China on the Verge of Launching the Cross-Boundary Wealth Management Connect Pilot Scheme in the Guangdong-Hong Kong-Macao Greater Bay Area

By Sandra Lu

On 29 June 2020, the day before the 23rd anniversary of the return of Hong Kong's sovereignty to China, the People's Bank of China ("**PBOC**"), the Hong Kong Monetary Authority ("**HKMA**") and the Monetary Authority of Macao ("**AMCM**") jointly released the *Joint Announcement on the Launch of the Cross-Boundary Wealth Management Connect Pilot Scheme in the Guangdong-Hong Kong-Macao Greater Bay Area* ("**Announcement**") in which the PBOC, HKMA and AMCM decided to implement the cross-boundary wealth management connect pilot scheme ("**Wealth Management Connect**") in the Guangdong-Hong Kong-Macao Greater Bay Area ("**Greater Bay Area**"). This is China's another connect scheme under capital account after Mainland-Hong Kong Stock Connect ("**Stock Connect**"), Mainland-Hong Kong Bond Connect and Shanghai-London Stock Connect. The major breakthrough of Wealth Management Connect is that the subject securities involved will be wealth management products, and Macao will participate in the connect scheme for the first time.

In fact, Wealth Management Connect has been constantly mentioned by the policy documents in relation to Greater Bay Area since February 2019:

1. The *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* released by the Central Committee of the Communist Party of China and the State Council on 18 February 2019 provides that it is aimed to widen the scope for cross-boundary investment by Hong Kong and Mainland residents and institutions, and steadily expand the channels for Mainland and Hong Kong residents to invest in financial products in the other's market; subject to compliance with laws and regulations, it is aimed to progressively promote cross-boundary transactions of financial products such as

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funds and insurance within the Greater Bay Area, continue to expand the types of investment products and investment channels, and establish a mechanism for mutual access to capital and products.

2. On 6 November 2019, the Leading Group for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area introduced 16 policy measures that would benefit people from all walks of life, one of which is exploring the establishment of a cross-boundary wealth management scheme.

3. On 14 May 2020, the *Guidance on Financial Support for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area* issued by the PBOC, the China Banking and Insurance Regulatory Commission ("**CBIRC**"), the China Securities Regulatory Commission ("**CSRC**") and the State Administration of Foreign Exchange ("**SAFE**") again mentioned exploring to establish a cross-boundary wealth management connect scheme and supporting Mainland residents in the Greater Bay Area to invest in wealth management products distributed by banks in Hong Kong and Macao through these banks and Hong Kong and Macao residents to invest in wealth management products distributed by Mainland banks through Mainland banks in the Greater Bay Area.

It takes only around one and a half years to release the Announcement since the initial proposal of the concept of Wealth Management Connect. Such high efficiency demonstrates the Chinese Government's strong determination in implementing the Wealth Management Connect. The Announcement sets out the overall policy framework of Wealth Management Connect, and the date of formal launch and implementation details will be disclosed separately. This approach is similar to that of launching Shanghai-Hong Kong Stock Connect in 2014. While CSRC and Securities & Futures Commission of Hong Kong ("**SFC**") jointly issued the announcement for Shanghai-Hong Kong Stock Connect Pilot Scheme on 10 April 2014, Shanghai-Hong Kong Stock Connect was formally launched on 17 November 2014.

Based on the current laws and regulations on asset management business, the Announcement and previous reports on Wealth Management Connect by domestic and overseas media, we would like to share the following understanding and thoughts on the Wealth Management Connect for discussion.

1. Operation Model of Wealth Management Connect

Wealth Management Connect, in short, refers to the arrangement that Mainland residents in the Greater Bay Area can invest in investment products distributed by banks in Hong Kong and Macao through these banks, and Hong Kong and Macao residents may invest in wealth management products distributed by Mainland banks in the Greater Bay Area ("**Mainland Banks**") through Mainland Banks. The former arrangement is called "Southbound Wealth Management Connect", and the latter is called "Northbound Wealth Management Connect".

