

# THE COMMENCEMENT OF THE WEALTH MANAGEMENT CONNECT AND THE LONG-AWAITED SOUTHBOUND CHINA-HONG KONG BOND CONNECT SCHEMES

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## **China Asset Management and Investment Funds Alert**

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In early September 2021, the deputy governor of the People's Bank of China, the central bank of the People's Republic of China (PRC), announced the impending launch of two new cross-border investment schemes: Wealth Management Connect and Bond Connect. The Wealth Management Connect scheme officially launched on 10 September 2021 and the southbound leg of Bond Connect will officially launch on 24 September 2021. These schemes are the newest extensions of the "Connect" schemes, which are initiatives by the PRC government to liberalise and internationalise its currency, the Renminbi (RMB), by providing cross-border channels for investments in capital markets between the PRC and the rest of the world through Hong Kong and to a lesser extent, Macau.

The Connect schemes involving the special administrative regions of the PRC, Hong Kong and Macau, commenced with the Hong Kong-Shanghai Stock Connect in 2014, followed by the Hong Kong-Shenzhen Stock Connect in late 2016 and the China-Hong Kong Bond Connect program (Bond Connect) in 2017<sup>1</sup> (although the Bond Connect was restricted to northbound trading in onshore PRC bonds by non-PRC investors through the Hong Kong market infrastructure linkage). London also has a Connect scheme with the Shanghai Stock Exchange but this has attracted much less interest.

### **The Wealth Management Connect Scheme**

There is clearly a huge demand in the PRC for onshore wealth investment products as evidenced by the US\$380 billion take-up in 15 days for the new wealth product launched by a BlackRock-China Construction Bank-Temasek joint venture, which is the PRC's first onshore-created and managed wealth product that has higher exposure to stocks than the fixed-income products used by traditional PRC wealth products<sup>2</sup>.

Tapping into this pent-up demand, the Wealth Management Connect program enables residents of nine PRC cities within the Greater Bay Area economic cluster<sup>3</sup> to directly access investment products sold by Hong Kong and Macau banks, while Hong Kong and Macau residents may directly purchase PRC onshore wealth investment products sold by banks in the Greater Bay Area. Unlike the other Connect schemes, however, it is focused directly on individual investors in the Greater Bay Area. These products may only be purchased at banks with branches on both sides of the PRC-HK-Macau border.

Authorities on both sides of the border have set an aggregate quota of RMB300 billion (approximately US\$46.47 billion) for fund movement in both directions (divided equally into RMB150 billion in each direction). Individual

investors will be allowed to invest up to RMB1 million in such investment products which may only be sold by banks in the Greater Bay Area.

The Wealth Management Connect scheme only covers fund products classified as low and medium risk in the mainland. These include money market funds, bond funds, stock funds and index funds. Complex investment products with high volatility or leverage are excluded.

### **The Bond Connect Scheme**

The newly announced Bond Connect scheme extends the northbound channel of the PRC's cross-border bond-trading scheme to a southbound channel, which will enable onshore PRC professional investors to access bonds traded in Hong Kong. It completes the Bond Connect program as a whole, which will now encompass both northbound and southbound trading.

The southbound channel of the Bond Connect has a daily quota of RMB20 billion (approximately US\$3.1 billion) subject to an annual limit of RMB500 billion. The PRC government has authorized 41 PRC banks and 173 qualified domestic institutional investors<sup>4</sup> to trade in all existing bonds in Hong Kong. The Hong Kong Monetary Authority will establish a central clearing unit in Hong Kong dollars for Hong Kong dollar-denominated bonds and RMB for dim sum bonds initially, which will be expanded to other currencies at a later stage.

The PRC's onshore bond market is the world's second largest. Based on data provided by Shanghai Clearing House and China Central Depository & Clearing, foreign holdings of PRC onshore bonds grew from RMB850 billion before the northbound Bond Connect was launched to a record RMB3.8 trillion (approximately US\$568.45 billion) at the end of May 2021<sup>5</sup>. At the same time, Hong Kong's bond market is the third largest in value in Asia excluding Japan after the PRC and South Korea<sup>6</sup> and is the most preferred location for Asian international bonds to be arranged. In 2020, Hong Kong arranged 34 percent of all Asian transactions—ahead of the United Kingdom, the United States, and Singapore, due, in no small part, to the large number of offshore China bond issues in Hong Kong<sup>7</sup>.

