FinTech and the Greater Bay Area: Breaking down the barriers

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Methodology

This report is based on in-depth interviews between PwC's partners and more than two dozen leaders from financial institutions and Tech/FinTech players in Hong Kong and elsewhere in the GBA.

Where we are now: Incumbent financial institutions and FinTech players

The Greater Bay Area (GBA) is prompting incumbent financial institutions (FIs) in Hong Kong, Shenzhen and elsewhere to re-think their development plans. A contiguous, self-contained market of 68m consumers justifies higher levels of investment than the Pearl River Delta strategies of a few years ago. The potential prize is just that much bigger.

A level playing field based on greater regulatory reciprocity can help ensure that businesses from all the '9+2' cities that form the GBA have a chance of contributing to the overall vision. Such a level playing field will allow each city to play to its own particular strengths.

The uncertain relationships that exist between many incumbent FIs and FinTech players could become more strained as the GBA develops. Alternatively, the GBA could be the marketplace where these respective parties develop mutually beneficial ways of working.

Many of the issues raised in this paper are based on in-depth interviews with GBA market participants from banking, asset management and insurance. Among the concerns expressed by our interviewees is that legal and regulatory integration will need to go much further. They know that many initiatives are in the pipeline, but they would like a clearer idea of what will happen when. A number of measures to promote social integration are being rolled out, but economic integration needs to follow.

Hong Kong has been described as "the adaptor that converts the mainland's financial and legal voltage into the one used by the rest of the world"[1] . The city's role as a conduit to the rest of the world is, of course, thoroughly well established. But it will need to play a bigger role than that if the GBA vision is to be realised.

The challenge is to ensure that collaboration across the GBA creates something that is more than the sum of its parts. The technical capabilities to be found in Shenzhen and – to some extent – Guangzhou need to be complemented by the pools of talent in financial, legal and professional services to be found in Hong Kong.

The ultimate vision is for a network of cities and technical/commercial clusters that is a step change from the existing Free Trade Zones in Shanghai and Nansha New Area/Qianhai. There have been many comparisons: the San Francisco Bay; the US-Mexico-Canada Trade Agreement; the Schengen area. One of our interviewees compared the reforms required to the arrangements made available under Asia-Pacific Economic Cooperation (APEC).

[1] *The Economist*, 3 August 2017.

