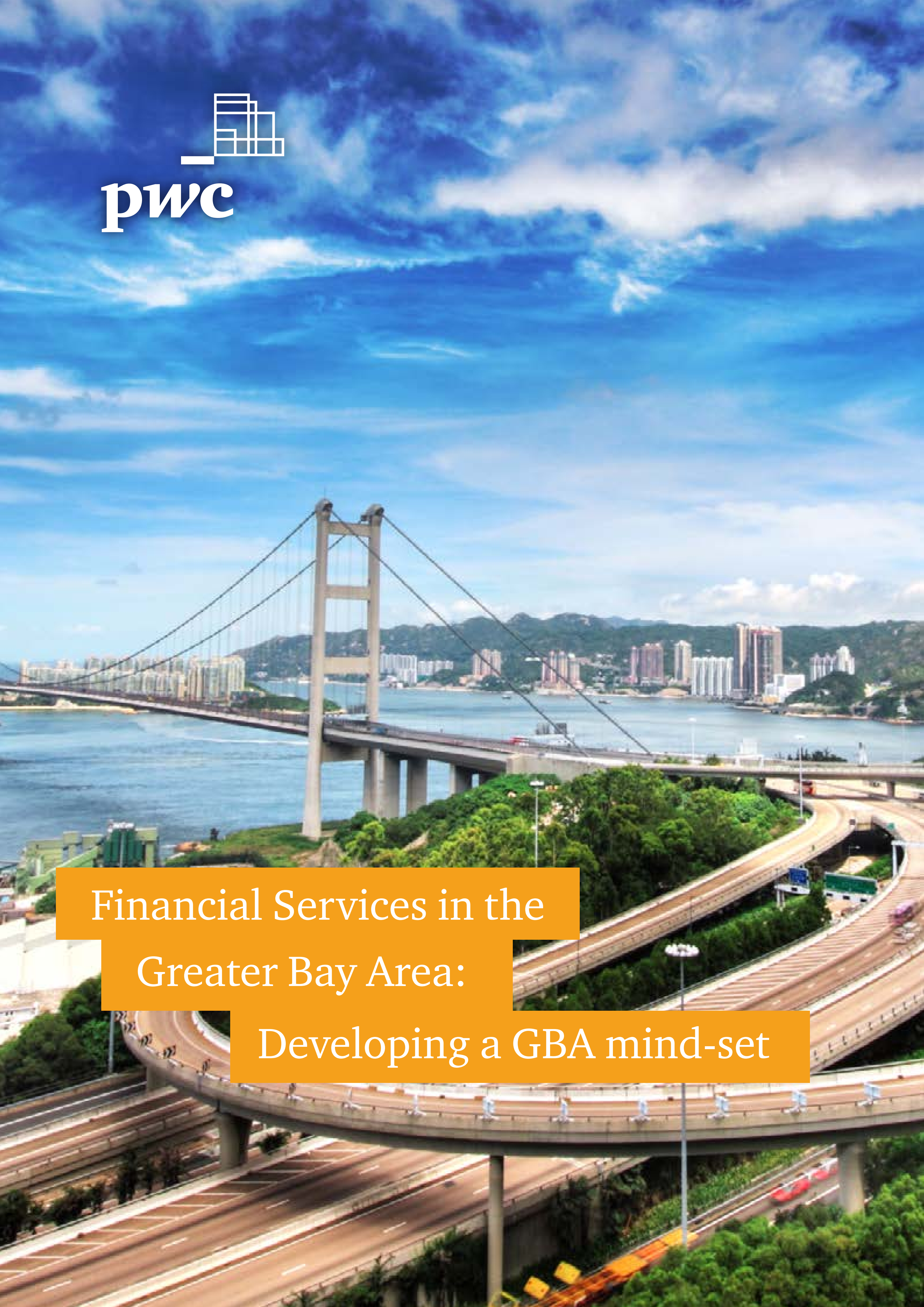
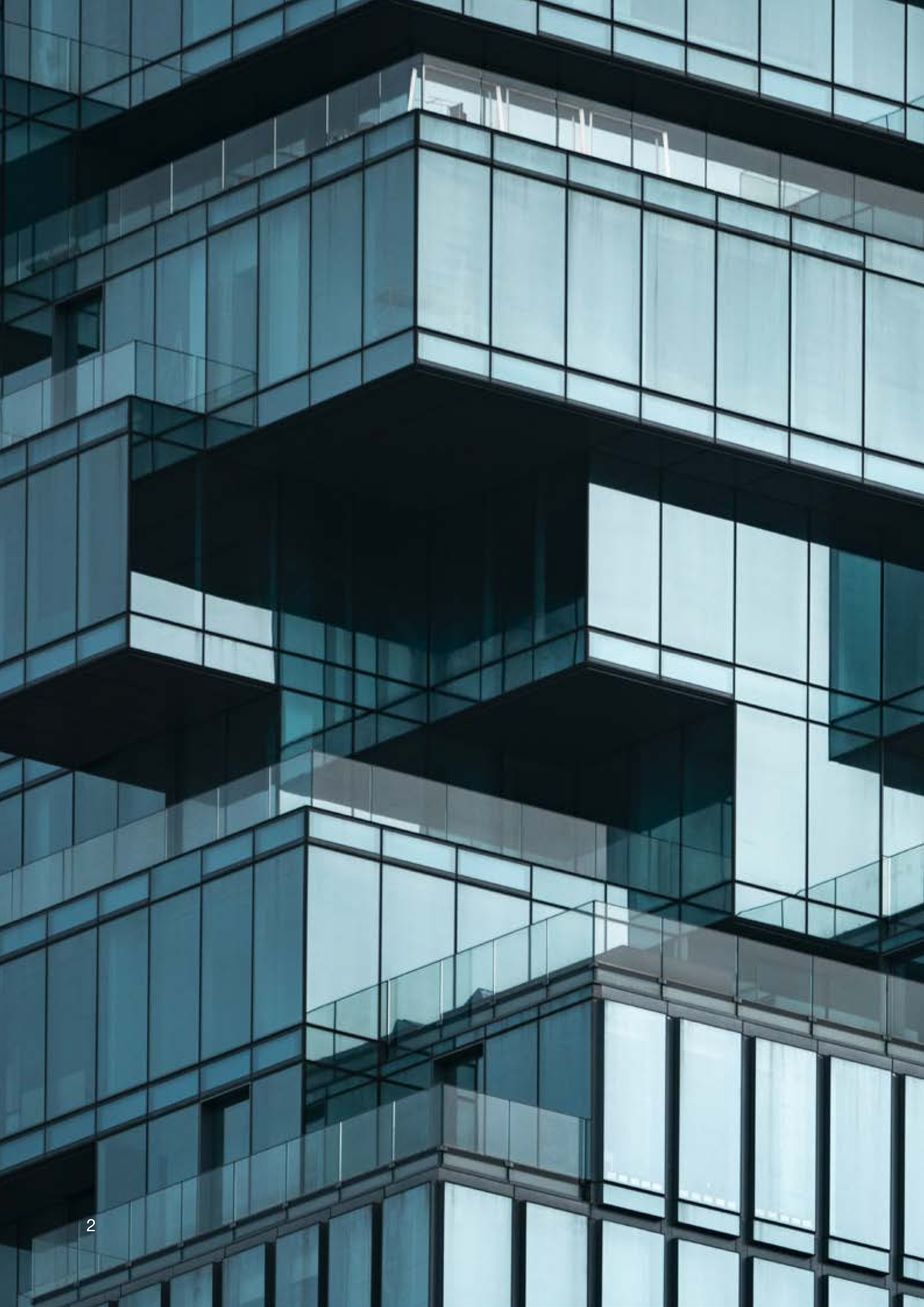


Financial Services in the Greater Bay Area: Developing a GBA mind-set



Contents

Executive Summary

The concept of the Guangdong-Hong Kong-Macau Greater Bay Area (GBA) was first raised in 2016 as part of China's 13th Five Year Plan. This was followed by the signing of a 'Framework Agreement on Deepening Guangdong - Hong Kong - Macau Cooperation' in 2017. The GBA's mission, along with six basic principles and seven areas of development, was then unveiled as part of the Outline Development Plan, which was issued in February 2019[1].

On 14 May of this year, the CBIRC, CSRC, PBOC and SAFE jointly issued 'Circular No.95'[2]. This document reaffirms the regulators' commitment to the development of the GBA through a list of thirty 'Articles' for the financial services industry.

With 12% of China's GDP, a population of over 70 million and a landmass three times that of the San Francisco Bay, no-one disputes the enormous potential of the GBA. But tangible developments have been slower than expected in the last year, given social unrest in Hong Kong and the coronavirus pandemic. It is hoped that Circular No.95 will help provide renewed impetus to the GBA.

When we canvassed our clients' opinions on the GBA for an earlier paper in 2019, much of the discussion was focussed on the high-level challenge of how to reconcile different regulatory and legal frameworks. While this is certainly still a major concern, there is a sense among some interviewees that their institutions should now focus on what is possible – on how they can work within the current constraints.

What we refer to as 'a GBA mind-set' is really a recognition that, while a fully-integrated and frictionless GBA may be some years away, the potential needs to be explored now. By introducing new products and services to their GBA audience, or by lobbying regulators for minor concessions or exceptions, these players can start to make the vision of the GBA a *de facto* reality.

Firms that innovate in this way, by operating on the frontiers of what is possible, can give a tangible demonstration of the potential benefits of the GBA once it is fully realised. This is a process of innovation from the ground up, rather than top-down reform.

[1] https://www.bayarea.gov.hk/en/outline/plan.html

[2] http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4023428/index.html

Introduction

This paper is based on in-depth interviews with senior executives from banks, asset managers and insurers working across the 9+2 cities of the Greater Bay Area, as well as representatives from academia and professional bodies[3]. As with some of our previous papers[4], discussions with our interviewees quite quickly homed in on three major challenges. These are the need to facilitate the free flow of people, of data and of capital. Of course, these three issues are not exclusive to the Greater Bay Area – they are of importance for the whole of China. However, they are critical for the GBA to achieve its full potential.