Through the newly-established southbound Bond Connect, PRC professional investors will be able to deal in all tradeable bonds in Hong Kong such as bonds issued by the Hong Kong and PRC governments and public bonds such as the Hong Kong Mortgage Corporation and Hong Kong MTR bonds. However, it is more likely that such investors will start with bonds with “familiar” identifiers such as offshore bonds issued by Chinese issuers with which such PRC investors are already familiar, high-yielding fixed-income Asian dollar bonds and dim sum (RMB-denominated) bonds issued by non-mainland Chinese issuers. Green and ESG bonds are likely to surge in popularity in line with President Xi Jinping's pledge for the PRC to be carbon neutral by 2060<sup>8</sup> and the PRC's growing awareness of and engagement in, such issues, both as investors and issuers. Initiatives such as the PRC government's policy to encourage voluntary pension contributions by PRC retail investors<sup>9</sup> mean that PRC pension funds along with PRC insurers are likely to target ESG and green bonds in Hong Kong, while PRC issuers intending to tap this market will look to Hong Kong for the skill and expertise required to develop, arrange and administer such products. All of these developments are likely to support Hong Kong's plan to market itself as the premier ESG and green finance platform.

While the Wealth Management Connect and the Bond Connect schemes are expected to expand and simplify PRC onshore investors' and offshore PRC investors' mutual access to each other's capital markets so that a greater pool and wider level of investors will be able to access such products, they will also create a demand for

new products, such as the aforementioned green and ESG bonds, as well as open up the door to the future development of products by creative fund management intermediaries, service providers and banks such as establishing wealth products that may not be directly available to domestic PRC or Hong Kong/Macau investors in their own jurisdictions.

## FOOTNOTES

1. <https://www.klgates.com/The-Commencement-of-the-Long-Awaited-China-Hong-Kong-Bond-Connect-07-05-2017>
2. [https://www.ignitesasia.com/c/3325284/422293/blackrock\\_wealth\\_product\\_debut\\_china\\_attracts?referrer\\_module=emailReminder&module\\_order=0&code=WTJodmlyeDVaUzUwWVc1QWEyeG5ZWFJsY3k1amlyMHNJREV4TVRRd01ESXNJRFkwTIRVek56QTNNZz09](https://www.ignitesasia.com/c/3325284/422293/blackrock_wealth_product_debut_china_attracts?referrer_module=emailReminder&module_order=0&code=WTJodmlyeDVaUzUwWVc1QWEyeG5ZWFJsY3k1amlyMHNJREV4TVRRd01ESXNJRFkwTIRVek56QTNNZz09)
3. The area consisting of Hong Kong, Macau, Guangzhou, Shenzhen, Zhuhai, Foshan, Zhongshan, Dongguan, Huizhou, Jiangmen and Zhaoqing, which the PRC government has earmarked as an integrated economic and business hub.
4. <https://www.scmp.com/business/companies/article/3149051/southbound-link-game-changer-will-boost-hong-kong-bond-market>
5. <https://www.thestandard.com.hk/breaking-news/section/2/175851/Bourse-CEO--Nicolas-Aguzin,-says-working-closely-with-mainland-regulators-on-southbound-Bond-Connect>
6. <https://www.legco.gov.hk/research-publications/english/2021fs01-bond-markets-in-hong-kong-and-singapore-20210128-e.pdf>
7. <https://www.icmagroup.org/assets/documents/About-ICMA/APAC/The-Asian-International-Bond-Markets-Development-and-Trends-March-2021-03032021.pdf>
8. [https://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/t1817098.shtml](https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1817098.shtml)
9. <https://www.klgates.com/Foreign-Advisers-to-Gain-a-New-Indirect-Route-to-Chinese-Private-Pension-Fund-Money-07-17-2019>

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