GBA Digest

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FOREWORD

Welcome to our 1st *GBA Digest*

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GBA Digest is a new series of perspectives brought to you by Deloitte China GBA Center of Excellence with a focus of financial services industry.

As the title suggests, *GBA Digest* sheds light on the latest developments in the Guangdong-Hong Kong-Macau Greater Bay Area (GBA) and presents our industry-leading insights and points of view on what's hot in the region and matters most to financial institutions and practitioners – from the market environment, business strategy, technology trends and solutions, to regulatory compliance, operations optimization and product innovation.

We are delighted that this inaugural issue coincides with a major milestone in the GBA development – the official launch of the long-awaited GBA Wealth Management Connect (WMC) Pilot Scheme, which was announced on September 10, 2021.

Being a key innovative initiative in the further opening-up of financial markets and an enabler of another form of connectivity between the Chinese Mainland, Hong Kong and Macau markets, WMC allows investors to allocate their wealth to cross-boundary investment products, and marks a further step forward in the opening-up of individuals' capital accounts within the GBA mainland cities in an orderly, secure manner.

The business opportunities arising from WMC are exciting to many banks and wealth managers, particularly those that are set to launch WMC businesses during the pilot stage. There are many other industry players already eyeing the longer-term opportunities from the further opening-up of Chinese Mainland individuals' capital accounts.

The successful launch of WMC during its pilot phase and beyond is critical to determining whether there can be further initiatives to deepen cross-boundary financial services and GBA financial market integration. It is also a great opportunity for banks that are able to run successful WMC businesses to demonstrate their GBA market expertise, robust cross-boundary compliance capabilities, and effective operations in supporting cross-boundary business. These achievements will form an impressive credential that will gain the trust and confidence of clients and regulators if these banks launch further cross-boundary businesses.

We are pleased to share our industry knowledge and expertise, and help you address potential challenges in your WMC journey – setting you on the path to a delightful success!

MACROECONOMICS

14th Five-year Plan: sustainable and quality growth

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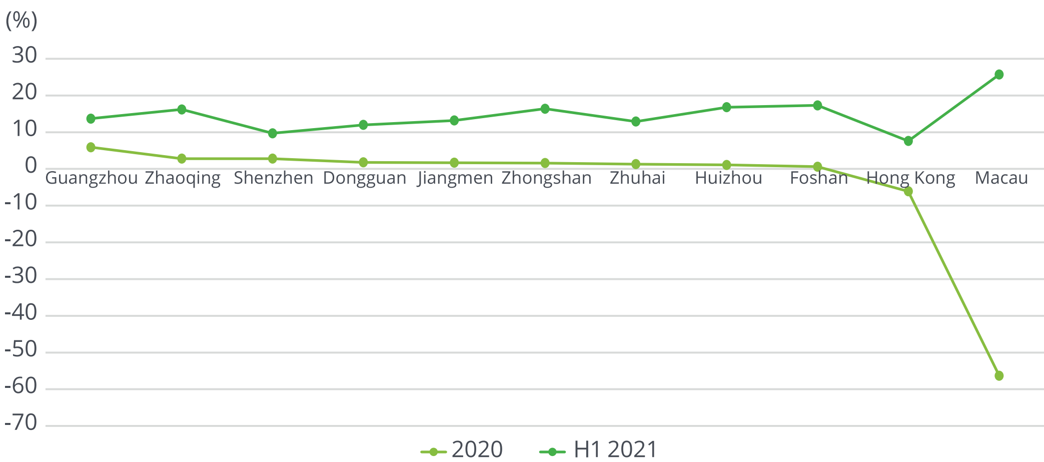
With some of the highest levels of opening-up and economic vitality in China, the Guangdong-Hong Kong-Macau Greater Bay Area (GBA) plays a leading role in China's economic advancement.

