GBA Digest

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FOREWORD

Robust GBA strategies a silver lining for financial institutions amid economic headwinds

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The market environment remains subdued in the third quarter of 2022, with global inflation and the resultant interest rate hikes posing significant challenges to businesses. With further interest rate increases expected in the coming months, this uncertainty is likely to prevail.

The continued impact of COVID-19 is another factor hampering business growth for many. However, the Hong Kong's insurance industry still looks promising, by demonstrating resilience and embarking recovery despite the challenges of the pandemic.

In this issue, we are delighted to have AIA Hong Kong & Macau CEO Alger Fung shared his views on the prospects of the insurance industry in Hong Kong and the GBA in our Executive Dialogue section. In conversation with Simon Dai, Insurance Partner of Deloitte China, Alger voices his optimism about the business potential in these areas going forward. He opines that the likely impending rapid economic and social development of the GBA will present ample opportunities for the insurance market, with the GDP and population growth providing perfect stimuli to address the region's insurance protection gap.

Insurers will be expected to develop alongside South China's transformation into an innovation hub, and, as Alger points out, this will include being able to demonstrate an enhanced service scope and digital capability. In view of Alger's insights, we are confident that Hong Kong insurance sector will benefit from the growth in the GBA region and enhance its position as a leading insurance hub in Asia.

Digital transformation of the financial industry remains a major area of concern for businesses, and at Deloitte, we are always keen to emphasize its importance to financial institutions. This issue features actionable insights from our experts for financial institutions wishing to outpace their peers in the race for digital transformation and ensure they have the capability to keep up with market innovation and meet evolving customer expectations.

In August, Deloitte supported the Chinese Banking Association of Hong Kong (HKCBA) in the organization of a seminar named Digital Transformation in Banking: Practice Sharing. At Deloitte's Hong Kong office a number of guest speakers shared their thoughts on and experience in enacting digital transformation in the financial industry, covering key topics such as data and cloud infrastructure and customer engagement in the Metaverse.

Deloitte Consulting Partner Sunny Ip spoke at the event, during which he explained that the process of digital transformation should go beyond simply utilizing online channels – change and innovation must be embraced across all facets of the business in order to achieve true digitalization. With many banks still using legacy platforms and systems that are costly and complicated to replace, the issue of modernization has become more pressing, and will need to encompass an overhaul of their operating models and infrastructure in order to be able to deliver real innovation to the market.

These thoughts were echoed by Shiwei Wu, Huawei Cloud APAC Chief Technology Officer, who emphasized the importance of having the right digital infrastructure to enable true digital transformation, with many financial institutions now choosing to move towards hybrid multi-cloud models. Further details on the HKCBA event and insights from digital transformation in practice can be found in this issue.

As the development of the GBA continues, new opportunities are emerging throughout the region's financial sector. The recently announced Swap Connect scheme is just one of a string of initiatives aimed at enhancing the connectivity between international and Mainland Chinese financial markets. Set to launch in early 2023, the mutual access scheme will initially facilitate interest rate swaps, with further products added in due course. In this issue, Deloitte FSI Audit and Assurance Partner Ivan Tang provided his analysis of the initiative and the potential benefits it is likely to offer.

The GBA offers a rapidly expanding array of opportunities for the financial sector.

As a number of financial leaders have alluded to, a robust GBA strategy addressing market development, emerging customer needs, and innovation and technology is imperative for capturing growth opportunities in the rapidly developing GBA market.

Executive Dialogue

Customer-centricity, health protection, and digital capabilities - the Top 3 priorities for insurers

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As Chief Executive Officer for AIA Hong Kong & Macau, Alger Fung drives the strategic business direction to extend AIA's distribution market presence and develop new opportunities for sustained growth in Hong Kong and Macau.

Prior to this role, Alger was Chief Executive Officer of AIA Thailand. Under his leadership, AIA Thailand significantly expanded its protection propositions and strengthened its unit-linked business, while continuing to raise the productivity of its agency force. AIA's partnership with Bangkok Bank was also further strengthened with continued new business growth and increased productivity of the sales force. He was previously the General Manager of Guangdong Branch of AIA China, where he helped to transform the agency business into a full-time, professional agency model that delivered significant VONB growth, contributing to AIA China's overall outstanding track record of success.