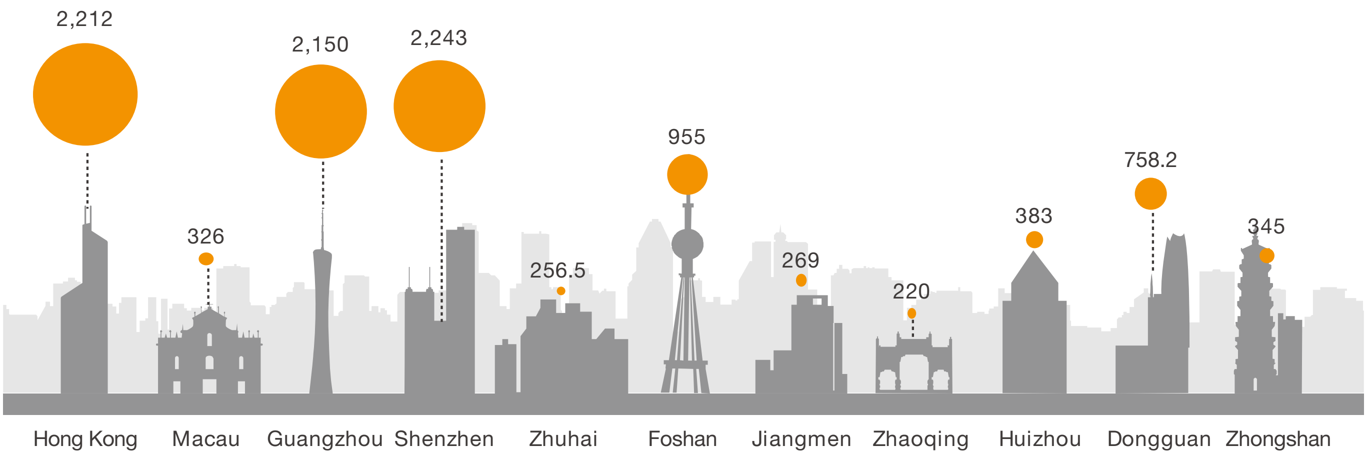
A closer look at the Greater Bay Area

The Greater Bay Area plan is a key part of Beijing's strategy to re-align its economy, find new sources of growth and promote greater domestic consumption. To achieve these objectives, the 9+2 cities will need to be able to work together seamlessly so that the GBA becomes more than the sum of its parts.

Despite the obstacles to greater integration outlined in this paper, private enterprise - typically in the new economy – is playing an ever greater role in China's growth. Shenzhen is rapidly catching up with Silicon Valley in terms of unicorn creation, as detailed in PwC's latest Billionaires Report[2], produced in partnership with UBS.

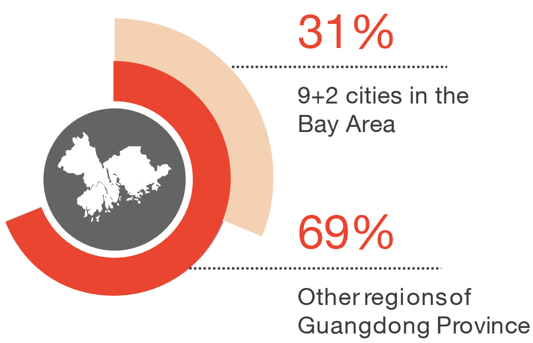
[2] UBS/PwC Billionaires Report 2018: *New Visionaries and the Chinese Century*

GDP of the Bay Area 9+2 cities, 2017 (RMB billion)