There were other areas of near or total unanimity in our interviews. On the plus side of the ledger, everyone agrees that the level of technological preparedness in the GBA can overcome almost any operational challenge. On the other side, many institutions are unsure who their first point of government or regulatory contact should be on matters relating to the GBA.

While there are some divergent views on specific issues, the GBA vision as a whole is strongly welcomed by our interviewees. Virtually all respondents see great potential in the 9+2 cities working together and becoming more than the sum of their parts. For Hong Kong-based businesses, the significantly larger customer base in the GBA will encourage investment in areas such as FinTech that would otherwise not be feasible.

Indeed, confidence in the power of technology is one of the main drivers of this positive assessment of the GBA. Respondents acknowledge that there are regulatory challenges and issues of inter-operability that need to be resolved for the GBA to take off – but technology can enable solutions to these.

On other issues, our interviewees offer starkly different opinions. From the prospects for Renminbi internationalisation to investor appetite for a possible Wealth Management Connect scheme (WM Connect), we encountered a rich variety of views. We endeavour to fairly summarise these contrasting assessments in the following pages.

In this paper we shall analyse in turn the challenges and opportunities arising from the flow of people, of data and of capital.

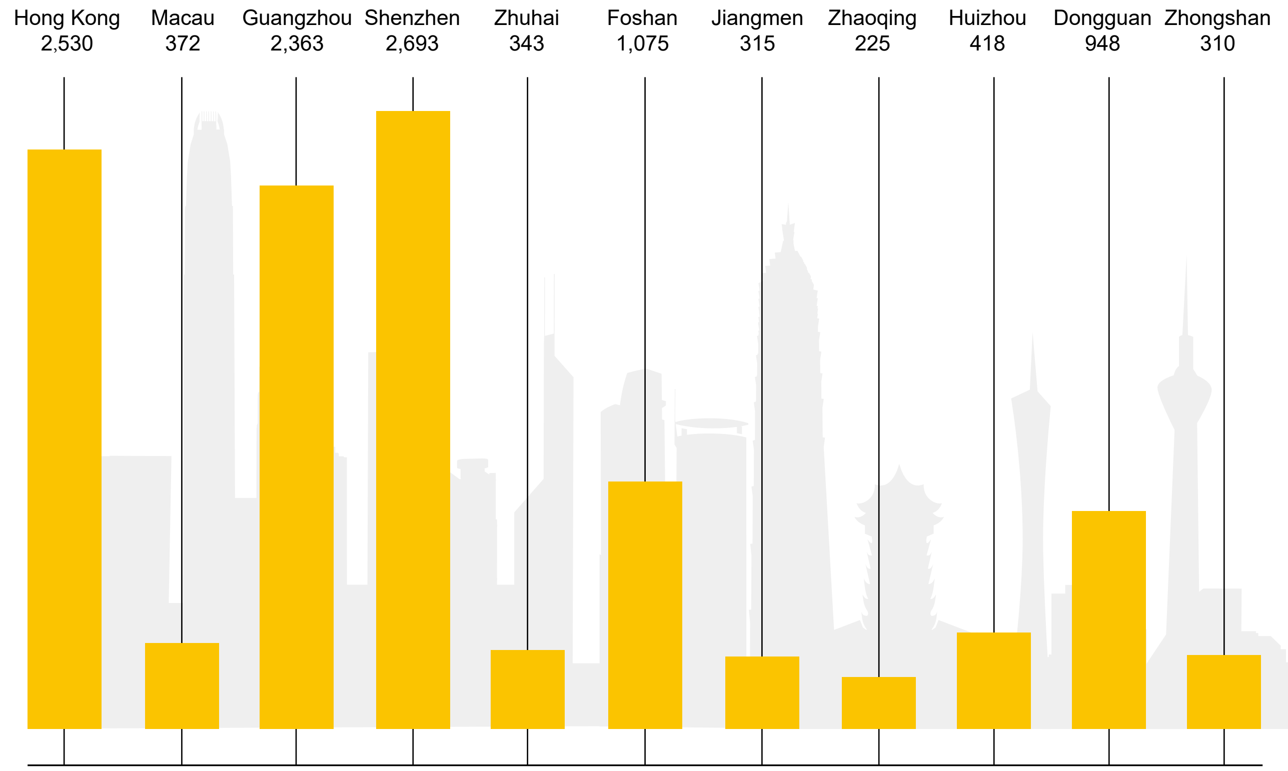
> “The GBA is turbo-charging the role of Hong Kong as an access point into and out of Mainland China.”
>
> **Peter Burnett, Managing Director, Corporate & Institutional Banking — Standard Chartered Bank; Chairman — British Chamber of Commerce, Hong Kong**

[3] This report is based on in-depth interviews with senior representatives from eleven banks (including four Hong Kong subsidiaries of Mainland Chinese banks and one virtual bank); six asset managers; one European and one Mainland Chinese insurer; one industry body and one international policy institute.

[4] https://www.pwccn.com/en/research-and-insights/greater-bay-area/publications/fintech-greater-bay-area-breaking-down-barriers.html

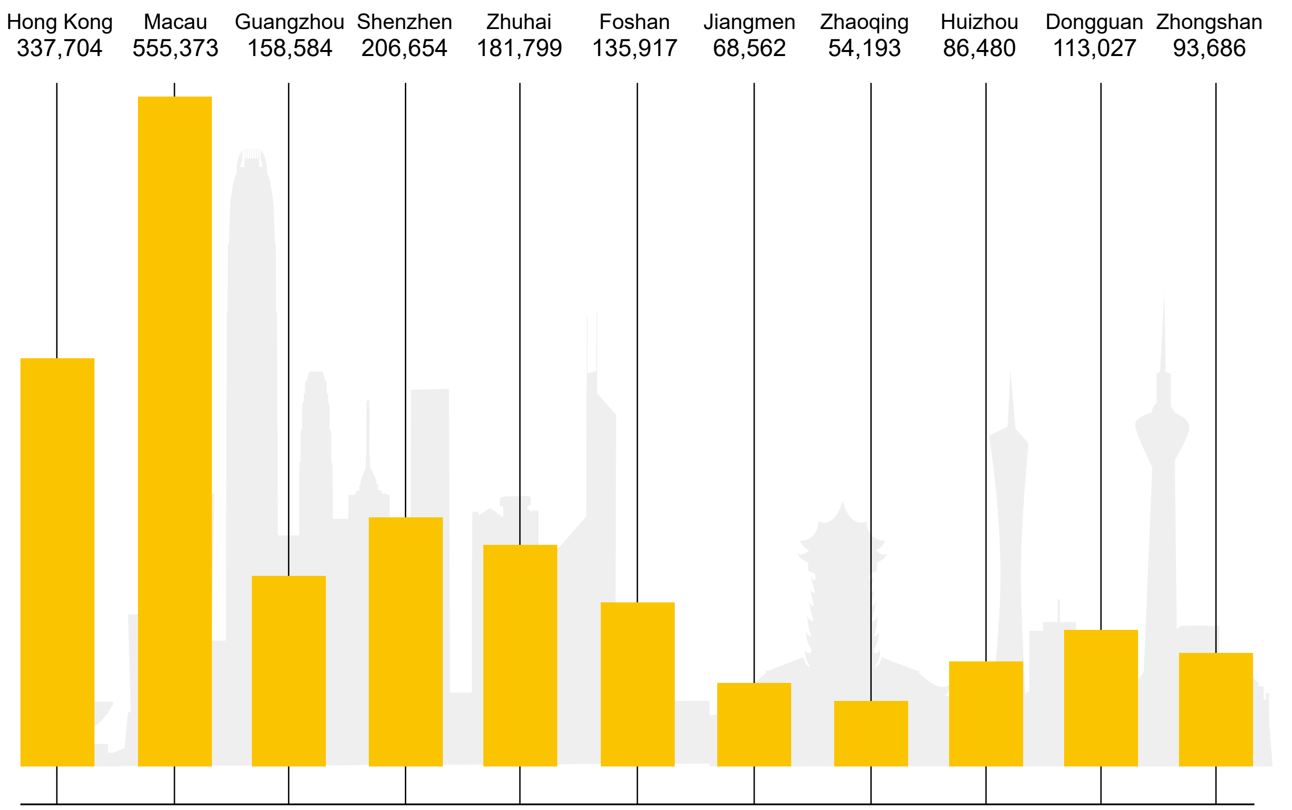
The GBA at a glance

GDP of Greater Bay Area cities in 2019 (in RMB bn.)



Source: CEIC, National Bureau of Statistics, PwC

Per capita GDP of Greater Bay Area in 2019 (RMB)



Source: CEIC, National Bureau of Statistics, PwC

> While Macau's per capita GDP is the highest in the GBA, its economy is quite homogeneous. The Outline Development Plan will open up more opportunities both for Macau and for financial services players."
>
> **Monica Ng, Partner, PwC Macau**

People

Overview

The GBA is frequently compared to the Tokyo and San Francisco Bay areas, as well as to the New York metropolitan area. But the GBA differs from its peers because of land borders between Guangdong and the two SARs of Macau and Hong Kong. Many of our interviewees cite the practical difficulties of deploying staff or contractors to either side of the borders at short notice. Asking a colleague to attend an urgent meeting is often not feasible.

Other practical considerations – ranging from tax differentials to ease of accessing medical care – also serve to impede the evolution of the GBA by making it more difficult to attract and retain talent.

But where there are difficulties there are also business opportunities: helping firms and their staff overcome these obstacles is an area of interest to some of the banks we have spoken to. Others are more focussed on the marketing challenges of the GBA – anticipating the effect of differences in demographics and customer behaviour across the GBA could be the key to success.

Understanding customers is one thing: how to operate in different parts of the GBA is quite another. The GBA is homogenous enough to be seen as a single market, but it is heterogeneous enough to pose challenges for our interviewees – many of whom cite a lack of consensus from city to city on how to get things done.