Alger brings with him a wealth of experience with over 25 years in the life insurance industry. Throughout his career, he has served in a wide range of leadership roles with an exceptional track record of success. Alger joined AIA Group Office as Regional Chief Agency Officer in 2013, responsible for China, Singapore, India, and Sri Lanka, where he was key in implementing AIA's Premier Agency strategy. He received recognition from the Financial Services Bureau of the Guangzhou Government and he was also appointed as Adjunct Professor by Lingnan College of Sun Yat-sen University in 2016.

SD: As one of the world's largest life insurers, AIA Group is headquartered and listed in Hong Kong with over 90 years of history in this international financial center. How do you see the overall development of the insurance industry in Hong Kong and its impact to Mainland China and other Asian markets?

AF: The insurance industry has played a vital role in solidifying the position of Hong Kong as an international financial center. With the rising calls for protection, the total gross premiums in Hong Kong have escalated from HKD 489 billion[1] to HKD 603 billion[2] from 2017 to 2021, with a compound annual growth rate of more than 5% in the past five years, which demonstrated a significant expansion of the insurance market in Hong Kong. Moreover, as of 2021, there have already been at least 17[3] insurance companies listed on Hong Kong Stock Exchange, making up approximately 5% of the total market capitalization.

While the insurance market in Hong Kong is well developed, Mainland China and other Asian markets present strong growth. A research study estimated the health protection gap in Guangdong to be USD 50 billion,[4] demonstrating a huge market demand for insurance. Due to geographical proximity, the insurance industry in Hong Kong could have positive impacts for neighbouring regions by leveraging its solid professional experience.

One of the key contributions from the insurance industry in Hong Kong is technological innovation. Initiated by the Insurance Authority, insurtech is being highly promoted in Hong Kong to improve the operational efficiency of insurance businesses. For instance, with the help of big data processing, customer dynamics can be analyzed and managed at scale to develop propositions with a higher level of personalization and improve the customer experience, which enable a better product delivery to both local and regional policyholders.

Moreover, regional business collaboration can also be leveraged to enhance the customer experience across geographies. One example would be bank partnerships to expand the distribution network for wider customer reach. At AIA, we have entered an exclusive, 15-year strategic bancassurance partnership with The Bank of East Asia to strengthen our competitive advantages across GBA areas. Not only can it help boost the brand exposure of both parties, but it could also bring more choices of insurance products for customers in the future based on their protection needs, risk profiles and financial goals.

1. *Insurance Authority releases Hong Kong insurance business statistics for 2017* by Insurance Authority (28 September 2018)
2. *Insurance Authority releases provisional statistics of Hong Kong insurance industry in 2021* by Insurance Authority (11 March 2022)
3. *Insurance growth opportunities eyed* by Government of the Hong Kong Special Administrative Region (27 April 2022)
4. *AIA Hong Kong recognized at the first 'Greater Bay Area Outstanding Enterprise Awards' leverages solid experience and unique edge to drive insurance development in the region* by AIA (25 October 2021)

SD: Despite the challenges of the pandemic, Hong Kong insurance industry has demonstrated strong resilience and a rapid recovery. According to the Insurance Authority, Hong Kong insurance industry's Q1 2022 statistics showed a year-on-year increase of total gross premiums by 0.5% to HKD 158.2 billion.

In your opinion, how has the insurance industry adapted to the "new normal" during the pandemic? And, what are the particular qualities of Hong Kong's insurance industry that helps it overcome difficult times?

AF: Inevitably, the pandemic situation has caused huge disruption to every sector. In response to the change in business environment, the operational model of the insurance industry in Hong Kong has evolved to cope with the "new normal" through digitalization and product innovation.