2020 economic review

The COVID-19 pandemic hit the global economy hard in 2020, and China was the first country to restart its economy. The GBA economy has opened-up further and maintained its resilience while moving towards closer economic collaboration and regional integration, enhanced by the introduction of several business-favorable policies. In 2020, all nine Mainland cities in the GBA recorded positive GDP growth. The combined GDP of GBA cities was RMB11.4 trillion, or more than 10% of the national GDP. The GBA's strong economic growth momentum continued in H1 2021, resulting in overall GDP of RMB5.25 trillion, with Hong Kong and Macau joining the recovery.

GDP growth of the GBA cities



Sources: National Bureau of Statistics, municipal bureaus of statistics in Guangdong Province, HK Census and Statistics Department, Macao DSEC

Higher contribution of financial services in the GBA

Financial services in the GBA contributed RMB1.5 trillion to China's GDP in 2020. The industry also represented 12% of the GBA cities' combined GDP, much higher than its contribution nationally (8%). Hong Kong, Shenzhen and Guangzhou represented 82.4% of the total GDP contributed by GBA financial services, and ranked 4th, 8th and 22nd respectively in the latest Global Financial Centers Index (GFCI29) released in March 2021. These achievements, and the GBA having one of the largest populations of high-net-worth individuals, have made it one of the world's most robust and sustainable financial industry clusters.

14th Five-year Plan Forecast

2021 marks the beginning of the 14th Five-year Plan (FYP). This heralds China's entrance into a new era of development, in which the GBA will have a more important role to play.

The further deepening of financial collaboration between the Chinese Mainland, Hong Kong and Macau will be a major focus of GBA development, and there will be further integration of their financial markets.

Hong Kong's RMB offshore market will remain its leadership connecting Mainland markets with the world. And, by leveraging the distinct advantages of each city in the GBA and their synergy, together with the smooth flows of increasing trade activities and key factors of production under the Regional Comprehensive Economic Partnership (RCEP), the GBA will become a modern integrated hub in the Belt and Road Initiative.

About Deloitte China Center for Financial Services

The Deloitte China Center for Financial Services is the think tank for our Financial Services Industry Program in China, providing professional industry insights and research support to financial institutions in different arenas, including banking & capital markets, insurance and investment management.

As the core research capability dedicated to the financial services industry, we bring together the findings and insights of financial services industry thought leaders from across the Deloitte global network, sharing our perspectives on key issues including macro policy, industry trends and business management.

BANKING

Top 3 questions and 12 must-dos for banks in WMC

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The official announcement of the Implementation Arrangements for the Cross-boundary Wealth Management Connect (WMC) pilot scheme in the Greater Bay Area (GBA) on September 10, 2021 marked the beginning of cross-boundary investment in the GBA, and a major step in the further opening up of China's financial markets in accordance with the 14th Five-Year Plan.

The banking industry is pivotal to the success of the pilot, as GBA banks will be the only distribution channel for eligible wealth management products under WMC pilot scheme. Participating banks must observe and comply with regulators' WMC guidelines. Of these, there are detailed regulatory requirements around customer onboarding, the maintenance of closed-loop fund flow management, investment suitability and selling practices, and the handling of product inquiries and complaints which are the key areas that affect customers.

To aid the readers to get a glimpse of the WMC pilot scheme, we have summarized the top 3 most commonly asked questions about WMC and to discuss what measures banks should take before they commence business.

Which investors qualify for WMC?

Under the Northbound Scheme, all holders of Hong Kong Identity Cards, except vulnerable customers (VC)[1], are eligible to participate.

However, under the Southbound Scheme, GBA Mainland regulators have imposed additional investment experience and financial requirements. Eligible residents of the nine cities in the GBA Mainland[2] who wish to participate in the Scheme are required to (1) have a minimum of two years' investment experience and (2) hold financial assets of no less than RMB2 million, or have had net financial assets of no less than RMB1 million in the preceding three months.

What wealth management products are eligible?