Fostering people mobility

As we shall discuss elsewhere in this paper, a number of interviewees are looking at what banks can do to help Hong Kong residents to open accounts and carry out transactions in the GBA. For some, in the current regulatory environment, this is at best a marginal activity. For example, Hong Kong residents only account for 2% of residential property transactions in the GBA, having bought about 10,000 properties in 2018[5].

But others see a win-win: in the case of property, each of the nine Mainland GBA cities has slightly different requirements for non-local residents seeking to buy[6]. Helping would-be buyers to navigate these rules and supporting day-to-day needs (such as paying utility bills, etc.) can be a business growth area. It is also an example of a 'ground up' measure that contributes towards the GBA becoming a reality. Quite apart from the bank's customers, it can be a useful way to attract and retain staff who may be required to work on both sides of the border over the course of their careers.

But while banks' individual initiatives can help move the needle, there also needs to be change at a policy level. "Immigration rules do not help the movement of talent. We should look at the EU's freedom of movement rules as a model," says David Ng, COO, of CSOP Asset Management Limited."In order to attract talent to work in the GBA, there needs to be comfort around issues such as availability of healthcare. There also need to be tax incentives to encourage people to work in Mainland China."

A Guangzhou-based banker concurs: "Facilitating the flow of people is the top priority in promoting mutual market access, but the majority of the flow will probably be northbound. Mutual recognition of qualifications and licensing, as well as alignment of remuneration, is necessary."

Policymakers are conscious of the impact of differences in individual income tax rates between Mainland China and Hong Kong. Consequently, Guangdong province has implemented tax rebate policies for qualified overseas talent (including Hong Kong, Macau and Taiwan) who work in the nine Mainland cities of the GBA. Individual income tax payments exceeding 15% of taxable income may be rebated.

"The more relevant initiatives in the GBA are about convenience – transport, people mobility, buying property, tax issues between different cities. All of these need to be addressed in the first two to three years of the GBA."

Eleanor Wan, CEO — BEA Union

[5] https://www.scmp.com/business/article/3037411/demand-greater-bay-area-homes-set-rise-easier-ownership-rules-hong-kong

[6] There are variations in bank loan caps, price control measures and requirements for social security contributions: https://www.scmp.com/property/hong-kong-china/article/3005112/explainer-which-city-within-greater-bay-area-should-hong

Individuals working across borders in the GBA should be mindful of the different tax regimes in Hong Kong, Macau and the Mainland so as to better manage tax risks arising from cross-border activities, as well as to mitigate double taxation and tax disputes.

A further step to facilitate movement of people concerns social insurance. Since January 2020, Hong Kong, Macau and Taiwan residents who work, live or study in Mainland China have been able to participate in social insurance schemes and enjoy social insurance benefits.

While most of these measures will apply across the board to all overseas talent, some should be introduced to target particular segments of the working population, according to the CEO of a Hong Kong virtual bank. “We suggest short to mid-term work/ internship visas to facilitate talent flow at a more junior level. Now the policy only allows top talent and tourists to come, leaving a gap in the middle.”

Sometimes the impediments to living and working across the GBA are simply due to an individual’s lack of familiarity with their new environment – how things get done, where you need to apply for approval of certain transactions, etc. At other times it may be that local institutions have not developed a ‘GBA mind-set’ and are reluctant to help customers that they don’t have a history with. In either case, this is an opportunity for retail banks. Some are beginning to offer ‘property concierge’ and other services – either as a value-added service to build customer loyalty or as a new area of revenue growth.

Marketing challenges: brand credibility, investor appetite and demographics

Contemplating the regulatory and other practical challenges to GBA integration may lead us to pay less attention to the more traditional challenges that businesses have always faced: customers and their preferences.

While there are different predictions of how demand for Wealth Management (WM) Connect and other services will develop, it is important not to fall into the trap of seeing the GBA as a single homogenous market of potential clients:

“Demographics should not be overlooked: how do we penetrate the younger customer base in the GBA? What are their aspirations? How do we meet the needs of ageing customers?” says the President of the Hong Kong subsidiary of a Mainland Chinese bank. “Banks need to be aware of cultural issues. Not just language, but how you express yourself – some phrases don’t travel well.”

“Customer behaviour in Mainland China differs from Hong Kong. For one thing, they are more tech-savvy and happy to use digital platforms for investing. This new customer base should be an incentive for fund managers to innovate.”

Dr. King Au, President — Value Partners

Apart from demographics and cultural orientation, the universe of investment options has been very different for investors: “Developing a single market for asset management in the GBA will take time: the MPF[7] has been around for twenty years but Hong Kong investors still benchmark their MPF’s performance against the HSI,” says Eleanor Wan of BEA Union. “The dollar peg also means Hong Kong investors have a very US-centric world view, while Mainland Chinese investors are focussed on RMB.”

There is a range of opinions among our interviewees regarding investor risk appetite and sophistication. Some argue that exposure to products under the Mutual Recognition of Funds has removed the notion of an implicit guarantee from the minds of Mainland Chinese investors. While others believe that even the most stark wake-up calls have had little effect: “The growing number of bond defaults in China are not changing sentiment,” says David Ng of CSOP. “Mainland Chinese investors still like products with implicit guarantees.”

PwC’s own research[8] has shown that potential Virtual Bank clients are looking for more help in the area of investor education. In particular they would like the banks to make investment research available. But this is only half of the equation. As one asset manager points out, for the issue of investor education to be addressed, clients still need to read the research.

[7] The Mandatory Provident Fund (MPF) is a mandatory, privately managed, fully funded contribution scheme for Hong Kong employees. It was launched in December 2000. www.mpfa.org.hk

[8] https://www.pwchk.com/en/industries/financial-services/banking-and-capital-markets/publications/2019-digital-banking-customer-survey.html

Talent issues

As outlined in the first section of this chapter, there are obstacles to recruiting and retaining talent among and between the jurisdictions of the GBA. Some of the most conspicuous differences, such as income tax rates, are being addressed by Guangdong's provincial government. Other liveability issues may be addressed by firms that see a business opportunity in taking care of day-to-day headaches for people migrating from one part of the GBA to another.

The assumption that Hong Kong will be the investment centre of the GBA and Shenzhen the technical centre is accepted as a sensible solution by some of our interviewees. For others it highlights a lack of mobility between the 9+2 cities. Will the result be a patchwork of different skill sets across the GBA – with shortages of certain skills in some cities, and unproductive surpluses in others?

Some believe that this is healthy and probably inevitable – different cities within the GBA will compete on the basis of their comparative advantages. The end result will be a GBA that is more than the sum of its parts.

Real estate research suggests possible over-supply of office space in some parts of the GBA. Nevertheless, demand for back office space remains healthy.

The realities on the ground – the cost of talent or of office space, for example – may well dictate what happens. Efforts to resist this trend could lead to some distortions. As the CEO of a virtual bank says earlier in this chapter, there is a danger that efforts to attract talent are concentrated on the most senior people – neglecting the need for junior and middle tiers of management.

> "Living costs in Hong Kong are much higher than the rest of the GBA, making it difficult to attract talent – especially tech talent. High rents have an impact, too – we prefer to have our R&D and back office in Shenzhen."
>
> **Chief Financial Officer, a Mainland Chinese brokerage**

In a recent survey of office tenants in Hong Kong, 20% of respondents said the GBA will lead them to expand their local operations, while 14% said they would increase budgets for business growth in other GBA cities[9].

An index of GBA grade-A offices[10] showed a 2.5% decline in rents over the second half of 2019 and a 3.6% decline in sales prices. The new supply of grade-A offices in the eleven GBA cities totalled 1.4m sqm, with Shenzhen accounting for more than 75% of the total. Despite this, demand for back office spaces in Zhuhai, Shenzhen and Guangzhou from clients in Hong Kong and Macau increased over the same period.

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[9] https://www.colliers.com/-/media/images/apac/hong%20kong/2019_images/radar/190626-occupierreport2019/colliersradarhongkongoccupiersurvey2019_final.pdf

[10] The Greater Bay Area Grade A Office Index. Savills Research, March 2020

Distortions in the market for human capital are also evident in recent cases of over-qualified staff from other parts of China applying for relatively modest roles in Shenzhen. They are attracted not only by higher salaries, but also such perks as 'talent housing'[11].

Cai Fang, a standing committee member of the National People's Congress (NPC) and vice president of the Chinese Academy of Social Sciences, recently noted that Shenzhen had reached what economists call its 'Lewis turning point' in 2004[12]. This is when migrant labour has been fully absorbed into the workforce, prompting an increase in wages.

The traditional response in such a situation is to upgrade economic activity and move up the value chain. The danger is that the largest employers will lavish benefits on scarce talent, making it ever more difficult for SMEs to recruit. The consensus view among our interviewees is that market forces should be tempered by policies in all three GBA jurisdictions to encourage a more equitable distribution of talent.

"A GBA talent mobility scheme that consolidates region-wide resources and services is needed to provide opportunities to live and work across different jurisdictions, societies and cultures. Preferably, this scheme would be jointly initiated by governments in the region, with business closely participating."

Chen Gang, Senior Business Director, China Taiping Life Insurance (Hong Kong) Company Limited

[11] https://greaterbayinsight.com/shenzhen-considers-its-talents/

[12] Ibid.

Learning how to operate in the GBA

In this section we have looked at how the environment within the GBA can influence where people want to live and work, or where they feel most comfortable. We have also looked at how demographic and cultural differences may affect people's investment behaviour. Finally, we consider how people interact with different governance and regulatory structures.

A common complaint from our interviewees is uncertainty about which bodies they should be speaking to: "The governance of the GBA is not clear," says a senior officer from a European insurer. "Who do we need to talk to? The IA, the CBIRC, city governors?"

While some are frustrated at a lack of clarity in GBA initiatives, others welcome a willingness to try out new things. This contrasts with a relatively cautious approach to governance in Hong Kong. As one banker commented: "In Mainland China, the job of government officials is to make things happen – even if some of these initiatives prove not to be successful."