Digital transformation has been catalyzed to advance user experience during the pandemic. Although the social distancing rules have challenged how traditional insurance channels interact with customers, they have also further prompted the need for digital offerings and services. To maintain competitiveness and customer relationships, insurers nowadays are generally expected to provide an enhanced level of digital services to facilitate client engagement throughout the entire insurance purchasing and servicing journey, like blockchain-supported data transfer as well as the seamless integration between mobile apps and websites.

Other than the change in distribution channels, an increase in the demand for health services that take care of customers' needs comprehensively has also reshaped the insurance industry in Hong Kong during the pandemic period. The outbreak of coronavirus disease has resulted in a prevailing increase in health awareness. In light of rising market demand for medical protection, local insurers have taken the initiatives to extend the service scope of medical insurance products, including diagnosis benefit, virtual medical consultation service, and special claims arrangements for hospital cover, which cater for a variety of customer needs.

On top of the practical resolutions to deal with the "new normal", the resilience of the insurance industry also rests largely on the unique attributes of insurance companies in Hong Kong.

The key feature of insurers in Hong Kong is enterprise agility. With extensive experience, insurance companies in Hong Kong are highly responsive to market change. For instance, underpinned by our drive to collaborate with different digital platforms as a key business strategy to actively broaden touchpoints with customers, AIA is undertaking partnerships with various digital platforms to make protection a part of customers' everyday life, to enhance customer experience, thus helping them live "Healthier, Longer, Better Lives".

Another key trait is the commitment to customer centricity. Corresponding to the high market demand for health-related products, insurance companies in Hong Kong continuously improve their proposition designs by incorporating value-added elements into their offering. Likewise, at AIA, we have gone beyond the traditional norm of insurance about paying out claims only and taken a proactive approach to provide 360-degree solutions, including telemedicine service (provided by an independent third-party vendor in Hong Kong) and cashless hospitalization in local and overseas areas. The comprehensive scope of insurance products can help deliver quality solutions to policyholders during turbulent times.

SD: The Guangdong-Hong Kong-Macao Greater Bay Area (GBA) has a population of more than 86 million and a combined GDP of RMB 12.6 trillion that offers many opportunities for insurers. What is your opinion on the overall development of the GBA in the short-term and long-term? What would be the hard-to-miss opportunities for the insurance industry?

AF: Under the national blueprint to develop the GBA as a strategic zone, it is foreseeable that there will be rapid economic development, with the influx of talents, goods, and capital. The region can also attract senior citizens and youngsters in Hong Kong to go northbound for retirement and work, and thereby further fostering socio-economic development in this region in the long run.

Given the GBA initiatives would create a favorable business environment, there are certainly ample opportunities which should not be missed by the insurance industry in Hong Kong.

From the social perspective, the GBA offers immense potentials for the insurance market. The envisaged growth of population and GDP indicates a golden opportunity to address the insurance protection gap there.

Taking Guangdong as an example, the estimated health protection gap amounts to USD 50 billion in 2019.[4] Additionally, similar findings were also observed for life and property-and-casualty insurance in 2019 that its penetration rate stood merely at 6% for Mainland cities and GBA regions, compared to 18% for Hong Kong.[4] These statistics have signaled huge market demand for insurance products, revealing vast opportunities for the insurance industry.

Particularly, for Hong Kong insurers, we are in a great position and possess a competitive edge in tapping into the GBA market as seen in the strong interest by Mainland Chinese visitors. A recent AIA research revealed that more than half of the Mainland Chinese visitors, including GBA residents, claimed that they would visit Hong Kong (or Macau) after border reopening. Furthermore, the same research also showed that respondents are interested in visiting Hong Kong or Macau and buying insurance there because of its variety (i.e. medical and critical illness and multi-currency-denominated policies), reliability, and returns.[5]

With deepening cooperation between Chinese Mainland cities and Hong Kong (and Macau), we are seeing an increasingly efficient transportation network for the mobility of people and flow of goods, which will definitely facilitate greater business opportunities for Hong Kong insurers.

5. *AIA Mainland China Visitor Report* by YouGov (June 2022)

SD: As a leading life insurer in Asia and an active player in the GBA, from your experience, what are the key factors for insurers to succeed in the GBA market?