Hong Kong banks can offer the following wealth management products under Southbound Scheme:

1. the investment products listed below (limited to "non-complex" and "low" risk to "medium" risk)
   - funds domiciled in Hong Kong and authorized by the Securities and Futures Commission (SFC); and
   - bonds
2. deposits in specified currencies (excluding structured deposits)

Banks in the GBA Mainland can offer the following types of products under Northbound Scheme:

1. fixed income and equity wealth management products issued by mainland wealth management companies, with product risk ratings from "Grade 1" to "Grade 3"
2. mutual funds with risk ratings from "R1" to "R3"

From investors' perspective, choice of investments is relatively limited initially. This is due to regulators' prudent stance at the start of the pilot scheme. The differences in regulatory requirements across product due diligence, risk ratings and investment cultures also mean investors participating in WMC should be cautious of the inconsistent market practices of various extents when selecting wealth management products in the other jurisdiction.

Under regulatory guidelines, banks remain responsible for ensuring there has been sufficient product due diligence and product risk ratings are classified in accordance with their existing regulatory framework. Banks also have a duty to explain to investors the different types of risks involved in cross-boundary investment under WMC.

How are investors protected?

As stipulated in the *Memorandum of Understanding on the Launch of the Cross-Boundary Wealth Management Connect Pilot Scheme in the Guangdong-Hong Kong-Macao Greater Bay Area*[3], regulators in the Chinese Mainland, Hong Kong and Macau agree to protect the rights and interests of investors based on the principle of "regulation by the jurisdiction where the business is conducted".

Complaints handling

Complaints arising from cross-boundary remittances and the purchase and sale of wealth management products under WMC shall be handled by financial regulators in accordance with the laws and regulations of the place in which the banks conducted that business. For example, investors' complaints concerning banks in Hong Kong will be handled according to Hong Kong Monetary Authority (HKMA) Supervisory Policy Manual IC-4 *Complaint Handling Procedures*. For Northbound Scheme, banks in Hong Kong should refer investment related complaints to the Mainland partner banks and provide necessary assistance to investors. Furthermore, banks in Hong Kong are expected to follow up the progress of complaints and ensure Mainland partner banks respond to and handle these in a proper, timely manner.

For Southbound Scheme, banks in Hong Kong should provide exclusive channels such as online platforms, hotlines, and mailboxes for handling of investment related complaints. Hong Kong banks should refer complaints about cross-boundary remittances to Mainland partner banks for handling, similar to the handling of complaints in Northbound Scheme.

Distribution model

At the initial stage, banks can only adopt an "execution-only" model. This means they are prohibited from soliciting customers or promoting specific wealth management products, with the exceptions of Southbound Scheme customers present in Hong Kong[4].

Banks are allowed to display only general information about WMC and broad descriptions of the scope and categories of wealth management products that they offer. Specific details such as lists of wealth management products offered and information about individual products can be given only to investors who request them.

Action list for banks

Banks intending to embark on cross-boundary WMC activities should have proper governance and internal controls in place before they commence WMC business.

Below is a list of actions banks should take as a minimum to ensure compliance with the Implementation Arrangements and regulatory requirements:

1. Conduct a thorough assessment to ensure relevant parties, including the board of directors and senior management, understand the risks of WMC business and have sufficient resources and expertise to engage in the business.
2. Establish a committee to oversee WMC business with sufficient participation from senior management.
3. Develop a framework and establish criteria to assess the eligibility and suitability of cross-boundary partner banks.
4. Ensure sufficient operational details are included in partnership or service agreements with partner banks.
5. Customize account opening workflow for Northbound and Southbound investors, including information collection and coordination with partner banks, process for confirming the eligibility of investors under WMC, and arrangements of cross-boundary account opening by attestation (if applicable).
6. Develop proper workflow and systems with built-in logic to monitor and flag transactions in "dedicated WMC remittance/investment accounts" to maintain a closed-loop fund flow.
7. Review existing online and offline selling processes, including online and mobile banking platforms, to ensure compliance with the "execution-only" model required by the regulators.
8. Review and streamline new product approval and due diligence processes for onboarding of new funds and wealth management products.
9. Establish product risk monitoring and investor communication protocols when there is a change in product risk or when a product becomes no longer eligible under WMC.
10. Build specific channels and protocols for receiving and handling investor complaints relating to WMC business.
11. Train relevant staff members engaged in WMC business to make sure they are properly registered/licensed and have sufficient knowledge to respond to enquiries in relation to WMC.
12. Establish a dedicated WMC compliance testing program.