A number of interviewees point out that the governance situation is more complex than just three different legal systems: "There are different requirements from town to town and little consensus on what is needed," says one banker. "Do I need a WeChat account or a local phone number to open a bank account? Information on policy is scattered, suggesting we need a common body or committee for the GBA."

In last year's paper, many of our interviewees raised the issue of regulatory integration in the GBA. The emphasis this year has shifted from the strategic to the operational.

The flow of data

Overview

Access to reliable data between the two SARs and the Mainland cities of the GBA is hampered by the three jurisdictions' differing approaches to data privacy regulation. This, combined with the burden of KYC compliance, means that SMEs in the GBA have been historically under-served. As we shall discuss in this section, alternative data and innovative technology may provide solutions to this long-standing problem.

The Hong Kong subsidiaries of Mainland Chinese banks may appear best placed to support the SME sector, but the role of virtual banks (VBs) should not be overlooked. There is a lively debate among our interviewees as to whether VBs should see their future in the GBA or as regional players.

Remote account opening and cross-border transactions are two areas where data reliability, technology and regulation intersect. The challenge for Blockchain, AI and other technology solutions is to provide such a degree of certainty that regulators will allow cross-border business to take off.

The role of SMEs in the GBA: data flows, credit ratings, Blockchain

The GBA's meteoric growth in recent years now places it higher in GDP rankings than South Korea and not far behind Canada[13]. While the GBA has produced several world-leading tech giants, much of this growth has been driven by an army of SMEs. Some of these firms are affiliated with long-established companies headquartered in Hong Kong or in other major financial centres. But many others have had to make it on their own.

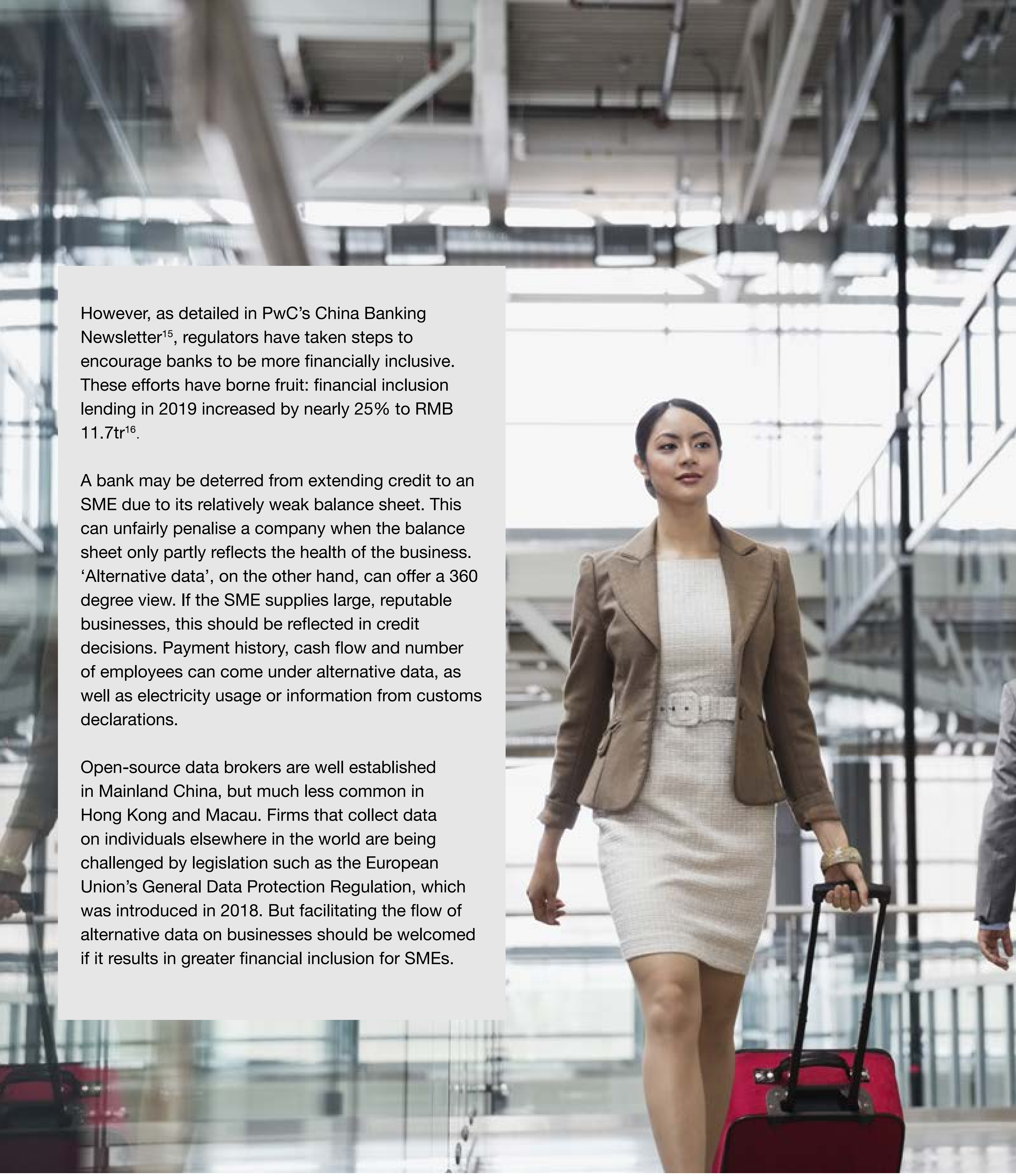
Historically, SMEs across China have been under-served. The cost of KYC/AML compliance has deterred banks from taking on SME clients. P2P lending, which at its peak is estimated to have totalled RMB 1.3tr[14], was one avenue of financing. But this option has now been effectively closed due to tighter regulation.

As the managing director of a Mainland Chinese bank commented: "We are risk sensitive, rather than price or margin sensitive. SME lending has been stuck for the last ten to fifteen years because the workload is just too much."

> "
> SME lending is one area that virtual banks should jump into. They have an advantage over incumbents in that they may have access to alternative data on customers from other sources."
>
> **CEO, Hong Kong subsidiary of a Mainland Chinese bank**

[13] https://greaterbayinsight.com/gba-in-numbers/

[14] https://www.scmp.com/economy/china-economy/article/3006170/chinas-p2p-lending-market-could-be-decimated-year-amid



However, as detailed in PwC's China Banking Newsletter[15], regulators have taken steps to encourage banks to be more financially inclusive. These efforts have borne fruit: financial inclusion lending in 2019 increased by nearly 25% to RMB 11.7tr[16].

A bank may be deterred from extending credit to an SME due to its relatively weak balance sheet. This can unfairly penalise a company when the balance sheet only partly reflects the health of the business. 'Alternative data', on the other hand, can offer a 360 degree view. If the SME supplies large, reputable businesses, this should be reflected in credit decisions. Payment history, cash flow and number of employees can come under alternative data, as well as electricity usage or information from customs declarations.

Open-source data brokers are well established in Mainland China, but much less common in Hong Kong and Macau. Firms that collect data on individuals elsewhere in the world are being challenged by legislation such as the European Union's General Data Protection Regulation, which was introduced in 2018. But facilitating the flow of alternative data on businesses should be welcomed if it results in greater financial inclusion for SMEs.

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[15] https://www.pwccn.com/en/banking/banking-newsletter-a-newsletter-for-the-china-banking-community-jun2019.pdf

[16] http://www.cbirc.gov.cn/en/view/pages/ItemDetail.html?docId=891703&itemId=983

For the GBA to reach its full potential, the small businesses operating in innovative industries and aspiring to be among the next wave of giants need access to credit. And lenders need access to data that is both reliable and easily transferred between the different parts of the GBA. It seems that the solution to the SME problem will be a technological one.

The President of the Hong Kong subsidiary of a Mainland Chinese bank stresses the importance of "mutual recognition of credit scoring." She also points out that Hong Kong banks with a Mainland Chinese parent are better placed to assess credit risk: "SMEs wanting to borrow in Hong Kong can be checked on, as we can work on a bilateral basis with our GBA branches." Cooperation between credit scoring institutions within the GBA, as well as mutual recognition of credit data, are referred to in Article 22 of Circular No.95 (see p.4).

Even when banks can get access to data, there may be questions as to its reliability. Has the potential client inflated its sales figures? Does it have outstanding payments to suppliers? The Guangdong Local Financial Supervision and Administration Bureau recently launched a new initiative to tackle this issue of data reliability[17]. To date, it has collected information on more than 11m businesses across Guangdong Province in order to build risk ratings and profiles[18].

> "It is likely that SMEs will always be under-served. But we hope that we will be able to leverage AI to spot good lending opportunities."
> **Bi Mingqiang, President and CEO — China Citic Bank International**

Based on a blockchain, the system allows companies to record assets, liabilities and transactions in real time with 26 government agencies, including the State Administration for Industry and Commerce. The plan is that, in return for sharing verifiable data, the SMEs involved will gain easier access to credit from banks and other financial institutions.

AI, big data and blockchain are the likely solutions to help bridge the data gap between SMEs and lenders, though one Guangzhou-based banker inserts a note of caution: "Digital technology helps to boost corporate lending. But when it comes to risk management, models or systems are not enough, as some credit risk is actually fraud risk. So, staff training is also very important."

Another possibility is that a new category of lenders – with a fresh approach and innovative business model – will see opportunities where traditional players see challenges.

[17] https://www.ocft.com/index.php?s=en/shownews_49_74.html

[18] https://finance.sina.com.cn/roll/2020-01-02/doc-iihnzahk1580842.shtml

Virtual banks and the GBA

As outlined in a recent PwC paper[19], virtual banks (VBs) are expected to transform banking services in Hong Kong and the region – just as they have started to do in Europe and North America. They have been strongly influenced by China's FinTech giants, which have demonstrated the huge power of the eco-system approach. This entails offering a wide range of services – many not traditionally associated with financial institutions – by partnering with diverse businesses.