AF: The GBA development aims to shape the South China region into a world-class innovation hub. To seize the market opportunity, insurers are expected to demonstrate the following qualities.

Steadfast commitment to customer-centricity is crucial when entering the GBA market. Although Hong Kong and Mainland China share many cultural traits, there are still differences in terms of market needs and customer preference. For instance, research studies show that covers for medical protection, treatment, and recovery are at the top of the wish-list of Mainland China customers. Most importantly, affluent groups there are more interested in – and are looking for – products with value-added services such as the cross-border and overseas medical referrals,[6] demonstrating a unique customer need in the GBA. Hence, thorough market study and customer analysis are needed before entry into the GBA, on top of the approval of the government and relevant authorities.

Another key to success in the GBA market is the **enhanced scope of health-related service offerings**. From a marketing point of view, the provision of value-added service in a product offering can boost customer loyalty. For example, in response to the increasing interest in health protection, AIA adheres to design a comprehensive scope of services covering from prevention, protection, and diagnosis, to treatment and recovery, which would unquestionably stand out from the market as it offers a 360-degree solution to third-party expert advice, personalized treatment and rehabilitation plan all in one go, making insurance service go beyond just paying insurance claims.

Last but not least, **digital capability** is also a fundamental feature in the development in the GBA market. With the rise in use of technology, digital services are expected to create higher operational efficiency and customer satisfaction. Similarly, at AIA, we stress the importance of technology, digital and analytics, known as our TDA strategy, to capture growth opportunities by driving productivity improvements and greater efficiency. For instance, powerful digital tools will enhance agency efficiency and professionalism across every aspect of the value chain. We believe, digital services would lead to better business outcomes, including improved retention and enhanced financial performance.

6. *Health and medical insurance in China's Greater Bay Area Survey* by Swiss Re Institute (September 2021)

About AIA Hong Kong & Macau
AIA Group Limited established its operations in Hong Kong in 1931. To date, AIA Hong Kong and AIA Macau have close to 19,000 financial planners[1], as well as an extensive network of brokerage and bancassurance partners. We serve over 3.4 million customers[2], offering them a wide selection of professional services and products ranging from individual life, group life, accident, medical and health, pension, personal lines insurance to investment-linked assurance schemes with numerous investment options. We are also dedicated to providing superb product solutions to meet the financial needs of high net worth customers.

1. as at 31 December 2021
2. Including AIA Hong Kong and AIA Macau's individual life, group insurance and pension customers (as at 31 December 2021)

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INnovate and unite for a vibrant future

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Today's problems can't be solved with yesterday's answers. We aim to elevate the human experience through a combination of data, technology, strategy, and creativity.

Technology

Beyond doing digital, BEING digital – the key to every digital transformation journey

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Digital transformation is at the forefront of the banking industry's collective mind. To stay ahead, banks must learn to make innovation a core part of their brand DNA or risk losing market dominance, as evidenced by big household names that have fallen from grace.

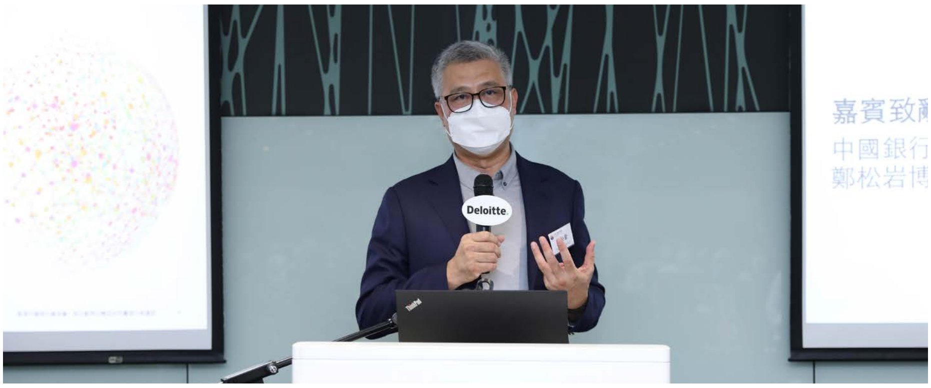
Today, digital disruption happens at a pace few previously imagined, with Web3.0 and the Metaverse likely to revolutionize how we view and interact with the world around us. However, to avoid reducing the use of these innovations to just a gimmick and be truly transformative, organizations need to redefine what it means to be digital.