Prior to the launch of Wealth Management Connect, in order to invest in offshore financial products, Mainland residents must have funds that are legally retained offshore or make use of investment channels including QDII and QDLP. Similarly, Hong Kong and Macao residents previously could not directly invest in wealth management products distributed by Mainland Banks through these banks.

Obviously, the residents in the Greater Bay Area would enjoy more convenience in cross-boundary investment with the launch of Wealth Management Connect. They can not only invest in stocks issued in the other's market via Stock Connect, but invest in wealth management products offered in the other's market via Wealth Management Connect. Meanwhile, the launch of Wealth Management Connect will provide the financial institutions in Guangdong, Hong Kong and Macao with broader market and business scope. For Mainland China, Wealth Management Connect no doubt marks a significant opening-up measure on capital account.

2. Who Can Invest in Wealth Management Products via Wealth Management Connect?

Firstly, Wealth Management Connect is a mechanism for investment by individual residents in the Greater Bay Area, and the institutions registered in the Greater Bay Area cannot participate in the investment.

Secondly, Wealth Management Connect is a mechanism designed to make it easier for residents in the Greater Bay Area to make investment. Therefore, non-Greater-Bay-Area residents cannot participate in such investment. In addition to Hong Kong and Macao residents, residents in the Greater Bay Area include the residents in nine cities in Guangdong province, including Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqin. Currently, the Greater Bay Area has residents of more than 70 million in total, including 7.5 million Hong Kong residents and 680,000 Macao residents.

Lastly, not all residents in the Greater Bay Area, but only eligible investors that meet certain conditions, may participate in Wealth Management Connect. Such conditions would be specified in the subsequent implementation rules. It has been reported by some media that Mainland residents must have financial assets of RMB 500,000 or more to participate in Wealth Management Connect.

3. Scope of Eligible Investment Products under the Wealth Management Connect

Similar to Stock Connect, only wealth management products meeting certain conditions ("**Eligible Investment Products**") may be invested by residents in the Greater Bay Area via Wealth Management Connect. Specifically, these conditions include:

(1) Products Distributed by Banks

Mainland residents in the Greater Bay Area may invest in Eligible Investment Products distributed by banks in Hong Kong and Macao, and Hong Kong and Macao residents may invest in Eligible Investment Products distributed by Mainland Banks. In other words, residents in the Greater Bay Area must invest in investment products in the other's market through banks, instead of directly investing in products through the product managers. This is not only a recognition of banks' distribution capability, but reliance on their risk control capability.

In addition, for Northbound Wealth Management Connect, there is no requirement that the product manager of Eligible Investment Products shall be registered or operate in Guangdong province.

It is relatively clear that wealth management products launched and managed by the banks and their subsidiary in Mainland will be an important part of Wealth Management Connect: on 27 April 2018, the Chinese financial regulators jointly issued the *Guiding Opinions on Regulating Asset Management Business of Financial Institutions*, which unifies the regulatory rules for all asset management products. On one hand, banks are no longer allowed to launch wealth management products on a capital pooling basis, but shall launch genuine wealth management products that are based on NAV management. On the other hand, the wealth management products of commercial banks should be under the custody of a third party who has the custodian license, rather than being under self-custody; as such, a commercial bank with the fund custodian license shall set up a bank wealth management subsidiary ("**WMS**") specializing in the launch and management of wealth management products as soon as possible. As of the publication date of this article, the following WMSs have been set up and in operation:

WMS of China Construction Bank	WMS of Bank of China	WMS of Agricultural Bank of China
WMS of Bank of Communications	WMS of Industrial and Commercial Bank of China	WMS of Postal Savings Bank of China
WMS of Industrial Bank Co., Ltd.	WMS of China Merchants Bank	WMS of China Everbright Bank
WMS of Bank of Ningbo	WMS of Bank of Hangzhou	WMS of Huishang Bank

WMSs, operating the asset management business of banks, are an important part of Chinese asset management industry. All the products of a WMS are distributed by its parent bank (i.e., the parent company of the WMS). Low risk wealth management products issued by WMSs would be an important type of investment products for Hong Kong and Macao residents participating in the Wealth Management Connect.