In fact, seven of the eight virtual banking licenses awarded by the HKMA last year are to firms backed by Mainland Chinese FinTech players. The arrival of the VBs prompts two big questions: How will the incumbents respond? And will the VBs pivot towards the East Asia region, or towards the GBA?

Some commentators argue that, having gained the significant validation of a Hong Kong banking license, VBs will have ambitious expansion strategies. But some of our interviewees cite the difficulties experienced by international banks when they try to break into other Asian markets with different regulatory environments. The GBA will represent "the natural move."

It is improbable that Hong Kong's new batch of VBs will all opt for the same strategy. It is far more likely that each bank's expansion plans will be dictated by its own specific strengths and by what differentiates it. This, in turn, will be strongly influenced by the strengths and expertise of the companies backing each VB.

For those that do choose to pivot to the GBA, what should be their areas of focus? The CEO of one of the VBs awarded a banking license last year agrees that a large market is essential to survive:

[19] https://www.pwchk.com/en/industries/financial-services/banking-and-capital-markets/publications/2019-digital-banking-customer-survey.html

“The biggest opportunities for digital banking are in cross-border investment and financing the needs of individuals in the regions: in account opening, investment, insurance and payments. Cross-border platforms should be established to facilitate those needs. We also need to improve access to trade finance for SMEs: using Blockchain to set standards for e-trade finance.”

A lack of reliable data has historically impeded the growth of SMEs by cutting them off from credit. But now we have new players in the market who thrive on data and see their greatest potential in serving cross-border customers, including SMEs. Let’s now turn to the role of data in facilitating cross-border transactions.

Cross-border issues

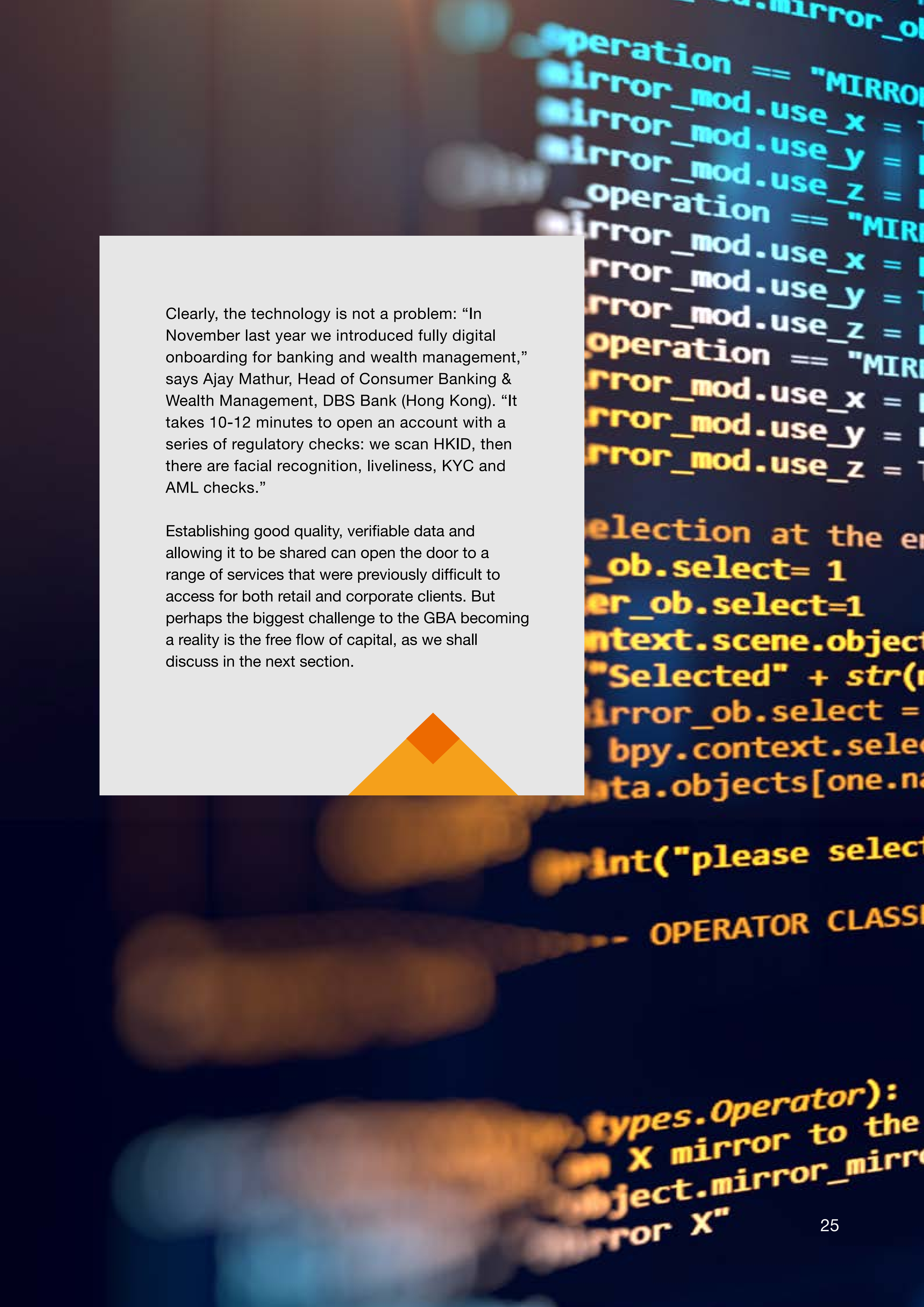
Enabling the remote opening of accounts by Mainland Chinese investors will be critical to the success of WM Connect, for the wider adoption of insurance and pension planning, and for other GBA-related initiatives. Many potential clients find it inconvenient to have to travel to Hong Kong to open an account.

Hong Kong subsidiaries of Mainland Chinese banks may be at an advantage compared to branches of foreign banks in Mainland China when granting such services. While the latter will appeal to some clients as a natural bridge to overseas transactions, the former may enjoy stronger links with Mainland Chinese regulators and are likely to be more aligned with central bank policy on the GBA. They can allow Mainland Chinese citizens with Hong Kong identity cards to open accounts in Hong Kong, as they can more easily complete KYC processes with the support of their Mainland China branches.

However, helping Hong Kong residents to open accounts and carry out transactions in the GBA is considered a marginal activity by some of the bankers we interviewed, given the much larger customer base and likely levels of demand for Southbound business. They see it as "a value-added service" or even "an aspect of corporate social responsibility", rather than a revenue stream. That said, the GBA Outline Development Plan clearly supports Hong Kong and Macau-based firms providing financial services in Guangdong[20].

"Hong Kong mortgages on Mainland Chinese property are an example of the financial products that can become available with the efficient cross-border transfer of data," says Gary Ng, Partner, PwC Hong Kong. "Borrowers could choose to pay down the mortgage in HKD or RMB depending on their view of future currency movements, or based on their personal circumstances."

[20] https://www.pwccn.com/en/financial-services/publications/framework-agreement-guangdong-hk-macao-cooperation-in-gba.pdf



Clearly, the technology is not a problem: “In November last year we introduced fully digital onboarding for banking and wealth management,” says Ajay Mathur, Head of Consumer Banking & Wealth Management, DBS Bank (Hong Kong). “It takes 10-12 minutes to open an account with a series of regulatory checks: we scan HKID, then there are facial recognition, liveliness, KYC and AML checks.”

Establishing good quality, verifiable data and allowing it to be shared can open the door to a range of services that were previously difficult to access for both retail and corporate clients. But perhaps the biggest challenge to the GBA becoming a reality is the free flow of capital, as we shall discuss in the next section.

Capital

Overview

Maintaining monetary and economic stability is a key concern of the central Government. Global uncertainties in recent years have led to greater caution on the part of the PBOC when it comes to the relaxation of capital controls. Nevertheless, there are several initiatives raised by our interviewees that promise to greatly facilitate the flow of capital into and out of China – with a significant proportion of this activity focussed on the GBA.

There are high expectations for a Wealth Management (WM) Connect scheme, which can build on the success and the lessons learned from Stock and Bond Connect, as well as the Mutual Recognition of Funds (MRF) scheme. Our interviewees take different views, however, on likely patterns of demand for products under the scheme.

Cross-border purchase of insurance products is an area where our interviewees see great demand but multiple regulatory uncertainties. They argue that this sector needs to be supported, as most citizens outside of the wealthiest cities are under-insured. The establishment of service centres in the GBA would be the best way to ensure visibility of insurance transactions.

Greater visibility of capital flows may be achievable using a Blockchain-based solution (Blockchain was described as a "core technology" by President Xi in a speech last October[21]). The PBOC has been engaged in a 'Digital Currency / Electronic Payment' project since 2014. Many commentators are hopeful that such a system will enable the central bank to allow less stringent controls on the currency.

"

Hong Kong's expertise is in aggregating and allocating capital. That expertise will be greatly welcomed in Guangdong, as it can both reduce risk and ensure that risk is rewarded correctly."

Peter Burnett, Managing Director, Corporate & Institutional Banking — Standard Chartered Bank; Chairman — British Chamber of Commerce, Hong Kong

"

Banks will have a crucial role to play as safe, established platforms for the distribution of asset management and insurance products. They provide the PBOC and government bodies with confidence in terms of data security and because they are highly regulated."

James Tam, Partner, PwC Hong Kong

[21] http://www.xinhuanet.com/english/2019-10/25/c_138503254.htm

The potential of Wealth Management Connect

Possibly the widest range of views captured in this study relate to wealth management and the expected launch of a Wealth Management (WM) Connect scheme. Opinions differ sharply as to the scope for its development, investor appetite and the impact of such a scheme on the competitive landscape for asset managers. While WM Connect would be scalable beyond the GBA, a significant share of related institutions and talent would be concentrated there. Article 9 of Circular No.95 (see p.4) specifically proposes supporting the sale and purchase of wealth management products between Hong Kong, Macau and the rest of the GBA – both Southbound and Northbound.