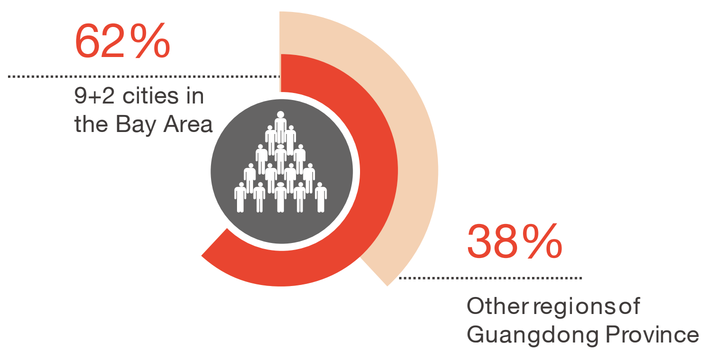


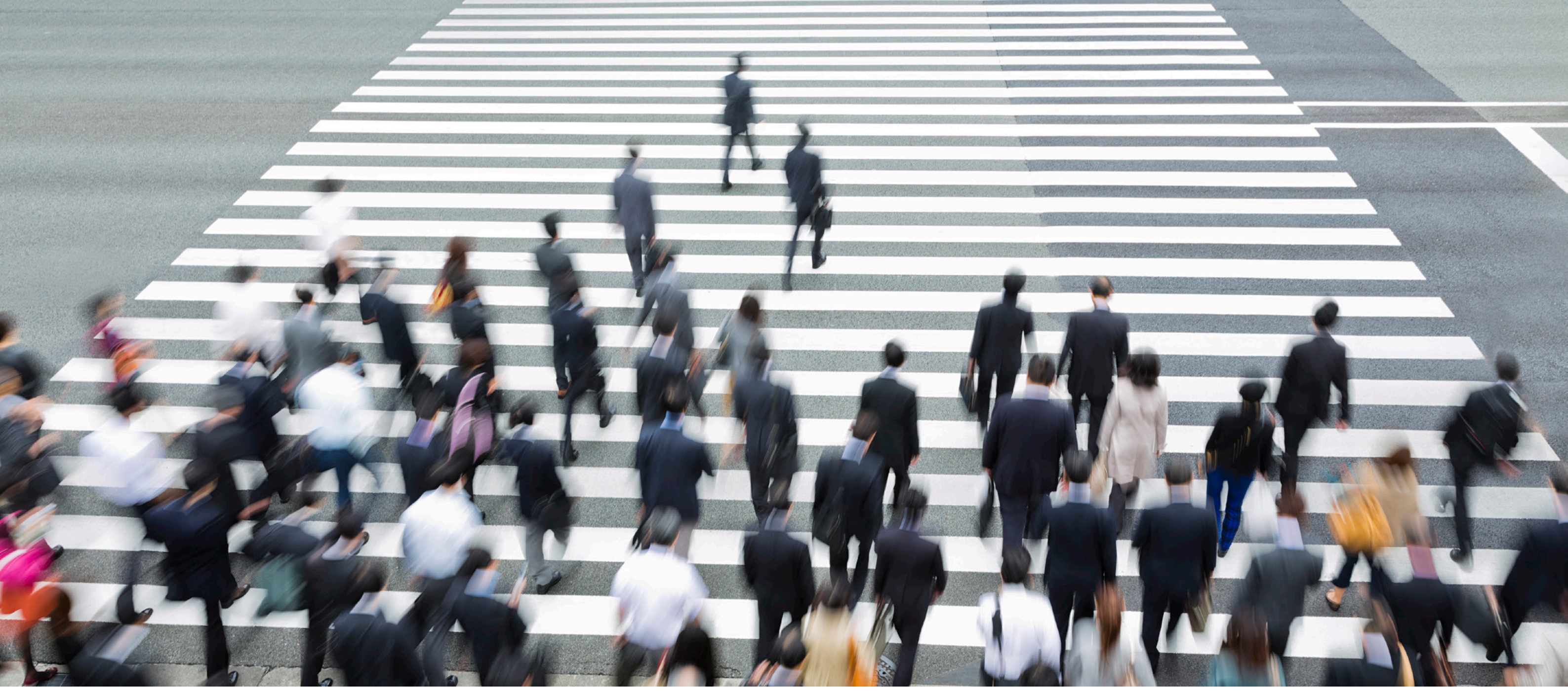
Source: HKTDC. Closing price of HKD and MOP against RMB on 31 December 2017.

