FINANCIAL CONNECTIVITY WITHIN THE GUANGDONG-HONG KONG-MACAU GREATER BAY AREA AND HONG KONG AS A FINANCIAL HUB

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Executive Summary

1. With more than 1,200 mainland enterprises listed in Hong Kong (H-Share Companies) and a combined market capitalisation of HK27.9 trillion, the Mainland is evidently playing an increasingly important role in Hong Kong's financial industry.

2. Hong Kong is at risk of losing its status as the gateway to China after China's opening up and promotion of its globalised outlook; the importance of its entrepôt trade for mainland China has declined considerably over the past decade.

3. To strengthen its competitiveness and position as an international financial centre, there is a need for Hong Kong to collaborate with the nine mainland cities of the Guangdong-Hong Kong-Macau Greater Bay Area (GBA).

4. The state plan for promoting financial connectivity across the GBA is to offer more lucrative business opportunities for mainland-based Hong Kong and Macau financial institutions.

5. As a well-established international financial centre with a worldwide reputation for operating a prudent and robust financial regulatory regime, Hong Kong has internationally active financial markets that offer comprehensive and sophisticated financial and professional services.

6. While Hong Kong's financial sector remains robust, its global ranking has fallen three spots to the sixth place largely due to the massive street protests and social unrest, as well as its economic decline.

7. Shenzhen and Hong Kong have their own economic strengths and unique industrial competitiveness. Shenzhen is a key national innovation hub and Hong Kong a renowned international financial hub. Hong Kong's once dominant role has been greatly undermined by the rise of Shenzhen. It now accounts for less than 3% of China's gross domestic product.

8. Nevertheless, given Hong Kong's sophistication in financial development, variety of financial products and pool of financial professionals, Shenzhen is unlikely to replace Hong Kong as an internationally recognised financial hub in the foreseeable future.

9. The inclusion of a recently passed national security law in Annex III of Hong Kong's Basic Law will provide the Chinese authority with the legal tools to pursue its national security agenda in Hong Kong.

10. With the enactment of the national security law, Hong Kong's appeal as an attractive investment destination and favourable place to do business could be undermined, thereby casting the economic and financial viability of the GBA into uncertainty.

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Is Hong Kong a Golden Goose in the Greater Bay Area?

1.1 Since the handover of Hong Kong to China in 1997, Hong Kong's economy has been effectively integrated with that of the Mainland. So has Hong Kong's financial industry. Currently, more than 1,200 mainland enterprises are listed in Hong Kong (H-Share Companies), with a combined market capitalisation of HK$27.9 trillion.

1.2 In 2019, mainland enterprises accounted for over 50% of companies listed in the Hong Kong Stock Exchange, representing 73% of total market capitalisation in Hong Kong (HK$38 trillion). In terms of newly listed firms, 114 mainland enterprises accounted for 62% of Hong Kong's total.[1]

1.3 With Beijing's blessing, offshore RMB business was launched in Hong Kong in 2004. Hong Kong has since become a global hub for offshore RMB business and the world's largest RMB liquidity pool outside mainland China with the widest range of offshore RMB wealth management and other investment products.

1.4 Hong Kong is a well-established international financial centre (IFC) with a worldwide reputation for operating a prudent and robust financial regulatory regime. It has internationally active financial markets, and offers comprehensive and sophisticated financial and professional services.

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1 Hong Kong Stock Exchange, "HKEX Market Statistics 2019", April 2020, pp. 1-15, available at https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2019-Market-Statistics.pdf (accessed 3 June 2020).

1.5 The financial industry is the mainstay of the Hong Kong economy, accounting for 20% of its gross domestic product (GDP) in 2018. According to the Hong Kong Monetary Authority, Hong Kong has around 258,000 people working in its financial sector. In terms of numbers per 100,000 population, Hong Kong has among the world's highest concentrations of financial institutions and financial professionals.

1.6 With China's opening up and promotion of its globalised outlook, Hong Kong's role as the gateway to China and importance as an entrepôt for mainland China trade have declined considerably over the past decade. Hong Kong will need to collaborate with the nine mainland cities of the GBA in particular to strengthen its competitive edge and status as an IFC.[2]

1.7 According to evaluations of 108 financial centres by the 2020 Global Financial Centre Index (GFCI 27) on the competitiveness of the world's major financial centres,[3] Hong Kong has dropped three spots to the sixth place largely due to the massive street protests and social unrest, as well as its economic decline. New York and London took the respective two top spots, with Tokyo replacing Hong Kong in the third spot (see Table 1).