Many interviewees feel that WM Connect may be more challenging to implement than previous Connect schemes, but also potentially more influential than either Bond or Stock Connect. As with those schemes, the CBIRC will need to ensure that money can be safely ring-fenced. The challenges will not be technical in nature, but will reflect a more complex product offering involving multiple asset classes.

"It should resemble the other Connect schemes, but the logistics will be more complicated," according to the President of the Hong Kong subsidiary of a Mainland Chinese bank. "There can be one level of control in terms of investor eligibility – a certain level of wealth. Secondary levels of control, such as quotas, are more difficult to fix in a multilateral system. It may also be hard to control how many accounts an individual might have."

Assuming a WM Connect portal is established, a number of protocols will have to be agreed before the scheme can go live. These include how products are promoted and how risk profiles are assessed. Some interviewees wonder if there will be quotas for each individual investment product, in addition to daily or annual quotas for overall volumes.

> "As assets in WM Connect would be held in a custodian account, it shouldn't be too difficult to achieve a closed loop."
>
> **CEO, Hong Kong subsidiary of a Mainland Chinese bank**

There are differing views among the institutions we interviewed about likely patterns of demand. For some, wealth management in Mainland China still lacks sophistication – it is largely a currency play to switch to HKD, as the RMB comes under sustained downward pressure. Others point to a well-established tier of investors who have already accessed alternative investments through the Qualified Domestic Limited Partner (QDLP) and Qualified Domestic Institutional Investor (QDII) programmes and would welcome new channels.

Some interviewees argue that, regardless of investor appetite, the scheme will be dominated by simple, low-risk products – particularly in the early days. Southbound investors may also be limited to Hong Kong SFC-approved products. Above all, regulators will want to strike a balance: to ensure that Mainland Chinese investors do not incur early, heavy losses while making it clear that there can be no 'implicit guarantees' in WM Connect.

Of course, Mutual Recognition of Funds (MRF) has been in place since 2015, so Mainland Chinese investors are not completely new to these investment options. As Dr. King Au, President of Hong Kong-based Value Partners, points out: "The MRF scheme has helped lay the ground for greater investor education in Mainland China– dispelling the notion of any 'implicit guarantee' and giving investors a better sense of market risk."

Others challenge the assumption that demand will be almost entirely Southbound. They point to the investor base in Singapore, Malaysia and elsewhere in the region – particularly among the Chinese diaspora – who will be eager to access higher-yielding Mainland Chinese investments. "Considering the low or even negative interest rates across developed markets, Mainland Chinese wealth management products may be attractive," says the Head of GBA Development for one Hong Kong bank.

While considerably more complicated to implement, WM Connect can build upon other successful, well-established schemes. Playing to the comparative advantages of Hong Kong and Shenzhen, it should be a cornerstone initiative of the GBA.

"The arrangement of having Shenzhen as the innovative technology hub and Hong Kong as the investment exchange centre is a good combination, given their respective roles and strengths, as detailed in the GBA Outline Development Plan. The keys are capital controls, and better defined rules and regulations across borders."

Enoch Tsui, Regional Chief Digital Officer — Invesco Asia Pacific

The potential to reach the middle class of the GBA via WM Connect is very exciting for many financial services players. It will benefit the banks who distribute the products, as well as the asset managers and insurers who produce them."

Josephine Kwan, Partner, PwC Hong Kong

Developing insurance in the GBA

As the old saying goes: “Insurance is sold, not bought.” Mainland Chinese customers have been buying insurance products in Hong Kong for several years – but the focus has been on investment or savings products. Low insurance penetration and a lack of emphasis on the protection component is a common issue across Asia. However, as Mainland China’s middle class expands, it will need to change approach. The CBIRC is working to encourage optimisation of the insurance product mix. In 2018, accident and health premiums for the nine Mainland cities of the GBA stood at RMB 69.6bn, or 24% of all personal premiums[22].

The GBA could serve as a laboratory to address the challenge of an under-insured population. Insurance penetration[23] is 8% in Hong Kong, but roughly 4% across the GBA[24]. Best practice in developing the insurance market in the GBA could then be rolled out to the rest of Mainland China.

Provisional figures for 2019 from the Insurance Authority[24] show that policies issued to Mainland Chinese visitors stood at HK$43.4 billion (down 8.8% year-on-year). This still represents 25.2% of all individual business. Critical illness (57%), whole life (34%) and medical products (3%) remained the most popular policies for Mainland Chinese visitors.

[22] https://www.bloomberg.com/professional/blog/gba-initiative-injects-new-life-chinas-burgeoning-insurance-industry/

[23] https://www.fsdc.org.hk/sites/default/files/FSDC%20Life%20Insurance%20Paper%20%2817%20Dec%29.pdf

[24] https://www.ia.org.hk/en/infocenter/press_releases/20200313.html

As a number of interviewees pointed out, it is worth focussing on the GBA. Setting up an insurance business in each Mainland Chinese province is labour-intensive, whereas the GBA is “a large but achievable prize.” There is consensus that Hong Kong-based insurers should be allowed to set up service centres in the GBA, though there are differences of opinion as to which services should be available[25].

“From a servicing angle it makes no sense for Mainland Chinese customers to have to come to Hong Kong to buy policies,” says the Chief Strategy Officer of a European insurer. “It should be easy to start with general insurance, then health policies and then ultimately life insurance.”

Consequently, the insurance sector is lobbying the CBIRC and PBOC to be allowed to set up such service centres. One of their main arguments is that regulators would then have greater visibility over clients’ accounts.

> “Life Insurance Connect could build upon the existing Qualified Domestic Institutional Investor scheme and the Stock and Bond Connect initiatives. Life Insurance Connect might be expanded later to allow for uniform GBA regulation of distribution as well.”
>
> **Financial Services Development Council[26]**

“One way through would be to set up service points for Hong Kong insurers in the GBA, or even in the Free Trade Zones of the GBA, for them to provide services other than sales,” says Chen Gang, Senior Business Director of China Taiping Life Insurance (Hong Kong) Company Limited. “These could include payment of premiums, change of policy beneficiary, claims and some advisory services. When the moment is ripe, designated areas in those service points may be set up to allow HK insurers to send professionals to provide product consultation.”

There is a great deal of uncertainty among our interviewees about the impact of the GBA on the competitive landscape for insurers. “If Hong Kong-based insurance products are better in terms of pricing, design and helping towards retirement – so be it,” says the President of the Hong Kong subsidiary of a Mainland Chinese bank. “But Mainland Chinese insurers may well object unless Hong Kong opens up to them. And will they prove to be competitive?”

The CBIRC has tightened restrictions on new insurance licenses for Mainland Chinese players, while allowing foreign insurers to become majority shareholders in their Mainland China operations. A notable example is HSBC’s recent acquisition of its China insurance subsidiary, making it a wholly-owned HSBC business. Such developments are likely to change the complexion of the insurance industry in the GBA. Many believe that the CBIRC will accept the impact of competition on Mainland Chinese insurers as necessary pain. It will prompt these firms to raise their game in terms of product design, risk management and human capital. Circular No.95 reaffirms the overall direction of this policy.

[25] Article 19 of Circular No.95 (see p.4) supports further opening of the insurance industry, including permitting foreign-owned life insurers in the GBA.

[26] https://www.fsdc.org.hk/sites/default/files/FSDC%20Life%20Insurance%20Paper%20%2817%20Dec%29.pdf

"Some Hong Kong insurers are already developing their presence in the GBA while the regulatory landscape is still evolving," says Billy Wong, Partner, PwC Hong Kong. "This can be by building a closer working relationship with their joint venture in Mainland China or entering into business relationships with medical service providers in the GBA."

One insurer wonders whether Mainland Chinese insurers could sell USD-denominated policies back to their Mainland Chinese customer base. While there is a general view that Hong Kong products are more comprehensive and sophisticated, there is also concern that Mainland Chinese insurers are catching up. As one interviewee commented: "If Hong Kong-based insurers are allowed to sell policies in Mainland China, shouldn't it be reciprocal – especially given the GBA? So we should be careful what we wish for."

A number of banks and insurers are expected to launch insurance service centres in the GBA in the near future, though there is still much discussion regarding their eventual scope. In the short term these service platforms will chiefly address the needs of Mainland Chinese policyholders who have bought Hong Kong policies. In the medium term they could be expanded to allow the sale of certain types of insurance product, such as motor and medical. Again, Circular No.95 largely reaffirms this policy direction.

"Foreign insurers still lead in terms of the design of their products. Mainland Chinese insurers lag behind in terms of asset and liability management because they lack the global portfolio of long-term investments held by overseas competitors."