Total area of the 9+2 cities accounts for 31% of Guangdong Province

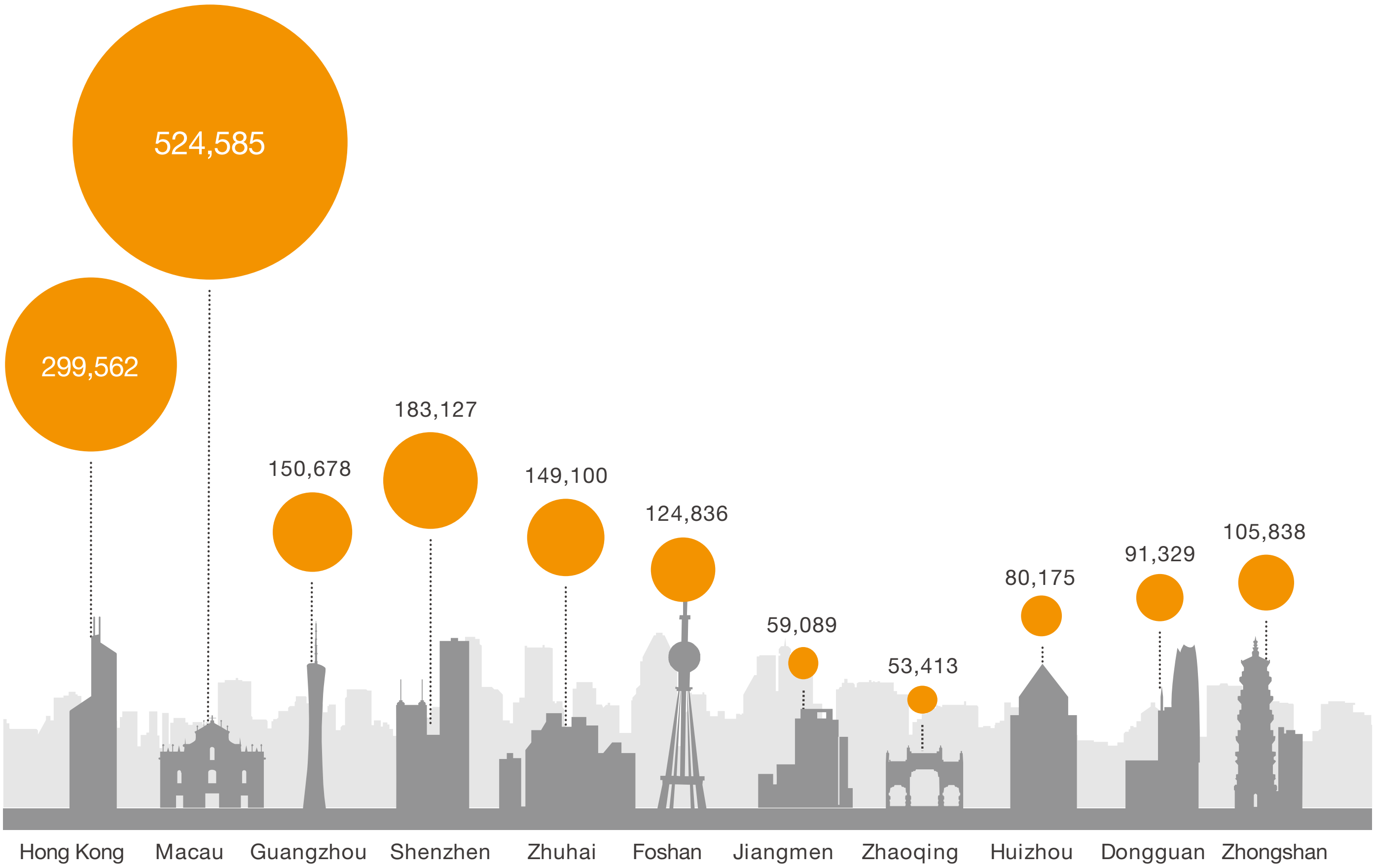


Total population of the 9+2 cities accounts for 62% of Guangdong Province





GDP per capita in the Bay Area, 2017 (RMB/person)



Source: Municipal bureaus of statistics, Hong Kong Trade Development Council (exchange rate: closing price of HKD and MOP against RMB on 30 December 2017); PwC Analysis

The Interviews

Introduction

When we asked our respondents for their views on the GBA and FinTech's role within it, two or three distinct strands of opinion started to form. Firstly, some Chinese listed firms do not currently see a case for devising a GBA strategy distinct from their existing China-wide one. They assume the GBA will mainly be a focus for foreign FIs or Hong Kong subsidiaries of Chinese banks.

Secondly, our respondents feel that the main opportunities in the GBA will be for those FIs targeting individuals, sole proprietors and partnerships, rather than large corporate clients. Services that are subject to fewer regulations, such as mobile payments for individuals, may be easier to integrate across the GBA, though legal and regulatory hurdles still need to be tackled. Incoming FIs that target the corporate sector will face daunting competition from incumbents.

"The sheer size of the incremental market is mind-boggling. Many Hong Kong banks will be forced to raise their game in terms of customer journey. We shouldn't discount the possibility of a Chinese tech giant winning the prize. But investment banking services for TMT clients or offshore borrowing for SMEs will require full-service banks."

- Ajay Mathur, Head of Consumer Banking, DBS

Another viewpoint that clearly emerges is that liveability issues will be critical to the eventual success of the GBA. While these are largely outside the remit of this paper, we need to recognise a number of practical factors that affect the ease of operating in the GBA. These range from individual tax liabilities to daily inconveniences such as the need to switch phone networks. Visa restrictions can mean people missing meetings.

Five talking points

Full integration across the GBA will require regulatory conversion. But for that to happen there will need to be legal conversion first.