1.8 The prospects of Hong Kong as a thriving IFC are uncertain. The GFCI 27 survey reported professionals' views on financial centres, and Hong Kong has fallen behind Shanghai, Seoul, Shenzhen, Guangzhou and Singapore.

1.9 While Hong Kong's reputation as an established international financial centre and an attractive destination to do business took time to build, it only took persistent social unrest and violence to bring it down.

2 Hong Yu, "The Guangdong-Hong Kong-Macau Greater Bay Area in the Making: development plan and challenges", *Cambridge Review of International Affairs*, DOI: 10.1080/09557571.2019.1679719.

3 The ranking of the 2020 Global Financial Centre Index is measured and calculated based on a series of indicators and on five broad areas of competitiveness comprising institutional and regulatory environment, depth and breadth of industry clusters, availability of capital, market liquidity and economic output.

TABLE 1 GFCI 27 TOP 20 RANKINGS AND RATINGS

Financial Centre	GFCI 27		GFCI 26		Change in Rank	Change in Rating
	Rank	Rating	Rank	Rating		
New York	1	769	1	790	0	-21
London	2	742	2	773	0	-31
Tokyo	3	741	6	757	+3	-16
Shanghai	4	740	5	761	+1	-21
Singapore	5	738	4	762	-1	-24
Hong Kong	6	737	3	771	-3	-34
Beijing	7	734	7	748	0	-14
San Francisco	8	732	12	736	+4	-4
Geneva	9	729	26	706	+17	+23
Los Angeles	10	723	13	735	+3	-12
Shenzhen	11	722	9	739	-2	-17
Dubai	12	721	8	740	-4	-19
Frankfurt	13	720	15	733	+2	-13
Zurich	14	719	14	734	0	-15
Paris	15	718	17	728	+2	-10
Chicago	16	717	16	732	0	-15
Edinburgh	17	716	29	701	+12	+15
Luxembourg	18	715	25	708	+7	+7
Guangzhou	19	714	23	711	_+4	+3
Sydney	20	713	10	738	-10	-25

Source: Z/Yen and China Development Institute, "The Global Financial Centres Index 27", March 2020, pp. 1-55.

1.10 Shenzhen and Hong Kong have their own economic strengths and unique industrial competitiveness. Shenzhen is a key national innovation hub, whilst Hong Kong is a renowned international financial hub. Given that it accounted for less than 3% of China's GDP, Hong Kong's once dominant role has been substantially undermined and challenged by the rise of Shenzhen.

1.11 The economic rise of Shenzhen and its high-tech clout would not have been possible without the inflow of investment and talent from Hong Kong. Shenzhen has received huge capital investment from Hong Kong and many manufacturing factories were set up by Hong Kong businesspersons, especially during the 1980s and 1990s.

1.12 Shenzhen which used to look up to Hong Kong as a role model is now fast catching up. While Hong Kong is facing grave uncertainties and experiencing its slowest economic growth in a decade, Shenzhen is contributing enormously to the China's transformation into an innovative economy. With the shift in economic power and state's support, Shenzhen is set to replace Hong Kong in China's drive for GBA's development.

1.13 In August 2019, the Chinese central government unveiled a new development plan for Shenzhen to transform it into a model socialist city.[4] The international community speculates that Beijing is attempting to elevate the status of Shenzhen as a replacement to Hong Kong as a financial hub.

1.14 However, Hong Kong's free flow of capital, convertible currency, ease of doing business, prudent regulatory framework and sound legal system would remain as its strengths as a financial hub. Its edge in the sophistication of financial development, variety of financial products available and pool of expert financial professionals could be too big a gap for Shenzhen to replace Hong Kong as an internationally recognised financial hub in the foreseeable future.

1.15 As a whole, these policy initiatives aim to offer more lucrative business opportunities for Hong Kong and Macau financial institutions in the Mainland. As shown in Table 2, Hong Kong-based local and foreign banking institutions have already established sizeable branches/sub-branches in Guangdong and Macau. The newly announced business opportunities would be a booster for Hong Kong's banking institutions looking to expand their business undertakings to better serve customers in the Mainland.