[1] Examples of vulnerable customers include (i) the elderly (aged 65 or above); (ii) visually impaired; (iii) illiterate or with a low educational level (primary or below); and (iv) those who have limited means and/or no regular sources of income.
[2] Registered residents or persons who have made social insurance contributions or paid individual income tax in one of the nine GBA Mainland cities for at least five consecutive years.
[3] On 5 February 2021, a joint announcement was made by the PBoC, CBIRC, CSRC, SAFE, HKMA and SFC and AMCM on the Agreement of the Principles of Supervisory Cooperation under the Cross-boundary Wealth Management Connect, and the aforesaid MoU was signed. Source: HKMA press release on 5 February 2021
[4] The HKMA allows Hong Kong banks to solicit or make recommendation to Southbound WMC investors if they are present in Hong Kong. However, they are still subject to the scope of eligible wealth management products and quota limit.

TECHNOLOGY

Key considerations in tech upgrade for cross-boundary business

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While financial institutions are planning for the launch of their Wealth Management Connect (WMC) businesses, they should also consider how to upgrade the functionality and security of their IT systems to ensure cross-boundary transactions comply with the relevant regulatory requirements.

Closed-loop fund management
Banks should look into and build IT systems and business operations that ensure the closed loop management of funds between dedicated investment and dedicated remittance accounts. Each dedicated remittance account must be the sole source of funds for a dedicated investment account, and proceeds from the redemption of wealth management products must be remitted back via the same route. In addition, investment funds must only be used for the designated purpose – investing in eligible wealth management products under WMC.

When closing an individual investor's WMC account, the bank should ensure all investment products held in that account are redeemed and any proceeds are remitted back to the corresponding dedicated remittance account. The closed-loop between the dedicated remittance account and dedicated investment account will then be deactivated.

Quota limit monitoring and CIPS settlement
It is also essential that banks have the IT capabilities to monitor cross-boundary fund flows under WMC against quota limits. Currently, the quota limit for individual investors is RMB1 million, and the aggregate investor quota limit for Northbound and Southbound Schemes is around RMB150 billion each way. Banks should refine their remittance systems to meet the new requirements of the Cross-border Interbank Payment System (CIPS) for WMC business.

Personal accounts management
Some banks have adopted digital solutions to enhance the experience of cross-boundary customers of their extant business lines, which will benefit their WMC businesses. However, it is vital that they ensure the solutions being considered fully address WMC regulatory requirements on customer due diligence, such as capabilities to verify customers' eligibility and authenticate their sources of funds based on three principles – know-your-customer, know-your-business, and due diligence.

In particular, each individual investor can only hold one dedicated investment account and one dedicated remittance account. To meet this requirement, banks have to enhance their systems to retrieve information from the Renminbi Cross-border Payment Management Information System (RCPMIS).

Cybersecurity in cross-boundary data transfer

During IT system upgrades or building new digital channels for WMC business, banks should pay attention to the cybersecurity laws in their jurisdictions.

For mainland banks, transfers of personal financial information outside China should comply with the Cybersecurity Law of the People's Republic of China and more recent laws and regulations enacted since June 2021, including China's Data Security Law[1]; Personal Information Protection Law (PIPL)[2]; Critical Information Infrastructure Security Regulations; Shenzhen Data Regulation; as well as other related industry regulations and national standards including security measures to cover the entire cycle from collection, transfer, storage and use of personal financial information. In order to ensure effective security controls over cross-boundary data transfer, banks need to have effective data classification and security assessment mechanism in place in compliant with the relevant data classification regulatory requirements (e.g., Personal Financial Information Protection Technical Specification (with effect from 13 February 2020) and Financial Data Security Classification Guidelines (with effect from 23 September 2020)).

