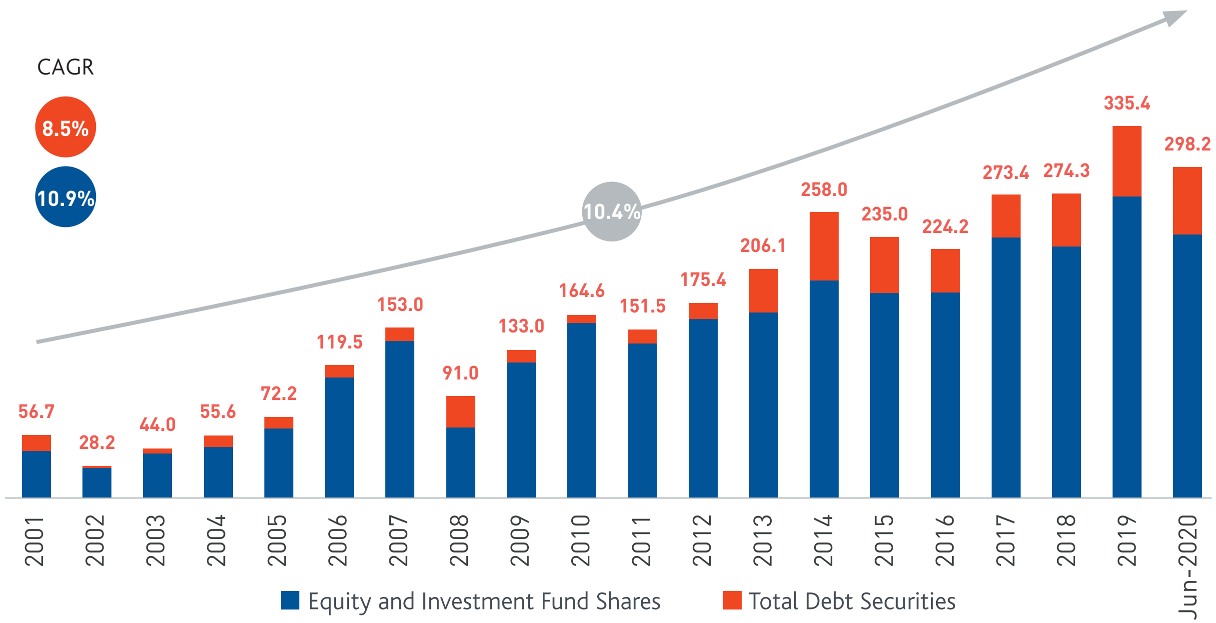

*Source: International Monetary Fund*

[5] Funds Europe

Looking from the outside in, the untapped growth and aforementioned removal of foreign investment entry barriers from China's financial market have stimulated an unprecedented increase in the foreign holdings of Chinese securities - with global investors drawn in by the appeal of diversification and higher yields. These initiatives, combined with the recent regulatory developments promoting the opening up of China's financial sector, have brought in an era of unprecedented cross-border investment, with foreign holdings increasing almost eightfold since January 2014 – reaching EUR 720bn as of September 2020 according to the Bank of China.

This accelerated influx has been particularly pronounced within China's fixed income market as of late; with the country's economic resilience, low correlation with global markets, and virtually unaffected interest rates throughout the pandemic leaving the country as the most promising option for debt investors. Moreover, the lifting of restrictions on QFII and RQFII investment quotas in May 2020 has led to Chinese debt being added to a number of major bond indices, making them more accessible than ever. This increased accessibility has prompted a marked inflow of foreign cash, with European investors purchasing EUR 60.7 bn in Chinese bonds by June 2020 - approximately 95% of the previous year's overall figures (cf. exhibit 12). Looking forward, investors forecast the continuation of these satisfactory yield levels, and we expect to see a heightened volume of portfolio investment from Europe into the Mainland in the near future as a result.