TABLE 2 MAJOR HONG KONG BANKING INSTITUTIONS IN THE GREATER BAY AREA

Banking Institutions	**Number of branches in the GBA**
BEA 东亚银行	34 branches in Guangdong; four in Macau
Dah Sing Bank 大新银行	four branches in Guangdong; 14 in Macau
Hang Seng Bank 恒生银行	19 branches in Guangdong; one in Macau
Chong Hing Bank 创新银行	six branches/sub-branches in Guangdong; one in Macau
HSBC Bank 汇丰银行	86 branches in the Greater Bay Area
Standard Chartered 渣打银行	five branches and 16 sub-branches in Guangdong
Citi 花旗银行	two branches and three sub-branches in Guangdong

Source: Development Bank of Singapore, May 2019.

4 *Xinhua*, "Zhonggong zhongyang guowuyuan guanyu zhichi Shenzhen jianshe zhongguotese shehuizhuyi xianxing shifanqu de yijian" (China to develop Shenzhen as a global model city with distinguished competitiveness, innovation capability and influence), 18 August 2019, available at http://www.xinhuanet.com/politics/2019-08/18/c_1124890303.htm (accessed 1 July 2020).

1.16 Despite the state's push to forge stronger links between Hong Kong and mainland China, many in Hong Kong society have shown strong resistance to further integration with the Mainland for fear of further "Mainlandisation" of Hong Kong.

1.17 Guangdong's provincial and municipal authorities have been offering various incentives, in such forms as granting work permits, tax breaks and helping Hong Kong residents purchase properties in the Mainland, to attract HongKongers, particularly the younger generation, to relocate to the nine mainland cities.

1.18 Although Beijing plans to bind Hong Kong more closely to the Mainland, many Hong Kongers have no desire to live or work in the neighbouring city of Shenzhen, let alone other mainland cities, as they view mainland cities, including Shenzhen, as lacking in the rule of law and freedom of speech, and are illiberal and corrupt.[5] Many Hong Kongers, and the young generation in particular, seemingly do not support the state-led GBA development plan.

1.19 Implementation of the GBA plan has been sluggish since its inception in 2018, particularly after the massive and persistent anti-government protests in Hong Kong in June 2019.

1.20 The coronavirus outbreak that originated in the Chinese city of Wuhan has further reinforced fear and anxiety among the people in Hong Kong. The cross-border transport restrictions imposed by the authorities as a result of the coronavirus have limited the flow of people between Hong Kong, Macau and the mainland cities.

1.21 Although the pandemic outbreak is under control in mainland China, Hong Kong is experiencing a second wave of coronavirus outbreak now. Resumption of normal business and investment activities, deemed crucial to inter-city financial connectivity within GBA cities, will not come about anytime soon.

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5 Bloomberg, "Hong Kong versus Shenzhen: two competing visions of China's future", available at https://www.bloomberg.com/features/2019-hk-v-shenzhen/ (accessed 1 July 2020).
Financial Times, "Hong Kong v Shenzhen: the battle for supremacy", 21 January 2020, available at https://www.ft.com/content/8cf60164-2209-11ea-92da-f0c92e957a96 (accessed 1 July 2020).

1.22 The COVID-19 pandemic has added a new barrier to integration of Hong Kong in the state-driven GBA development plan. According to a survey,[6] many Hong Kongers have put off moving to the Mainland to take up jobs because of the virus.

The National Security Law in Hong Kong

2.1 To Beijing, under the Basic Law, Hong Kong's mini constitution, the Hong Kong government has the power to make its own decisions, except for those involving defence, foreign affairs and national security. Safeguarding China's sovereignty and national security in Hong Kong is the most important consideration for the central government.

2.2 On 30 June 2020, China's National People's Congress passed a national security law comprising 66 articles in six chapters, banning "any acts or activities" that will put China's national security in danger, including secession (e.g. seeking independence movements), subversion (e.g. overthrowing the power/authority of the Chinese government), terrorism (the use of violence/intimidation against Hong Kong residents) and collusion with a foreign country or external elements to endanger national security. With its inclusion in Annex III of the Basic Law, the national security law will provide the central authority with the legal tools to pursue its national security agenda in Hong Kong.

2.3 However, this legislation has bypassed local consultation and the Hong Kong Legislative Council, indicating a disregard for Hong Kong's legislative procedures. This would certainly erode the high degree of autonomy currently enjoyed by Hong Kong. To the Hong Kongers, the imposition of a national security law by Beijing will endanger the self-governance of Hong Kong.