Our respondents unanimously agreed with this statement. But all recognise that Hong Kong's legal framework is one of the main reasons that it exists as an international finance centre (its "adaptor" role, as mentioned on page one). So the challenge must be to achieve regulatory alignment within these different legal frameworks. One respondent suggests the Chinese and Hong Kong governments could devise an arrangement analogous to the APEC card for business travel: suitably qualified entities and individuals would enjoy privileges that could be extended more widely over time.

Since the GBA was first mooted, Sino-US trade relations have cooled markedly. China wants to maintain a stable Renminbi, but this makes it difficult to implement the various pilot schemes that could be used to try out relaxation of capital flows across the GBA.

One respondent argues that, while constraints on capital flows at a national level are logical, there need to be policy amendments at the GBA level. There is a desire to do business across the region, but the current environment is not as conducive as it could be.

Restrictions do not only apply to capital. As one respondent observed, data privacy requirements and potential limits on data transfers could inhibit the development of FinTech solutions within the GBA.

The GBA presents opportunities for some, but could be a threat to others. Some firms are dominant players in their market now, but may find themselves just one of many in this larger market.

A widely held view among respondents is that FinTech players have been the beneficiaries of regulatory arbitrage opportunities. They have been able to operate in areas such as wealth management and mobile payments where traditional banks face greater regulatory scrutiny. It is possible that virtual banks will enjoy some of these same freedoms.

This talking point also provoked a wide range of other views. One respondent argued that many large incumbent banks do not perceive a threat from the GBA, as it is still at the concept stage. For others, major physical infrastructure projects - such as the high-speed rail link to Hong Kong - will have the biggest impact on people's lives. One international banker feels that the advantage that incumbent banks enjoy could be diminished by a more attractive product offering from foreign banks.

Another respondent pointed to the ageing demographics of both Hong Kong and the GBA more broadly. 25% of the overall population will be over 65 by 2025. This means that a substantial chunk of the market may be more predisposed to traditional banking services.

A number of respondents believe that the best opportunities for FinTech firms lie in serving individual customers in the GBA, rather than corporates. Service offerings could include mobile payments and the ability to open PRC accounts remotely from Hong Kong.

First-mover advantage is going to be critical to success in the GBA. Those firms that can be operational straight away are likely to face fewer regulatory challenges.

Our respondents broadly agree with this, but argue that the benefits accruing from being a first-mover are still outweighed by the legal and regulatory challenges facing *all* players in this market. One banker feels that being a first-mover is less important in more sophisticated banking services. For all firms seeking to operate across the GBA, supportive policy changes from government will be essential.

One respondent points to the huge challenges facing companies in China when trying to move beyond the start-up stage. To trade internationally they often need overseas subsidiaries and even foreign employees, but it can take years to get the necessary approvals. Firms that can demonstrate a legitimate need should be able to apply for special status in order to establish a subsidiary in Hong Kong so that they can leverage the city's international connectivity.

Virtual or digital banks have a greater potential to succeed in the GBA than in major metropolitan areas, such as Beijing or Shanghai.

This proposition is challenged by our interviewees. The customer base in cities such as Shanghai and Beijing has already proved highly receptive to FinTech-based banking services. Unless there is a very overt policy steer from the authorities in the GBA, there is no reason why virtual banks should be more successful there than in other parts of China. Successful GBA integration will require two-way capital flows, but the Chinese government will be cautious about any policy loosening at this stage.

One respondent pointed out that the GBA has a proven track record of turning technology into profit-generating businesses, which is not always the case in other cities. The FinTech talent in Shenzhen is very market-focussed – it tends to be more research-based elsewhere, he argues.

A shortage of talent will be a key constraint in the GBA, but can also force innovative approaches.

Our respondents agree that talent may be an issue, but that it can be largely resolved through changes to the regulatory framework around the GBA. One banker argues that talent flows need to be two-way, just as capital flows need to be. Hong Kong can provide more financial expertise, while China can provide technology talent to Hong Kong.

Another respondent states that there is no shortage of talent in the GBA, but that the ability to move freely within it will be key. Non-financial infrastructure (transport links, etc.) will be critical to this aspect of GBA integration. Technical expertise will be in greatest demand at the start of the GBA project – for policy setting and the development of financial infrastructure. Once up and running, FinTech solutions should be less reliant on headcount.