**EXHIBIT 12:** EU-CHINA PORTFOLIO INVESTMENT SPLIT (EUR BN)

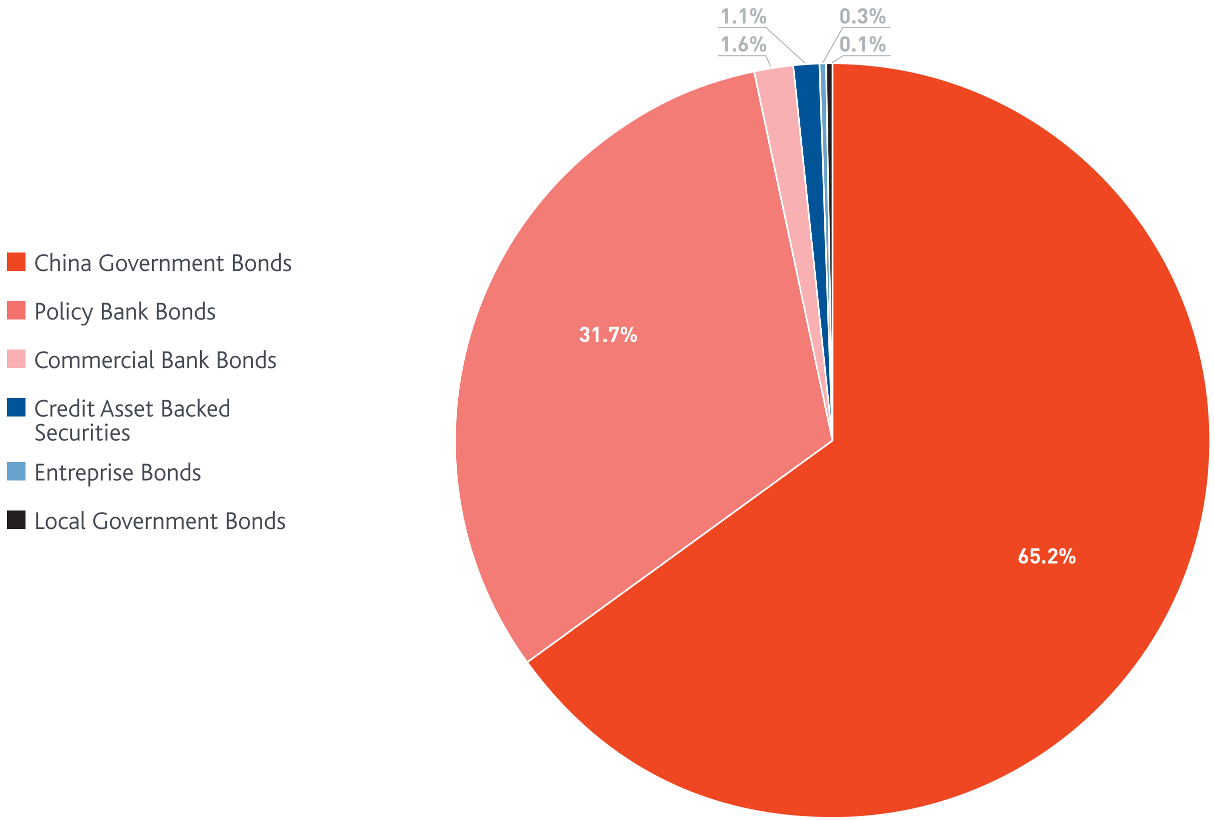



*Source: International Monetary Fund*

Currently, the vast majority of foreign investor holdings are allocated towards government bonds (65.2%) and policy bank bonds (31.7%) (cf. exhibit 13). By applying these percentages to total European debt investment into China as of June 2020, one can approximate that European investors hold roughly EUR 39bn and EUR 20bn in Chinese government bonds and policy bank bonds respectively. The strong preference for government bonds can be partly explained by the fact that China's foreign investor base is mostly comprised of central banks and international financial institutions, whose mandates are almost exclusively linked to government debt. Further, market indices including Chinese bonds are comprised largely of sovereign debt, leading asset managers to concentrate their allocations in government bonds.