2.4 On 28 May, Hong Kong's Chief Executive Carrie Lam, in response to the passage of the "Decision on Establishing and Improving the Legal System and Enforcement Mechanisms for the Hong Kong Special Administrative Region (HKSAR) to

[6] Karen Yeung, "Coronavirus adds new hurdle for Hong Kong's integration into China's Greater Bay Area plan", *South China Morning Post*, 1 March 2020, available at https://www.scmp.com/economy/china-economy/article/3052894/coronavirus-adds-new-hurdle-hong-kongs-integration-chinas (accessed 1 June 2020).

Safeguard National Security" by the National People's Congress, appealed to the Hong Kong people to support the national security legislation.

2.5 She sought to reassure concerned Hong Kong residents that their freedom of speech and human rights guaranteed under the "One Country, Two Systems" would not be impaired:

> *"The legislation to be enacted for the HKSAR to safeguard national security aims to prevent, curb and sanction an extremely small minority of criminals who threaten national security, safeguarding the prosperity and stability of Hong Kong and maintaining "One Country, Two Systems". It will not affect the legitimate rights and freedoms enjoyed by Hong Kong residents".*

2.6 Through the national security law, China aims to establish a new legal framework and enforcement mechanism to ensure the national security of Hong Kong. This law will allow China to legally tighten its grip on Hong Kong at the expense of the latter's autonomy.

2.7 According to the provisions of the national security law, Chinese intelligence organisations and security agents could legally be deployed to Hong Kong to conduct operations. Hong Kong's police force and national security officers from mainland China can intercept communications and conduct covert surveillance of both local and foreign suspects. Meanwhile, national security operations cannot be inspected or obstructed by law enforcement officers in Hong Kong.

2.8 This national security legislation for Hong Kong applies to both Hong Kong citizens and foreign nationals. Even foreign nationals not resident in Hong Kong, but who speak in support of Hong Kong independence or advocate for sanctions on Hong Kong or China, could be prosecuted upon entering Hong Kong or mainland China.[7]

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[7] Please see full text of "The Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region", available at http://www.xinhuanet.com/english/2020-07/01/c_139178753.htm (accessed 1 July 2020).

Is Hong Kong Now at Risk of Losing its Status as a Financial Hub?

3.1 The imposition of the national security law in Hong Kong has alarmed both foreign and local investors. The business and financial communities in Hong Kong are fearful for their own safety and concerned if they will receive fair legal treatment from the Hong Kong court.

3.2 Shortly after the state's announcement, the Hong Kong stock market recorded its sharpest fall in five years.[8] The rule of law, autonomy and independent judiciary are important factors for many foreign firms in their selection of Hong Kong as their operational base.

3.3 The national security law could shake business confidence among foreign investors in Hong Kong and cause foreign talents to flee Hong Kong. It could also impact Hong Kong's free business and investment environment.

3.4 Some Asian cities are considering offering preferential treatments such as visa waivers, tax breaks and discounted office space to attract finance professionals from Hong Kong.[9] Hong Kong will now have to work hard to retain its status as the top financial centre in Asia in the face of keen competition from Singapore, Shanghai and Shenzhen.

3.5 According to a survey conducted by the American Chamber of Commerce in Hong Kong in June 2020,[10] over 80% of the survey respondents are very or moderately concerned about Hong Kong's national security law. About 60% of respondents believed that the proposed law will harm their business operations in Hong Kong largely due to ambiguity in the scope and enforcement of the law, as well as jeopardise Hong Kong's status as an international business centre.

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8 "Hong Kong stocks fall most since 2015 as Beijing pushes security law", Reuters, 22 May 2020, available at https://www.reuters.com/article/hongkong-markets/hong-kong-stocks-fall-most-since-2015-as-beijing-pushes-security-law-idUSAZN18OW00 (accessed 14 June 2020).

9 "The battle to be Asia's premier financial centre", *Financial Times*, 25 June 2020, available at https://www.ft.com/content/77075422-b6f9-11ea-8ecb-0994e384dffe (accessed 1 July 2020).

10 The American Chamber of Commerce, "National Security Law and Hong Kong's Special Status", AmCham Temperature Survey Findings, June 2020, available at https://amcham.org.hk/uploads/media/default/0001/08/e63cc524fe6b2d94c1b12b01c6249e144a394a9a.pdf (accessed 9 June 2020).

3.6 Foreign companies indicate that they will take a "wait and see" approach and temporarily defer their investment decisions, while existing investors are getting ready to transfer their cash out of Hong Kong if the need arises.