(2) Low Risk Products:

On 29 June 2020, the PBOC issued a press release on its official website, which provides that individual investments by residents in the Greater Bay Area are very active, giving rise to strong demand for investing in low risk bank wealth management products across borders. This indicates that low risk products would be the primary type of products open for investment at the early stage of Wealth Management Connect. In Mainland, low risk Eligible Investment Products mainly include money market funds, wealth management products designed for cash management, bond funds, bond wealth management products, etc.

(3) Uncertain Scope of Eligible Investment Products

On one hand, it is uncertain whether Eligible Investment Products under Southbound Wealth Management Connect are limited to products domiciled in Hong Kong. In practice, investment products distributed by banks in Hong Kong include not only products domiciled in Hong Kong, but also those domiciled in countries/regions other than Hong Kong (e.g., funds domiciled in Luxembourg, Ireland, Cayman Islands, etc.). Whether investment products not domiciled in Hong Kong would be deemed as Eligible Investment Products is subject to further clarification of subsequent implementation rules. This issue would largely influence the number of Eligible Investment Products under the Southbound Wealth Management Connect.

On the other hand, Mainland Banks may distribute various asset management products including bank wealth management products, publicly-raised funds, trust products and insurance asset management products. The specific products distributed by Mainland Banks to be included in the scope of Eligible Investment Products under Northbound Wealth Management Connect is subject to the clarification of subsequent implementation rules. We understand, given that Chinese publicly-raised fund industry has been in compliant operation for more than twenty years, and many funds have outstanding performance as well as long-term historical performance, publicly-raised funds would be more acceptable to offshore investors. Therefore, it is reasonable to include publicly-raised funds into the scope of Eligible Investment Products under the Wealth Management Connect.

4. Quota for Wealth Management Connect

Similar to Stock Connect, Wealth Management Connect will also be subject to quota management, including aggregate quota and individual investor quota. The previous reports by domestic and overseas media estimated that the aggregate quota for Wealth Management Connect would be within the range of RMB 150 billion to 200 billion. However, this is just the estimate by the media, and the specific aggregate quota and individual investor quota are subject to the clarification of implementation rules.

5. Account Opening and Fund Settlement of Wealth Management Connect

Resident in Greater Bay Area must open designated bank accounts to invest in investment products distributed by banks in the other’s market. Such accounts may only be used for investing in investment products under the Wealth Management Connect.

Cross-boundary remittance of funds under the Wealth Management Scheme will be conducted and managed in a closed-loop through the bundling of designated remittance and investment accounts. Cross-boundary remittance will be carried out in Renminbi, with currency conversion conducted in the offshore markets. For example: we understand the Renminbi funds paid by Mainland investors to invest in Hong Kong wealth management products will be converted into funds in foreign currency offshore in order to invest in offshore wealth management products; and when mainland investors end the investment and redeem the wealth management products, the redemption proceeds will be remitted to the investment accounts of Mainland investors after being converted into Renminbi funds offshore.

6. Investor Protection

Once residents in the Greater Bay Area invest in investment products in the other’s market via Wealth Management Connect, they become the investors of such investment products. As an investor, they are entitled to the investors’ rights of such investment products and perform the investors’ obligations of such investment products. Therefore, the banks in Guangdong, Hong Kong and Macao (and the manager of Eligible Investment Products) shall fairly treat Wealth Management Connect investors in terms of marketing, suitability match, collection of fees and expenses, NAV disclosure, information disclosure, distribution, tax, etc.