We have observed a similar growth in foreign ownership of Chinese securities on the equity side, with global investors increasingly accessing the Chinese stock market in order to reap the benefits provided by the country's strong equity market performance and currency appreciation. As of June 2020, foreign investor assets in the Chinese stock market amount to EUR 343.1bn, of which European investors assets accounted for approximately 70% (EUR 237.5bn). Furthermore, a number of global fund giants, (namely BlackRock, JPMorgan and Vanguard), boosted their exposure to Chinese equities in 2020 - demonstrating the strong confidence and long-term commitment of major managers to the Chinese market.

**EXHIBIT 13:** FOREIGN INVESTOR HOLDINGS IN THE CHINESE MARKET BY BONDS TYPE



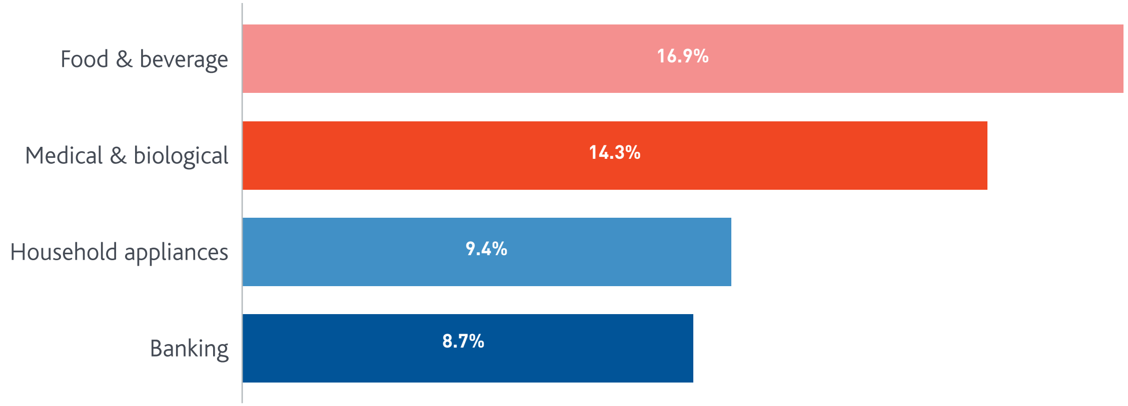

*Source: PwC Market Research Centre analysis based on CDB, EIBC and ADBC data*

Back to contents

While regulatory impediments remain (with foreign investors not being able to hold more than 30% equity in a Chinese listed company), global investors are presented with an unprecedented degree of accessibility to China's vast stock market, with the overall weight of China and China A shares in the MSCI Emerging Market Index standing at 37.4% and 5.1%, respectively as of August 2020. Subsequently, foreign ownership of Chinese equities has skyrocketed, with foreign investor holdings accounting for 5% of Chinese equities as of April 2021. In terms of sectors, Foreign investor A-share class allocations through Stock Connect were spread across a number of industries (cf. exhibit 14).

The internationalisation of China's markets and loosening of capital outflow controls has not only led to an unprecedented inflow of European assets, but of European asset managers themselves. The removal of the foreign ownership cap has also contributed to European asset managers demonstrating a clear appetite for entering the Chinese market. In 2020, Credit Suisse, Amundi and UBS voiced plans to take full control of their respective Chinese Joint Ventures. Some other companies are considering entry into the Chinese market via Wholly Foreign Owned Enterprises (WFOEs), with Abrdn and Vanguard having both applied as WFOEs to the Chinese market authority.