3.7 According to the reading of the international community and the West in particular, China is likely to use the law to silence political opposition and dissidents in Hong Kong. US President Donald Trump has warned that Hong Kong could lose its status as a financial centre if China proceeds with the proposed national security law.[11]

3.8 The preferential economic and trade treatment granted to Hong Kong by the United States according to its 1992 US Hong Kong Policy Act[12] is at risk of being withdrawn. On 14 July, as part of its retaliatory response to the imposition of the national security law on Hong Kong, President Trump signed "The President's Executive Order on Hong Kong Normalisation" to begin the process of revoking Hong Kong's trade privileges.[13]

3.9 The US government believes that with the law in force, the Chinese authority will crack down on dissent against Beijing in Hong Kong, and violate the rights of freedom of speech and assembly of the Hong Kong people. In Washington's view, China's move goes counter to the "One Country, Two Systems" principle, a long-held promise by Beijing.

3.10 The United States' decision to revoke Hong Kong's trade privilege status under the 1992 Hong Kong Policy Act is likely to lead to the capital flight of foreign investors, further dampening the economic and financial viability of the GBA. The GBA could suffer economically if Hong Kong were to lose its position as a major financial hub.

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11 Jennifer Jecobs, "Trump says Hong Kong will lose finance industry after China law", Bloomberg, 26 May 2020, available at https://www.bloomberg.com/news/articles/2020-05-26/trump-says-hong-kong-will-lose-finance-industry-after-china-law (accessed 2 June 2020).

12 See the details of this Act on https://www.congress.gov/bill/102nd-congress/senate-bill/1731 (accessed 9 June 2020).

13 White House, "The President's Executive Order on Hong Kong Normalization", 14 July 2020, available at https://www.whitehouse.gov/presidential-actions/presidents-executive-order-hong-kong-normalization/ (accessed 26 July 2020).

3.11 Currently, Hong Kong is home to around 85,000 Americans and over 1,200 American companies. Major American financial institutions have established a presence in Hong Kong as a gateway to access the huge market in mainland China. Trump's decision to revoke Hong Kong's trade privileges is a "double-edged sword", which could hurt American economic interests as well.

3.12 Since 1983, the Hong Kong dollar has been pegged to US dollar at roughly 7:1. The Hong Kong linked exchange rate system (or the pegging of Hong Kong dollar to the US dollar) is the bedrock of Hong Kong's economic and financial system. However, a currency delink is not on the US list of sanctions against China and Hong Kong for the imposition of national security legislation as the US government could not interfere with the currency pegging as maintaining the peg is a decision made by the Hong Kong authority.

3.13 Meanwhile, the Hong Kong government has made it crystal clear that it has no intention of discontinuing the peg. The risk of a currency delink remains low unless the Hong Kong economy runs into deep debts or runs out of foreign reserves. Hong Kong Monetary Authority chief executive has said that Hong Kong currently has US$440 billion available reserves to maintain the peg.[14]

3.14 It is also highly unlikely that the United States will impose any restrictions on capital flows between the United States and Hong Kong due to the impact it would have on the US dollar's status in the Asian market.

3.15 Ironically, the United States' increasingly hostile attitude towards Chinese firms and Chinese investment, as well as President Trump's latest threat of punitive actions could provide new business opportunities for Hong Kong's Stock Exchange and its financial industry in general.

3.16 What has contributed to this optimism is the delisting of Chinese firms from the US stock exchanges by American financial regulators that fail to comply with new rules

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[14] Fortune, "Trump promised to revoke Hong Kong's privileged trade status. 4 ways it could alter U.S. relations", 3 June 2020, available at https://fortune.com/2020/06/03/us-hong-kong-special-trade-status-revoke/ (accessed 1 July 2020).

and regulatory audits introduced after the collapse of Luckin Coffee, a New York-listed Chinese coffee chain.[15] Chinese firms which are unwilling or unable to comply with these new regulations are likely to turn to a more friendly market for listing, with Hong Kong potentially being the biggest beneficiary. Alibaba, a company which recently chose Hong Kong for its secondary listing, is a case in point. Given the political pressures and tightening of regulatory measures against Chinese firms, many US-listed Chinese enterprises are considering to list on the Hong Kong exchange.