Against this backdrop, the Chinese Banking Association of Hong Kong (HKCBA) organized the Digital Transformation in Banking: Practice Sharing seminar ("the Seminar") in August at Deloitte's Hong Kong office, which was attended by more than 40 senior banking executives specializing in digital strategy, information technology, fintech, innovation, and business development.

From L to R:

Ji Xiang, General Manager of Huawei Hong Kong Enterprise Business Group; Freddie Chui, Deloitte China FSI Markets & Global Network Leader; Dr Rocky Cheng, Bank of China (Hong Kong) Limited Chief Information Officer; Wong King Seng, Chinese Banking Association of Hong Kong Vice President; Sunny Ip, Deloitte China Consulting Partner; Shiwei Wu, Huawei Cloud APAC Chief Technology Officer

At the Seminar, guest speaker Dr Rocky Cheng, Chief Information Officer of Bank of China (Hong Kong) Limited, shared his insights and experience in digital transformation. He was followed by Deloitte Consulting Partner Mr Sunny Ip and Huawei Cloud APAC Chief Technology Officer Mr Shiwei Wu, who discussed their practical experience in core banking digital transformation, data and cloud infrastructure, and end-to-end customer engagement in the Metaverse and beyond.



Dr Rocky Cheng, Chief Information Officer of Bank of China (Hong Kong) Limited

Digital Transformation in Banking: Practice Sharing Seminar organized by the HKCBA at Deloitte Hong Kong office

"Being digital" vs "doing digital"

Traditional financial institutions need to move beyond just 'doing' to truly 'being' digital. All companies have online channels and most have an app, but is that enough to be digital?

For banks to win the game, they must embrace changes to their technology delivery, customer servicing, and even business models to achieve true digital transformation. And this digital transformation journey must take place across the full spectrum – how businesses behave, operate, and organize will all play a critical part in the final result.

To bring together channels and touchpoints, data insights, personalization, ecosystem partners, new financial products and services, and more, into entirely new customer propositions, companies need to draw inspiration from outside their industry, accept experimentation and a "fail fast, learn faster" mindset, and leverage technology as a strategic enabler, not just a cost-center.

Unlocking agility in the core

Many banks today still run on legacy mainframe applications and aging platforms that are hard to modify, with outright replacements risky and difficult to justify financially. Now that most banks have launched digital offerings and realized this only scratches the surface, they are encountering a substantial need to modernize their core platforms, rethink their operating models, and transform their infrastructure to really bring innovations to the market.