**EXHIBIT 14:** CHINA A-SHARE ALLOCATION BY LARGEST SECTORS




*Source: PwC Market Research Centre, Shanghai Securities Co., Ltd.*

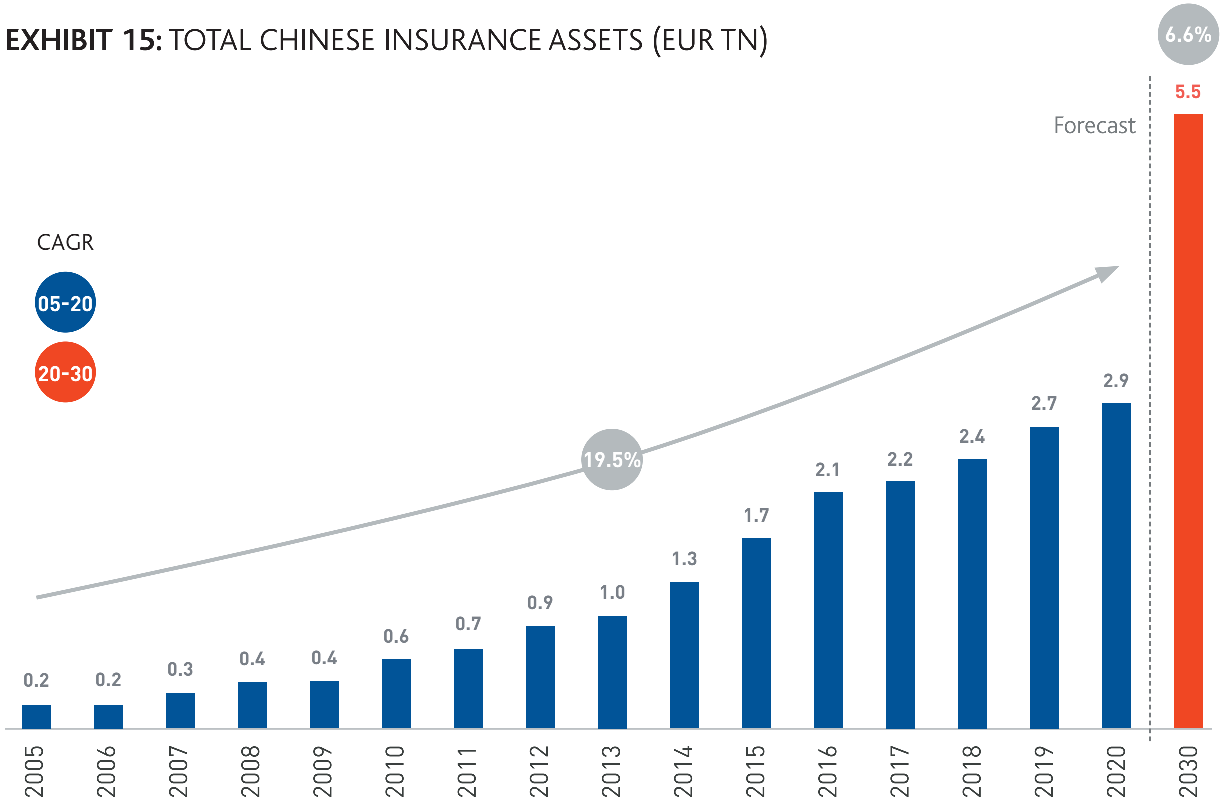
Given the recent regulatory developments in China and the strong interest shown by global players in accessing the Chinese market and vice versa, we strongly believe that the AWM sector represents a veritable opportunity to foster a lucrative, long-lasting financial relationship.

## INSURANCE

Increased deregulation and liberalisation are opening a similar wealth of opportunity in China's vast insurance industry. With total assets skyrocketing at a CAGR of 19.5% from 2005 to reach EUR 2.9tn at end-2020 (cf. exhibit 15), China's insurance market is developing at a truly impressive pace; now accounting for the world's second largest Should this growth trajectory continue at pace, China's share of global premiums could surpass that of the US by 2029.