In Hong Kong, banks must ensure they satisfy the data security and compliance requirements of the Hong Kong Monetary Authority (HKMA) and Office of the Privacy Commissioner for Personal Data (PCPD).

In Macau, banks must comply with the Personal Data Protection Act (PDPA) of the Office for Personal Data Protection (OPDP), as well as the Macau Cybersecurity Law, which came into effect in December 2019, and the Guideline on Cyber Resilience issued by the Monetary Authority of Macau (AMCM) for financial service industry in the same month.

The way forward

As WMC requirements mature, banks should remain vigilant and plan necessary system enhancements to comply with any new requirements. This will enable them to become first movers in unlocking cross-boundary business opportunities as WMC policies are further developed.

[1] For detail analysis, please refer to Deloitte's perspectives: Understanding the Chinese Data Security Law (Chinese only)

[2] For detail analysis, please refer to Deloitte's perspectives: Protection of personal information and regulation on digital economy: 12 measures for financial sector to protect personal information (Chinese only)

Deloitte offers a suite of cybersecurity, technology risk assessment, data and privacy services to financial institutions in tech systems design, enhancement and implementation for their cross-boundary business in the GBA.

Design/Improve banks' system functionality and controls for cross-boundary closed-loop funds flow, quota monitoring, data sharing, regulatory reporting, etc.

Independent assessment on technology solutions and systems related to the launch of the WMC business to ensure regulatory compliance

Data privacy support on:

- Privacy by design
- Privacy ethics and data innovation
- Data privacy technologies
- Trust experience (responsible data use)
- Accountability and governance
- Data management
- Privacy assurance
- Incident response

TAX

Calling for tax incentives to benefit WMC investors

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China's *Greater Bay Area Wealth Management Connect Guidelines* ("the Guidelines") stipulate that participating Mainland banks should comply with the People's Republic of China's Anti-money Laundering Law so as to prevent investors from evading tax through their Wealth Management Connect (WMC) holdings. If participating Mainland banks are aware of any tax evasion by GBA Mainland, Hong Kong or Macau residents, they should suspend or cancel the qualification of those individuals to invest under WMC. The Guidelines do not detail any tax incentives on income derived by GBA residents from investments in wealth management products via WMC. However, previous practices related to programs such as Stock Connect and Bond Connect indicate that any such tax policies or tax incentives will be announced by the Ministry of Finance and the State Administration of Taxation.

Under current Mainland tax law and regulations, GBA Mainland-resident individual investors are – if they do not avail themselves of any tax incentives – subject to individual income tax ("IIT") at 20% on investment-derived income, including dividends from stocks and interest income from corporate bonds. Similarly, Hong Kong- and Macau-resident individual investors are subject to Mainland China IIT at 20% on income derived from investment in Chinese Mainland stocks and bonds if they do not avail themselves of domestic exemption policies or applicable tax treaty rates (e.g. 7% on interest and 10% on dividends).

Under current tax incentives, Chinese Mainland-resident individuals who invest in Hong Kong funds under Mainland-Hong Kong Mutual Recognition of Funds are exempt from IIT and Value Added Tax ("VAT") on gains derived from trading in Hong Kong funds. Likewise, Hong Kong-resident individual investors are exempt from Chinese Mainland IIT and VAT on their gains from the trading of Mainland funds.

We hope that the Mainland government will consider granting tax exemptions on income derived by GBA Mainland residents from their investments in Hong Kong and Macau wealth management products, as well as to Hong Kong and Macau residents' on income derived from investments in Chinese Mainland wealth management products, which would be similar to the current preferential tax policies available to Hong Kong and Mainland residents under Mainland-Hong Kong Mutual Recognition of Funds.

In addition, will there be no tax exemptions as we suggested, there is a need for Chinese Mainland tax authorities to clarify whether Mainland banks will be responsible for withholding the tax payable on income derived by Hong Kong and Macau investors from investments in Chinese Mainland wealth management products.

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