One FinTech leader points to the global recognition of some of Hong Kong's universities. While many of these already carry out R&D programmes across the border, they could be much larger in scale. They would then be able to grant wider access to international education for Chinese post-graduates while raising research standards. Hong Kong, he concludes, offers the opportunity to accelerate the internationalisation of China in a way that is economically beneficial to all.

"The basket of GBA companies has historically outperformed the Hang Seng Index, so there is evidence that it can be more than the sum of its parts. China's opening up began in Shenzhen and we are seeing another grand experiment in this part of the world."

– King Au, CEO, Value Partners

"It should be possible to carve out the pension system for GBA from an investment and regulatory point of view. While it is strong economically, it is not a very big part of China, so it could be used as a test case."

– Eleanor Wan, Chief Executive Officer, BEA Union Investment Management Limited

"Why does the GBA raise so many successful tech and FinTech firms? I think the first reason is the dynamic talent pool. People come from all over China to work and innovate together. Then they link up with the legal and professional services offered by Hong Kong."

– Alan Ho, CFO Asia Pacific, J.P. Morgan

"We need to agree the right mechanism for customer verification across the GBA. Mainland customers are technologically sophisticated and have high expectations regarding identity management."

– Ajay Mathur, Head of Consumer Banking, DBS

"The Chinese government has always been very willing to experiment – it will try out liberalisation measures to see which work well and which work less well. It will need to try out a broad raft of such measures in the case of the GBA."

– Hong Kong-based banker

"The GBA is not going to happen overnight, but we will see more and more favourable policies in the next three to five years. There is a lot of optimism in various industries, not just financial services. China always prefers to take a gradual approach and the GBA is a good testing ground."

– Kai Mak, Co-Managing Director, Quantitative Investment Solutions, Value Partners

"Hong Kong's financial services can enormously benefit from competition. Those impacted by that are going to need to compensate for their likely lower margins by casting their nets more broadly. No doubt many will wish to increase their presence in southern China."

– Jonathan Larsen, Chief Innovation Officer, Ping An Group, and Chairman and CEO, Global Voyager Fund

Recommendations

The social, cultural and economic affinities between the eleven cities of the Greater Bay Area make it a coherent proposition. The GBA naturally forms a relatively self-contained environment for trade, work and living, supported by robust transport links and other infrastructure.

This makes the case for accelerated implementation of selected liberalisation measures. These measures can build on the successes of the Free Trade Zones, the Stock Connect and Mutual Recognition of Funds programmes, and the various quota schemes that have promoted two-way capital flows. Regulators also need to take on board which aspects of these schemes have proved problematic or have experienced limited take-up.

Our conversations with clients have consistently returned to the central question of how the Greater Bay Area can be more than the sum of its parts. The priority areas for reform that have surfaced from these conversations are:

- Creation of a special regime / business status analogous to the APEC card that would allow firms (and employees) to bridge the two jurisdictions. Alternatively, a 'new CEPA' could be devised, with eventual relaxation of the boundary and increased tax harmonisation.
- Visa and immigration regimes will need to be overhauled to accelerate cross-border mobility so that tech talent can work in Hong Kong more easily and finance experts can cross the border with fewer impediments.
- Introduction of a GBA sandbox, along with other pilot schemes that can facilitate capital flows – so long as they are supported by a clear business rationale. SAFE-imposed limits will need to be relaxed in the GBA.
- Region-wide passporting for Virtual Banks. Hong Kong-based Virtual Banks need to be given easier access to RMB funding (a major constraint on foreign banks).
- Reciprocal policy and regulations for FinTechs and traditional players will be needed to achieve a level playing field. These will include alignment of data governance and KYC regulations.
- Increased investment in talent collaboration, along with targeted and aligned incentives to address critical shortages in the talent pool.
- Regulatory uncertainty is prompting a wait-and-see approach. Many players might prefer to be 'fast followers' rather than 'first movers'. Greater clarity would ensure a more vibrant ecosystem across the GBA and reduce the risk that a handful of major players would dominate.

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