A strong and mutually beneficial Sino-European relationship is also evident in the insurance space. European insurance companies have traditionally partnered up with a variety of Chinese firms, ranging from retailers to food companies, in order to capitalise on the buoyant Chinese insurance market. Examples of such initiatives include German insurer Ergo forming a joint venture with Chinese car manufacturer Great Wall Motor. That being said, European insurers' exposure to the Chinese market has been historically limited by a raft of regulations and entry requirements - including having a 30-year-old track record in their respective domestic markets and a minimum of USD 200mn in assets. Similarly, Chinese insurers were limited in their abilities to provide their services overseas.

**EXHIBIT 15:** TOTAL CHINESE INSURANCE ASSETS (EUR TN)




*Source: PwC Global AWM Research Centre, CBIRC, National Statistics Bureau of China*

However, a lightening of certain regulatory boundaries similar to that in the AWM space promises to see increasing co-operation between China and Europe's insurance industries - further opening up China's market to foreign players. This increased regulatory liberalisation, coupled with its high penetration potential and digital proficiency has stimulated a surge of international investment and relocation into the Chinese market. As a result, foreign insurers are increasingly looking to China as a source of revenue and diversification in order to stimulate growth, with global insurers having established 64 foreign-funded insurance institutions, 124 offices and 18 insurance agencies in China, and total assets amounting to RMB 1.46 tn (EUR 186.7bn) as of Q1 2020. Moreover, the aforementioned removal of the foreign cap and entry barriers for foreign insurance companies have catalysed a similar surge of European players entering the Chinese market. Both Axa and Allianz, for example, already acquired full ownership of their businesses in China.

This liberalisation has also facilitated the expansion of Chinese players into the European market. In 2014, the China Banking and Insurance Regulatory Commission (CBIRC) permitted local insurers to make investments in 25 developed markets and 20 emerging markets. This has prompted a trend of Chinese insurers expanding their business offering and operations across the world. In December 2019, China Reinsurance Corp. acquired 100% equity in Chaucer Holdings Ltd. Similarly, ZhongAn announced corporate initiatives with partners across Latin America, Europe and Southeast Asia.

The scale and increased internationalisation of China's insurance sector stand to provide significant benefits to China's insurance industry and overall economy. While the Chinese market is undoubtedly flourishing, the entrance of foreign players into mainland China promises to overcome the coverage and accessibility challenge facing the current insurance landscape. In addition, local players could benefit from the expertise of foreign insurers in varied markets.