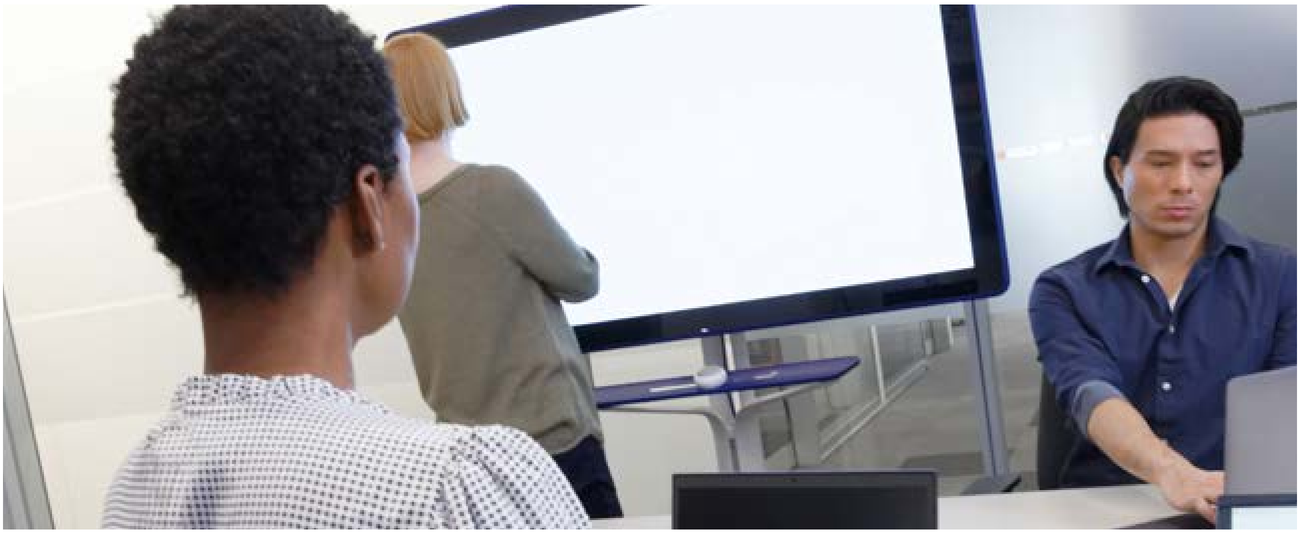
CEO, Hong Kong subsidiary of a Mainland Chinese bank

Tax considerations

Apart from the Mainland China concessions on individual income tax mentioned in the 'Fostering people mobility' section at the start of this paper, no specific taxation arrangements (e.g. on corporate income tax or indirect taxes) have been discussed in the GBA planning documents to date.

Financial products and services are generally complex. When they are traded cross-border they become even more complicated from a taxation perspective. At the moment, taxpayers can only apply general taxation principles between Mainland China, Hong Kong and Macau and the relevant Avoidance of Double Tax Arrangements to determine tax costs. In addition, entities operating in low tax jurisdictions such as Hong Kong and Macau need careful planning when intending to operate in a higher tax jurisdiction, such as Mainland China, especially as there is also VAT and other indirect taxes in the Mainland.

While qualified Hong Kong residents working in the Mainland cities of the GBA may enjoy reimbursements to ensure they do not pay more tax than they would in Hong Kong, there is no such regime for entities. Ideally, there should be tax arrangements in place among these 9+2 cities with the aim of offering more certainty and creating a harmonised tax position for entities undertaking cross-border operations in the GBA. However, before this becomes a reality, players in the financial sector should assess and understand their potential tax costs before they move ahead to set up such operations.



The future of the RMB

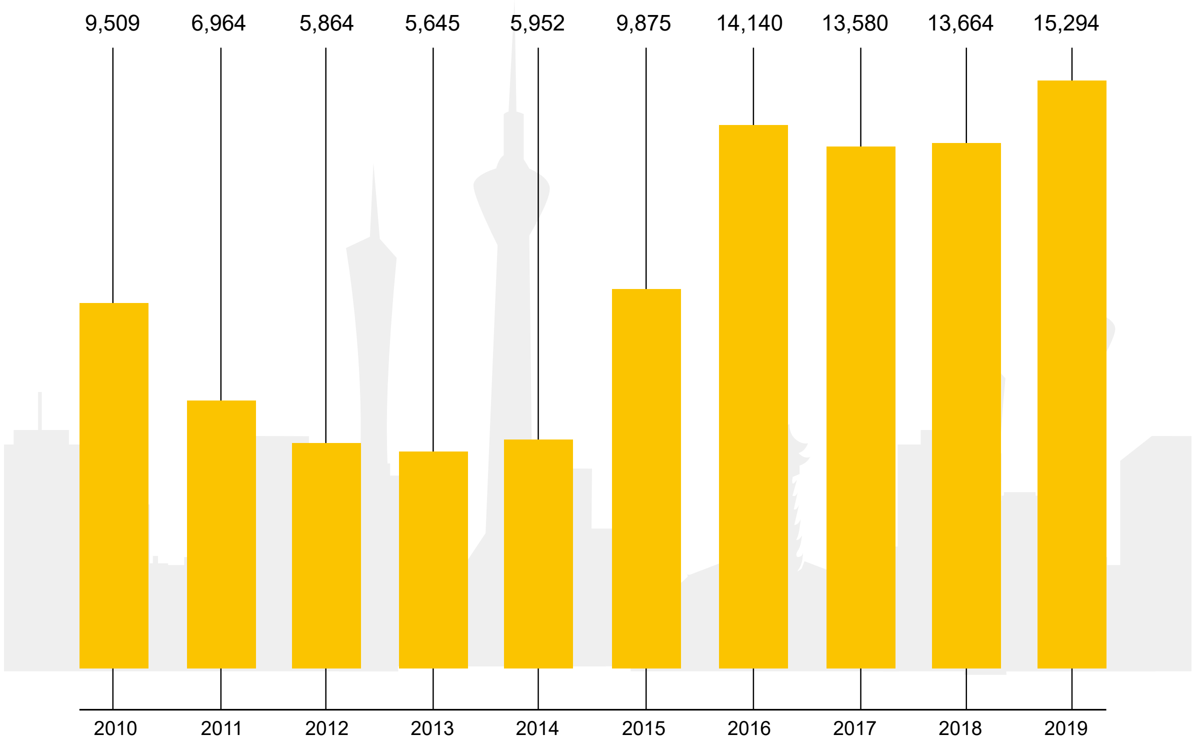
Facilitating the flow of capital is a key requirement for the GBA, so the role of the RMB is central to its success. Articles 22 and 23 of the recently issued Circular No.95 (see p.4) highlight cross-border use of the RMB for both businesses and individuals.

Among our interviewees there are sharply different views on the current state of RMB internationalisation. But there is growing interest in the potential for the RMB to be the world's first Central Bank Digital Currency (CBDC).

Many commentators are conscious that any relaxations of capital flows must be controllable. "A stable exchange rate and manageable capital outflows are priorities for the central Government," says James Tam of PwC Hong Kong. "So any new means of crossborder transactions need to be carefully piloted before being rolled out at scale."

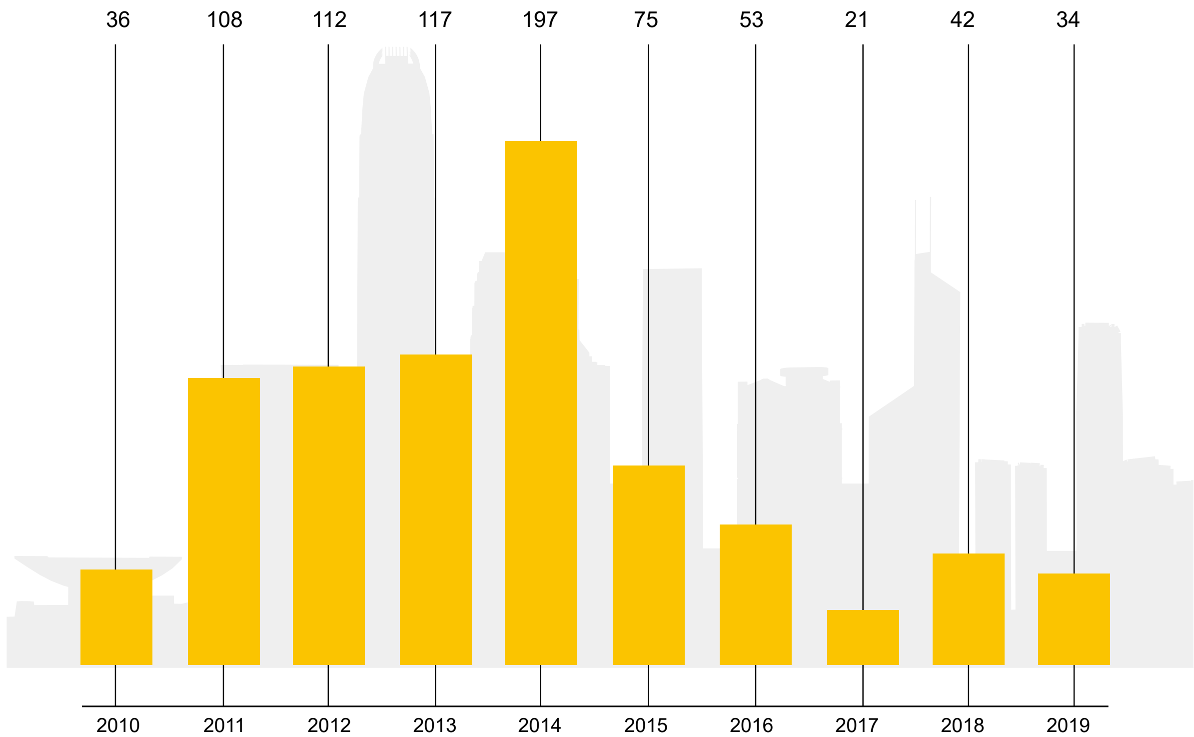
One banker argues that the process of RMB internationalisation has stalled. Pools of offshore RMB (CNH, as opposed to CNY) have diminished and the supply of RMB-denominated bonds has dried up.

Total RMB bond issuance (RMB bn.)



Source: CEIC

RMB bond issuance in Hong Kong (RMB bn.)



Source: CEIC

Other respondents take a completely different view: "We have moved on from talk of RMB internationalisation. It's already a trading currency – partly thanks to the Connect schemes," says Eleanor Wan of BEA Union. "The CNH and CNY difference has gone."

One asset manager predicts that WM Connect will lead to more and more RMB-denominated assets being held long term and offshore, thus leading to an inevitable internationalisation. However, the Head of Retail Banking at one Hong Kong institution is more cautious: "For the RMB to internationalise we need to build the confidence of traders and long-term investors that the currency will be stable, without the risk of devaluation."

"

The PBOC has allowed foreign banks to underwrite RMB debt. But the market wants a major change, such as lifting the 10% ownership cap on A-shares."

John Ball, Managing Director, Global FX Division — Asia, ASIFMA

"

Stock Connect, Bond Connect and related initiatives "resulted in net investment flows from Hong Kong SAR to the mainland in excess of RMB 350bn. between Q2 2018 and Q1 2019."