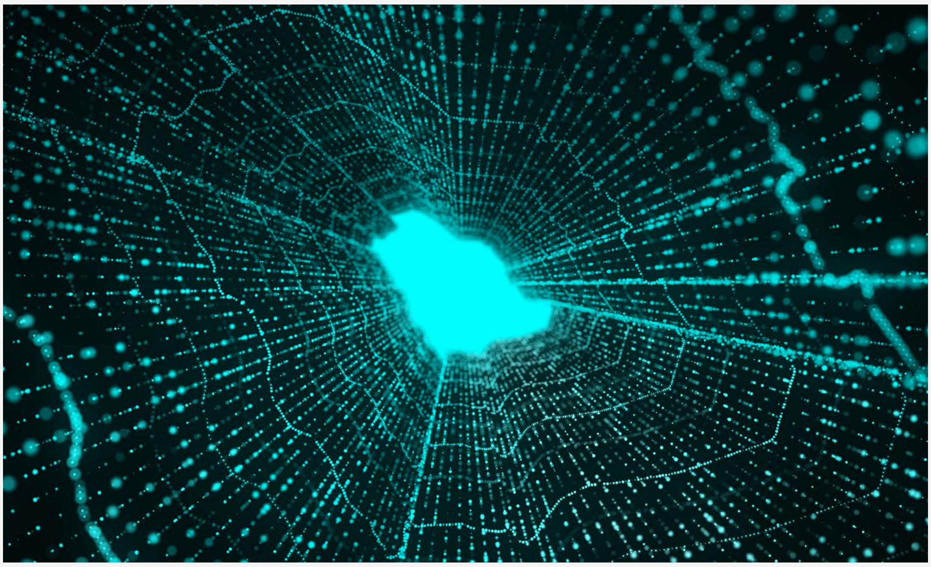
Transforming core platforms by adopting micro-services is a viable solution to incrementally add or refactor functionality related to core legacy systems, tying incremental changes to new business use cases, which minimizes operational risk and makes the business case for technology transformation clearer and more justifiable. This has the added benefit of better aligning with and enabling agile delivery processes, DevOps automation, and more modern teaming structures like end-to-end "product" teams, allow innovations to extend beyond the customer experience layer alone.

Re-imagining the customer journey

From transforming into a digital organization inside and out, and constant advent of new innovative technologies such as Web3.0 and the Metaverse, banks can truly reimagine the customer journey beyond typical interactions.

Although the definitions of the Metaverse and Web3.0 are still evolving, their foundations are well established, with many core aspects already being leveraged for transformational customer experiences. The Metaverse is a new paradigm for how banks can engage customers through virtual economies and mixed reality, with decentralized open platforms and persistent worlds, enabling immersive experiences and seamless ecosystem partnerships, new social and business interactions, and ultra-personalized and unique marketing activities, to name just a few use cases.

Nobody knows what the "killer app" in the Metaverse will be yet, and as with most innovations, the best way to be successful is to be agile, to test, learn, and pivot with a proposition in the market, and be open to ecosystem partnerships.



Case studies

A Mandatory Provident Fund (MPF) trustee in Hong Kong recently introduced a revamped mobile app with Metaverse elements, designed to bring a completely new engagement experience to members.

In addition to account management and financial product information, the new app has a persistent world where merchants can establish virtual "pop-up stores" that provide exclusive offers and experiences, members can "play to earn" coins to buy virtual assets or redeem them for real world offers, and much more.

Future releases could extend these virtual and real world integrations, build up social communities, or add other gamification elements. However, more than just these features themselves, launching quickly to allow time to test and learn how real customers in the market use the app, and iterate on new features from there, will be key.

With this in mind, Deloitte helped to launch the new app successfully, from scratch, within six months, and continues to deliver new features based on market feedback and data.

Green cloud for smarter finance

"One critical factor in the financial digital transformation journey is having the right digital infrastructure, and innovation is driving that change. Today, an increasing number of financial institutions are shifting towards hybrid multi-cloud models, making use of the best capabilities while mitigating lock-in risks."

—— **Shiwei Wu, Huawei Cloud APAC Chief Technology Officer**

The benefits are clear – banks will have the agility to tailor to business needs and budget, regulatory compliance and security requirements, and, perhaps most importantly, business continuity management, at any given time. A cloud-native core banking approach has multiple advantages, from data storage efficiency and protection, to superior connectivity and robust critical infrastructure that ensures transaction availability.

In addition, by adopting cloud-based infrastructure, financial institutions achieve significant environmental benefits and contribute to a greener economy, which is a key focus of GBA development.

Wu explained that on average, cloud infrastructure provides a 54% saving in power consumption resulting in greater network energy efficiency. Green construction, green energy, and green operation have also contributed to more efficient use of power, and cloud data centres are much more energy efficient than traditional on-premise solutions.

Conclusion

Although many financial institutions are eyeing the huge opportunities and market potential available in the Greater Bay Area, navigating this region, which encompasses three different jurisdictions and complex requirements, has not been easy. Ultimately, the winners in the GBA in the digital age are going to be financial institutions that embrace the human (not just customer) experience, ecosystem collaborations, and innovations, including the Metaverse, to realise their long-term GBA strategies.