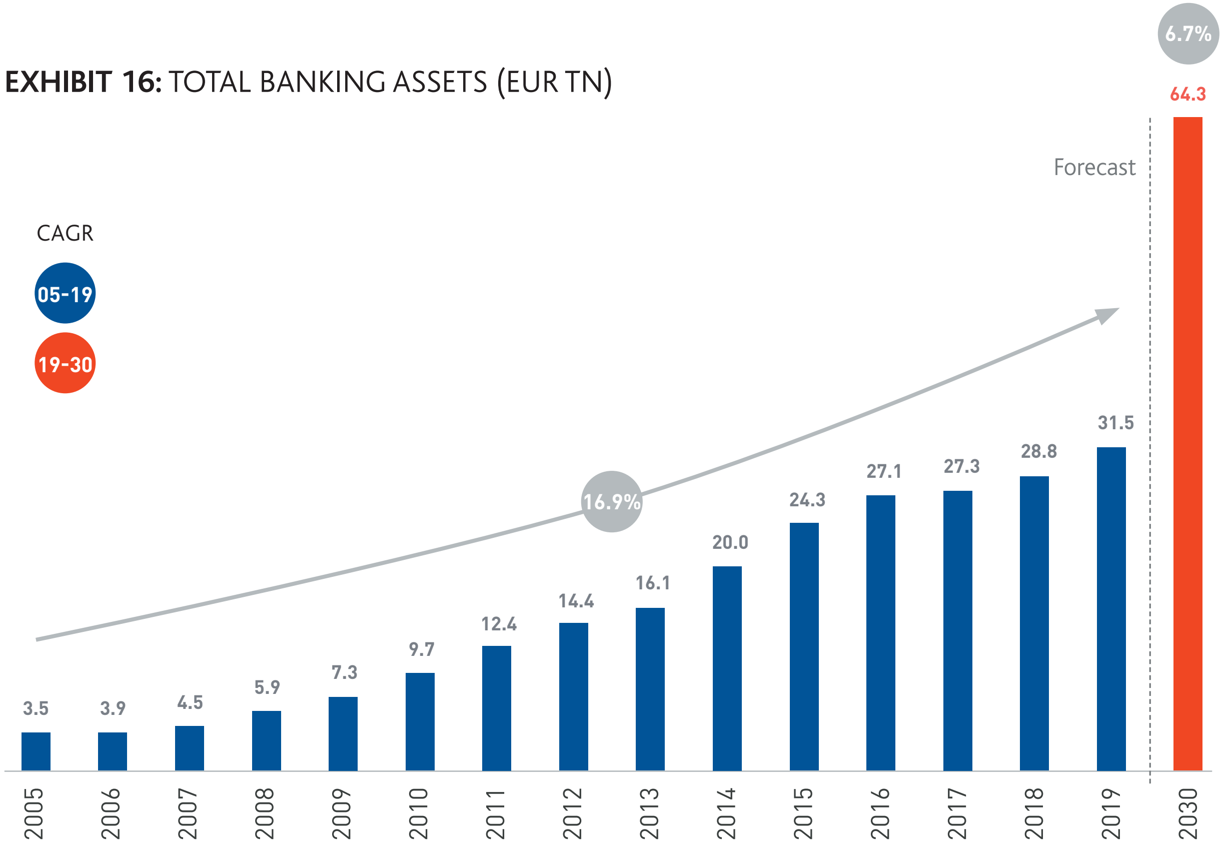
The EU insurance sector also stands to benefit from the internationalisation of China's insurance sector. First and foremost, the widening and deepening gaps in pension and healthcare in China represent a significant opportunity for European insurers to step in to meet unsatisfied demand. These European insurers can leverage their global management experience, scale and brand value to meet the demands of Chinese clients. China's vast InsurTech landscape and client base also represent a further opportunity for European players to enhance their own operating models. That is not to say, however, that this is not a reciprocal benefit; with a number of emerging European InsurTech companies making waves in the global landscape.

From the above, it is clear that the area of insurance represents a strong foundation on which a mutually beneficial bilateral relationship can be built. While regulatory impediments remain, opportunities will stimulate an accelerated inflow of investments and M&A deals into the Chinese insurance market for years to come. This will translate into growth in both Chinese and European insurance markets – with the regions' insurance projected to increase to EUR 5.5tn and EUR 16.5tn respectively. The increased adoption of InsurTech will also lead to increase efficiency in the global insurance space and promote the streamlining of existing business models.

## BANKING

While the expansion of Chinese banking operations within Europe dates as far back as 1979, with the opening of the Bank of China in Luxembourg, the country's "going global" policy implemented in the wake of the 2008 global financial crisis accelerated a surge of internationalisation in China's banking sector. This policy, which was born out of the need to support Chinese firms in their international operations, also served as a tool to bolster the internationalisation of the RMB. A subsequent blanket of government strategies and policies such as the Belt and Road initiative led to an increased presence of Chinese banks within international markets as well as increased acquisitions within the industrial and infrastructure sectors — cementing their role as global financiers. Today, with a total bank asset value of EUR 36.5tn as of May 2020, the Chinese banking industry is currently the largest globally (cf. exhibit 16). Of the top 20 banks globally, the top four banks - with a combined asset value of EUR 13.4tn - are headquartered in China.

**EXHIBIT 16:** TOTAL BANKING ASSETS (EUR TN)




*Source: PwC Global AWM Research Centre analysis based on Financial Stability Board data*

The strength of China's banking sector is bolstered by the fast-increasing private wealth of its population, with the number of Chinese investors with investable assets exceeding RMB 10mn surging from 300,000 in 2008 to 2 million in 2018. This significant wealth has been largely contained within China's borders due to its "closed capital accounts" policy and capital flight restrictions, which have restricted offshore investment and resulted in approximately 46.9% of household income in 2019 being deposited into banks. In 2020, total bank deposits amounted to EUR 27.8tn (cf. exhibit 10), representing a deposit money banks' asset to GDP ratio of 181.22%.