3.17 Listing in Hong Kong could be advantageous to these Chinese firms as it would place them closer to their suppliers and customers in mainland China. Hong Kong Stock Exchange and Clearing Chief Executive Charles Li recently said during a virtual industry conference that "[t]his is going to be a big year for IPOs, including both huge IPOs from China and very substantial returnees, as we call them, from the United States".[16]

3.18 Hong Kong's Financial Secretary Paul Chan Mo-po stated that the United States' decision to revoke preferential trade treatment for Hong Kong will have little impact on its economy as Hong Kong's exports to the United States, worth HK$304 billion, account for only around 7.5% of its merchandise export volume.

3.19 The revoking of Hong Kong's trade privileges could generate a far larger impact on Hong Kong's service trade than its merchandise trade. In terms of Hong Kong's services exports, the United States is a major destination. The United States accounted for around 13% of Hong Kong's total service trade volume in 2018.

3.20 In general, the United States is not a major foreign investor in Hong Kong. Only around 1.3% of the inflow of foreign direct investment to Hong Kong came from the United States in 2019 (Figure 1).

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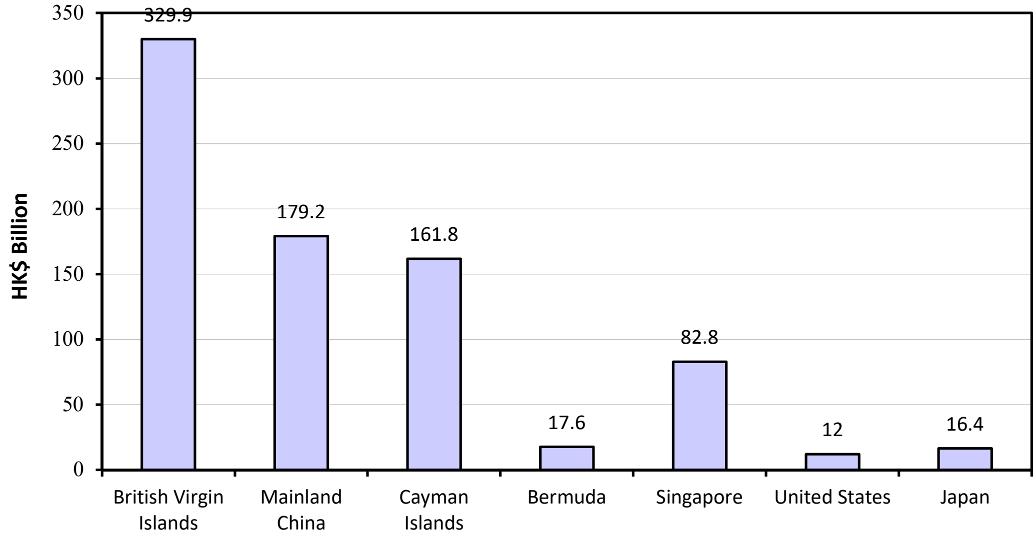
[15] Currently, 233 Chinese enterprises are listed in the United States. The total listed market cap is at US$1.03 trillion, making up 3.3% of the US equity market cap. Source: "Potential De-listing of Chinese Companies in the US", UOB Investment Insights, Quick Note, 22 May 2020, available at https://www.uob.com.sg/assets/pdfs/investment-quicknotes-22may-2020.pdf (accessed 6 June 2020).

[16] John McCrank, "HKEX says U.S.-listed Chinese firms plan Hong Kong listings", Reuters, 4 June 2020, available at https://www.reuters.com/article/us-hkex-ipo/hkex-says-many-us-listed-chinese-firms-plan-hong-kong-listings-idUSKBN23B22G (accessed 6 June 2020).

FIGURE 1 DIRECT INVESTMENT INFLOW TO HONG KONG FROM SELECTED MAJOR COUNTRIES/TERRITORIES, 2019



Source: *Hong Kong Annual Digest of Statistics 2019*, Hong Kong Census and Statistics Department, October 2019.

3.21 Financially, Hong Kong holds formidable financial firepower, with foreign currency reserve assets of HK$441.4 billion by the end of 2019 and per capita foreign currency reserve assets of HK$58,841. There has been no evidence so far of a palpable outflow of capital from Hong Kong.

3.22 Since the US-China trade war, the Hong Kong government has been preparing for a scenario of sanctions by the United States. Financial Secretary Chan said: "We have confidence and experience dealing with challenges as the financial market in Hong Kong has gone through a lot. With support from the whole country, we have nothing to be afraid of".[17]

[17] *Global Times*, 'US to pay heavily for reckless sanctions aimed at China', 30 May 2020, available at https://www.globaltimes.cn/content/1189980.shtml (accessed 2 June 2020).