7. Regulators Involved under Wealth Management Connect

The Announcement is jointly issued by the PPBOC, HKMA and AMCM. Since numerous implementation regulations remain to be enacted and promulgated, the Announcement provides that the PBOC, CBIRC, CSRC, SAFE, HKMA, SFC and AMCM will jointly discuss and agree on the implementation details. Compared with Stock Connect, the implementation of Wealth Management Connect involves more regulators, and the regulatory matters to be coordinated are more complicated.

In addition, with a view to better protecting the investors' interests, relevant regulators in the Mainland, Hong Kong and Macao will enter into memoranda of understanding on supervisory cooperation to establish robust supervisory cooperation arrangement and liaison mechanism to timely deal with any illicit activities in a timely manner. The tackling of illicit activities will be based on the principle of territorial administration. For example, where a Mainland resident invests in a Hong Kong investment product via Wealth Management Connect, based on the principle of territorial administration, Hong Kong regulators will govern any misleading or false statements in the distribution of such Hong Kong wealth management product according to the local laws of Hong Kong.

8. Preparation of Mainland Financial Infrastructure Institutions

The Announcement provides that the Mainland financial infrastructure institutions should take forward preparations for Wealth Management Connect, and the Wealth Management Connect pilot scheme will be formally launched once relevant rules and systems are in place. This indicates that the formal launch of the Wealth Management Connect pilot scheme largely depends on the progress of building rules and systems by the Mainland financial infrastructure institutions. In Mainland China, financial market infrastructure refers to multilateral systems for clearing, settling or recording payments, securities, derivatives or other financial trading among participating institutions (including the institutions operating such multilateral systems), which are classified into five types of financial public infrastructure, i.e., important payment system, centralized securities depository, securities settlement system, central counterparty and trading database.

9. Parallel Relationship between the Wealth Management Connect and Mainland-Hong Kong Mutual Recognition of Funds Mechanism

CSRC and SFC jointly launched the Mainland-Hong Kong Mutual Recognition of Funds ("**MRF**") mechanism in July 2015, which allows the publicly-raised funds in Mainland and Hong Kong to be registered and offered to the public in the other's market. Under the MRF mechanism, each publicly-raised fund must obtain the approval of the other's securities regulatory authority to conduct public fundraising in the other's market. The value of shares/units in the fund sold in the other's market shall not be more than 50% of the value of the fund's total assets. MRF funds are distributed in the other's market through appointing an agent in the other's market.

The operation model of the Wealth Management Connect is different from that of MRF mechanism. On one hand, there will be no cross-boundary distribution under the Wealth Management Connect pilot scheme, i.e., the distribution of Eligible Investment Products under the Northbound Wealth Management Connect is conducted by Mainland Banks, and the distribution of Eligible Investment Products under the Southbound Wealth Management Connect is conducted by the banks in Hong Kong and Macao. The only change the banks would face after the launch of Wealth Management Connect is that there will be a new category of offshore investor. Therefore, there is no need to obtain the approval by the securities regulatory authority in the other's market for each single product. On the other hand, while the Wealth Management Connect will be subject to aggregate and individual investor quota, there may be no quota limit on each single product. Therefore, the quota management of the Wealth Management Connect is more similar to that of Stock Connect.

In other words, the Hong Kong fund managers may expand the distribution to Mainland investors through MRF mechanism and Wealth Management Connect in parallel in the future.

10. Influence on Foreign Asset Management Institutions

Year 2020 is a remarkable year for the opening-up of Chinese financial sectors. Many foreign asset management institutions are more actively working on their Chinese business layout. Numerous foreign financial institutions have chosen their own entry strategies, including WFOE securities companies, WFOE publicly-raised fund management companies, WFOE futures companies, foreign-controlled bank wealth management companies, foreign-invested privately-raised fund manager, etc. In addition, the launch of Wealth Management Connect will prompt foreign asset management institutions to pay more attention to their investment in China, especially the investment in brand building and marketing. Foreign asset management institutions shall focus on how to integrate such investment with their offshore resources and how to optimize the collaboration between or reconstruction of such investment and the existing onshore business entities, which is, of course, a sweet trouble.

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