The aforementioned wave of deregulation has seen a number of Chinese banks establishing offices in Europe. Currently, 7 Chinese banks have been established in Europe, with the Big Four having a total of 618 branches outside of the Mainland. Moreover, Chinese banks have acquired three European banks in recent years — with Haitong Securities acquiring Banco Espirito Santo de Investimento in 2014, Fosun acquiring Hauck & Aufhäuser in 2016 and Banque Internationale à Luxembourg being acquired by Legend Holdings in 2017. Chinese stakeholders also own minority shares in Saxo Bank, Millennium BCP and Deutsche Bank. Moreover, China's largest bank, the Industrial and Commercial Bank of China (ICBC), announced the expansion of their retail and commercial banking services to five new offices in various European cities in 2011 - in addition to the four existing ones in Luxembourg, Frankfurt, London, and Moscow.

This emergence of Chinese banks in the EU does not only serve the interests of Chinese clients looking to invest in Europe, but also caters to European clients in need of financing – a development which can be attributed to China's significant ramp-up of its cross-border lending activities in recent times. Even with the scale of its cross-border expertise and transactions, cross-lending among EU countries has been historically hampered by structural impediments and political uncertainties, underscoring the need for alternative sources of funding. As a result, China has been progressively lending to the EU, demonstrated by a 33% increase in banking claims from 2010 to 2017 [6]. The proliferation of Chinese banking operations in the EU has not only been limited to commercial banking activities but is opening up within the private banking and wealth management segments as well. With increased savings rates leading to a significantly large amount of idle funds in Chinese accounts, the fund management operations of these Europe-based Chinese banks stand to greatly benefit the European capital markets.

On the flip side, we have also seen a veritable surge of international banks setting up shop in China, including HSBC, Deutsche Bank, UBS, BNP Paribas and Credit Agricole. As of Q1 2020, foreign banks had established 41 foreign-funded corporate banks, 115 branches and 149 offices in China, with total assets reaching RMB 3.6 tn (EUR 460.4bn). However, foreign banks seeking to establish or expand their operations in China still find themselves subject to a number of roadblocks; with structural and regulatory restraints impeding their organic growth. While recent regulatory developments have permitted wholly foreign-owned banks to operate in mainland China, they still need individual licences for each branch, and cross-border flows remain restricted. That being said, we believe that foreign banks are set to capture an increasing share of China's banking profits.

Overall, both Chinese and European players can grasp opportunities in the banking sector. Gradual changes in the regulation bring the promise of long-term benefits not only for the companies themselves, but also for the retail investors in China and Chinese banks looking to benefit from partnerships with more experienced players.

[6] EC-JRC (2019) China: Challenges and Prospects from an Industrial and Innovation Powerhouse

# CONCLUSION

Back to contents

Overall, financial integration between China and the EU is materialising, driven by the desire of both sides to bring their trade and investment relationship to its fullest potential. Given that bilateral portfolio investment between the two has undergone an unabated rise, and financial services makes up a similar share in both China's and the EU's FDI stock, we strongly believe that the financial services sector could represent a foundation on which a fruitful and balanced relationship between China and the European Union can be built.

In addition, the liberalisation of China's financial services is consistent with China's evolving relationship with foreign companies, reflected in the lifting of foreign ownership caps. The mutual vested interests and respective advantages that these regions hold in each sector could be highly conducive to sparking heightened diplomacy and attaining a mutually beneficial rapport. Although barriers remain and political tone is hardening, the strong economic ties between the two regions represent a strong foundation upon which prosperous, mutually beneficial co-operation can be built.

Agency for the Development of the Financial Centre