To future-proof their development in the GBA and meet policy requirements, banks should move fast and embrace digital innovation as part of their business DNA. The notion that digital transformation is just an app or online marketing tool is outdated – for every organization, it is imperative to adopt a "be digital" strategy to up their game and optimize digital infrastructure to move towards smarter, greener capabilities.

Policy

Swap Connect to supercharge connectivity with global markets

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Swap Connect, a new mutual access scheme between Hong Kong and Chinese Mainland interbank interest rate swap markets, is the latest of various schemes that link the world to Chinese Mainland financial markets. It is scheduled to be launched in late 2022 or early 2023.

Since the inaugural Shenzhen-Hong Kong Stock Connect in 2016 and Bond connect in 2017, Wealth Management Connect and ETF Connect have been added, creating vast opportunities for individual investors, corporate investors and financial institutions across China and the world.

Fast forward to early 2023, the new Swap Connect will further enhance and deepen connectivity by enabling global investors to access the Chinese Mainland interest-rate derivatives market through Hong Kong.

This will also give foreign funds new risk management tools for their Chinese bond investments, allowing them to manage onshore interest rate exposure better.

China's economic growth is projected to rebound to 4.6% in 2023 after slowing to 3.3% this year, driven by infrastructure investment from the Government's fiscal stimulus.[1] Statistics show investors increased their RMB interest rate swap holdings by more than 10% in each of 2019 and 2020, reaching about USD 5 trillion in 2021.[2] At the same time, global investment banks have shown confidence in the growth prospects of the Mainland China derivatives market, with positive sentiment towards the Swap Connect set to drive further market growth.

1. *IMF Downgrades Asia Pacific Forecast as Shocks Keep Rolling*, Bloomberg (29 July 2022)
2. *2021 CCP Volumes and Market Share in IRD*, Clarus Financial Technology (January 2022)

More advantageous to investors in fixed income securities in Mainland China

Swap Connect will promote the development of derivatives markets in Hong Kong and the Chinese Mainland, strengthening Hong Kong's status as a risk management hub.

It should also create synergies with Bond Connect by providing fixed income investors with tools to manage their exposure to fluctuations in interest rates.

Similarly, investors who seek to trade RMB interest rate swaps can use Swap Connect to help manage their RMB interest rate exposure.

Currently, onshore trading is cleared by Shanghai Clearing House (SHC) where investors use swap agreements developed by China's National Association of Financial Market Institutional Investors (NAFMII). After the launch, investors outside the Chinese Mainland, who might be unfamiliar with China's legal framework, can mitigate legal barriers as they are able to use the more familiar master agreements of the International Swaps and Derivatives Association (ISDA), by trading via Hong Kong Stock Exchange's OTC Clear clearing house.

In the offshore market, trading of CNH[3] interest rate swaps is commonly cleared through London Clearing House (LCH). Less liquidity in the offshore market could make hedging and funding costs significantly higher. Also, these trades are settled in USD, which adds FX risk associated with RMB-USD exchange rate movements. Under Swap Connect, such FX risk could be mitigated if settlements are in RMB.

Complimentary to the existing Bond Connect scheme, Swap Connect may also allow onshore bonds to be used as collateral while trading interest rate swaps. We anticipate the launch and inclusion of other types of risk management products (eg foreign exchange products) in future will further deepen connections and ease of investing with both Bond Connect and Stock Connect.

Other products to be added to Swap Connect

The Swap Connect scheme was announced on 4 July 2022 by the People's Bank of China, the Hong Kong Securities and Futures Commission of Hong Kong (SFC), and the Hong Kong Monetary Authority (HKMA). The scheme will start with northbound trading in the initial phase upon the official commencement, and more details are expected to be announced in the next few months.

With more risk management products expected to be added after the initial launch, we are excited to explore other benefits of Swap Connect as it continues to expand.

3. CNH is Renminbi that is traded offshore; CNY is Renminbi traded in Mainland China

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