Bank for International Settlements[27]

[27] *Renminbi turnover tilts onshore*, BIS Quarterly Review, December 2019

According to the Bank for International Settlements[28] 70% of central banks are now exploring CBDCs. The PBOC has described its project as 'DC/EP' (digital currency/electronic payments)[29]. As one banker pointed out, Mainland China is now almost completely non-cash, with 83% of payments being made on a mobile device[30]. If Hong Kong could accelerate adoption of services like WeChat Pay or Alipay, he argues, it would help the city's integration with the GBA.

Some have greater ambitions for the digital RMB. In a speech last August at Jackson Hole Economic Symposium[31], the then Governor of the Bank of England, Mark Carney, assessed the progress of RMB internationalisation. He speculated that a network of CBDCs could form a 'Synthetic Hegemonic Currency' that would "dampen the domineering influence of the US dollar on global trade."

The Chief Financial Officer of an international investment bank in Hong Kong argues along similar lines: "A reduction in the use of USD for trade settlement will help internationalise the RMB. A digital RMB could allow the authorities to move towards convertibility with greater confidence, as it could be more easily controlled. It could evolve into a China-driven digital currency – a basket with 50% RMB and 50% other Asian currencies."

Some fundamental changes to retail payments and, eventually, trade settlement seem to be on their way. In the short term, the DC/EP project (which is currently being piloted in Shenzhen, Suzhou, Chengdu and Xiong'an[33]) should give the regulators greater control and visibility over payments. Many of our interviewees hope that this will encourage the PBOC to gradually allow greater convertibility of the RMB while maintaining social and economic stability. Of the three great challenges to the GBA, the free flow of capital is perhaps the greatest.

"Digital currency could provide a real-time picture of economic activity in a country or region as well as provide more accurate and timely economic data for GDP estimates than are available today."

The Rise of Central Bank Digital Currencies — PwC[32]

"The PBOC aims to be the first central bank to offer a CBDC. If you replace fiat money with digital you can control the money supply if you work across both retail and wholesale banks."

John Ball, Managing Director, Global FX Division — Asia, ASIFMA

[28] https://www.bis.org/publ/bppdf/bispap101.pdf

[29] https://www.ft.com/content/e3f9c3c2-0aaf-11ea-bb52-34c8d9dc6d84

[30] https://daxueconsulting.com/payment-methods-in-china/

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[32] https://www.pwc.com/gx/en/financial-services/pdf/the-rise-of-central-bank-digital-currencies.pdf

[33] https://www.wsj.com/articles/china-rolls-out-pilot-test-of-digital-currency-11587385339?mod=searchresults&page=1&pos=1

Conclusion: Developing a GBA mind-set

"The GBA concept in principal is right, but is light on implementation. We hope to see liberalisation in both directions. The Connect programmes are a step in the right direction. We would like to see the GBA have its own quotas, with no limits between the 9+2 cities."

David Ng, COO — CSOP Asset Management Limited

"Rather than being daunted by regulatory friction, businesses should look at the comparative advantages of the 9+2 cities. The strength of the GBA lies in these differences – rather than everyone trying to do the same thing. Beijing sees these differences as useful."

Dr. Tim Summers, Senior Fellow — Chatham House

Due to macro-economic uncertainties – both globally and locally – concrete progress towards realising the GBA has been tentative over the last year. Despite this, enthusiasm for the project among our interviewees is even more pronounced than it was a year ago.

Some respondents are eager for more details and for guidance on how they will be able to operate in this space. But others show a willingness to just get on with it and to make things happen from the ground up, rather than waiting for a top-down resolution of the various constraints within the GBA. They want to make the GBA a *de facto* reality.

A number of interviewees argue that more should be done to allow the individual cities within the GBA to leverage their comparative advantages. In aggregate, such measures should allow all the 9+2 cities to play to their own strengths, thus boosting the GBA economy overall and making it more than the sum of its parts.

A 'GBA mind-set' is required, so that businesses, regulators and governments can look beyond their current constraints and realise a more joined-up way of working. Some have already adopted this mind-set and are arguing for certain regulations to be applied uniformly across the GBA rather than just to some of its components: "Currently, under the MRF system, no more than 50% of the AUM of a fund can be raised from China," says King Au of Value Partners. "This is a challenge for Hong Kong-domiciled funds – many of which are quite small. If the requirements could be changed so that 50% of AUM had to come from China ex-GBA, that would help."

In a recent paper (*Roadmap to revitalising Hong Kong*[34]), PwC's tax specialists argue in a similar vein. They point out that tax deductions for R&D expenditure are not being fully exploited, as the expenditure must take place in Hong Kong. Given the fact that much manufacturing and research takes place across the border, they propose that the tax deductions be extended to all R&D expenditure in the GBA. Apart from promoting the GBA mind-set, this would further strengthen the GBA's established reputation as China's innovation powerhouse.

Others go further and argue that a presence in the GBA could eventually confer privileges unavailable elsewhere in China. Such a presence, says one insurer, "could be a *de facto* license for Mainland Chinese insurers to offer Hong Kong insurance products."

> "Eventually we assume there will be a GBA ID, enabling holders to invest freely. This would embed HK into the fabric of the GBA. The GBA is not a question of whether, but of when."
>
> **Ajay Mathur, Head of Consumer Banking Group & Wealth Management — DBS Bank (Hong Kong)**

[34] https://www.pwchk.com/en/tax/publications/revitalising-hong-kong-economy_en.pdf

> One certainty is that reforms will continue, GBA citizens will get wealthier and they will have greater need of WM products. Challenges will need to be overcome one by one, just as when Shenzhen first started to open up."
>
> **Lincoln Chan, Finance Director — Hony Capital**

> The importance of the GBA is not the population – which is incomparable to China's 1.4bn – but the picture of a wider China that it describes."
>
> **Enoch Tsui, Regional Chief Digital Officer — Invesco Asia Pacific.**

Putting aside regulatory issues, for some institutions the GBA could be a game changer because it will provide the scale to justify investments that could not be made in Hong Kong alone: "As a retail bank our biggest issue is client base. If limits are lifted we can increase our target market and achieve synergies with our parent bank," says Bi Mingqiang, President and CEO, China Citic Bank International. "If we can access the GBA retail space we can think bigger and invest more in our FinTech strategy. With just the Hong Kong market that is difficult to do."

The GBA mind-set is clearly already established among our interviewees. A perfect, frictionless marketplace is some years off. But value can be created now.

Glossary

AI	In this report, AI refers to artificial intelligence.
A-share	Shares in Mainland Chinese companies traded on Mainland Chinese exchanges (as opposed to H-shares, which are shares of Mainland Chinese companies traded in Hong Kong).
Blockchain	The basis of many crypto / digital currencies. An immutable register of transactions that is visible to all participants in the blockchain. Also known as Distributed Ledger Technology (DLT).
CBDC	Central Bank Digital Currency
CBIRC	China Banking and Insurance Regulatory Commission, the main financial regulator alongside the China Securities Regulatory Commission (CSRC).
CNH	The ISO code for offshore Chinese Yuan, as traded in offshore centres such as Hong Kong, London and Singapore.
CNY	The ISO code for the Chinese Yuan
DC/EP	Digital Currency / Electronic Payment – the digital currency system proposed by the PBOC.
Dollar peg	The Hong Kong Dollar (HKD) peg was instituted in 1983. Since 2005 the HKD has been managed within a trading band of 7.75 to 7.85 to the US Dollar.
HKIA / IA	The Hong Kong Insurance Authority was established in 2017, taking over the regulatory responsibilities of the Office of the Commissioner of Insurance (OCI).
HKMA	The Hong Kong Monetary Authority is Hong Kong's de facto central bank.
HSI	The Hang Seng Index consists of the fifty largest companies traded on the Hong Kong Stock Exchange (market cap and free float-adjusted).
MPF	The Mandatory Provident Fund (MPF) is a mandatory, privately managed, fully funded contribution scheme for Hong Kong employees. It was launched in December 2000.
MRF / Mutual Recognition of Funds	Launched in 2015 and managed by the China Securities Regulatory Commission (CSRC) and the SFC, this scheme allows Hong Kong funds that meet certain requirements to be distributed in China, and vice versa.
Northbound	Refers to the flow, usually of capital, into Mainland China from Hong Kong or other offshore locations.

Glossary

P2P	Refers here to peer-to-peer lending. There were more than 6,000 P2P platforms in China in 2015, according to the CBIRC. There are now fewer than 500 as they are replaced by regulated small loan providers.
PBOC	The People’s Bank of China – China’s central bank.
QDII	The Qualified Domestic Institutional Investor scheme was launched in 2006 to allow designated institutions in China to invest in overseas securities. Quotas control the size of these investments.
QDLP	The Qualified Domestic Limited Partner scheme was launched in 2013 and allows qualifying Chinese institutions and high net worth individuals to invest in hedge funds and other alternative investments, subject to quota limits.
RMB	The Renminbi (RMB) is defined as the currency of China – often used interchangeably with the Chinese Yuan (CNY), which is described as the unit of account.
SAFE	State Administration of Foreign Exchange
SAR	Special Administrative Region. Jurisdictional term applied to Hong Kong and Macau.
SFC	Refers to Hong Kong’s Securities and Futures Commission – the markets regulator.
Southbound	Refers to the flow, usually of capital, from Mainland China to Hong Kong or other offshore locations.
Stock / Bond Connect	Schemes which allow eligible securities to be traded between Mainland China and Hong Kong exchanges. Both are designed so that capital flows are within a closed loop between the two settlement systems. Risk may also be managed through the use of daily and/or annual trading quotas.
Virtual banks	Digital or branchless banks are often referred to as ‘virtual banks’ in Hong Kong. This is the term under which eight licenses were awarded by the HKMA in 2019.
WeChat	A social media and messaging app developed by Tencent.
WeChat Pay, Alipay	The two dominant mobile and online payment systems in China. Alipay is developed by Alibaba.

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