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Wealth Management

Asia-Pacific Wealth Report

2009

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Asia-Pacific Wealth Report

TO OUR READERS,

On behalf of Merrill Lynch Global Wealth Management and Capgemini, we are pleased to present the 2009 **Asia-Pacific Wealth Report**, our fourth annual in-depth look at the High Net Worth marketplace in the region. The report builds on the success of the **World Wealth Report**, which is now in its 13th year. Both reports are the result of an extensive collaboration between our two firms, studying the key trends that affect high net worth individuals (HNWIs).

The last two years have been unprecedented from a market perspective. For the Asia-Pacific region, the fallout from the global economic downturn struck with unexpected speed and force, erasing any notion that the region might be immune to crises originating in geographically distant and more financially sophisticated markets. As the markets of the Asia-Pacific region are far from homogenous, the impacts of the crisis were not always evenly distributed, but the net result was widespread damage to the wealth and a decline in the number of HNWIs. Our 2008 findings show that HNWIs began to lose trust in the markets, regulators, and, in some cases, their financial advisory firms.

This report examines the effects of the crisis on Asia-Pacific's HNWIs and their wealth, but also argues that the region and its HNWIs should recover at a faster pace than the world's wealthiest nations. In fact, we believe the Asia-Pacific region, especially China and India, will be an important driver of global economic growth in the years ahead, likely elevating the region's HNWIs to a more dominant position among the ranks of the world's wealthy.

Restoring trust and confidence in the markets and the industry are resounding themes as we move forward. Our Spotlight looks at pivotal issues facing wealth management firms that aspire to secure a viable long-term position in the Asia-Pacific HNWI markets. We touch on creating appropriate and effective client relationship management and branding strategies, and developing the right advisory services and supporting tools to manage organic growth while retaining clients.

We are pleased to present this year's Report, and hope you will find continued value in our latest insights.

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STATE OF ASIA-PACIFIC'S WEALTH

- **Asia-Pacific's population of high net worth individuals (HNWIs[1]) shrank 14.2% in 2008 to 2.4 million, while their wealth dropped 22.3% to US$7.4 trillion.**
- **The HNWI population and its wealth were even more concentrated by the end of 2008 than they had been a year earlier.** Japan and China together accounted for 71.9% of the Asia-Pacific HNWI population and 65.8% of its wealth, up from 68.8% and 62.4% respectively.
- **Asia-Pacific's Ultra-HNWIs[2] suffered greater losses of wealth than Ultra-HNWIs in other regions and their population also diminished by more.** At the end of 2008, Asia-Pacific's Ultra-HNWI population was down 29.6% from a year earlier, compared with the global decline of 24.6%, and their wealth was down 35.1% vs. 24.0% globally.

ASIA-PACIFIC'S HNWIs WERE HIT HARD BY THE GLOBAL ECONOMIC DOWNTURN

After experiencing rapid growth for three years, the size and wealth of the HNWI population in the Asia-Pacific region shrank significantly in 2008. By the end of 2008, the region's HNWI population was down 14.2% from a year earlier to 2.4 million (see Figure 1), compared with a 14.9% decline in the global HNWI population. HNWI wealth was down 22.3% to US$7.4 trillion vs. 19.5% globally, after experiencing double-digit growth in 2006 and 2007. Ultimately, the region's HNWI population and its wealth ended 2008 below the levels seen at the end of 2006.

Average financial wealth per HNWI declined 8.8% in the region to US$3.1m in 2008, after growing at a sustained 3.0% per year from US$3.2m in 2005 to US$3.4m in 2007. At US$4.9m, Hong Kong still had the highest average financial wealth per HNWI in the region, despite experiencing the largest erosion of HNWI wealth on aggregate. Almost two-thirds of Asia-Pacific's markets were below the global average financial wealth per HNWI of US$3.8m.

The region's Ultra-HNWI population declined by 29.6% to 14.3k individuals, compared with a 24.6% decline in the global Ultra-HNWI population, and their wealth declined 35.1% vs. 24.0% globally. Asia-Pacific Ultra-HNWIs had allocated more of their investments than those in other regions to volatile assets such as real estate and alternative investments – at the end of 2008, 30% of their assets were in real estate and alternative investments, compared with 26% among Ultra-HNWIs globally. As a result, they suffered disproportionate losses, and those losses pushed a greater-than-average number out of the "Ultra" category.

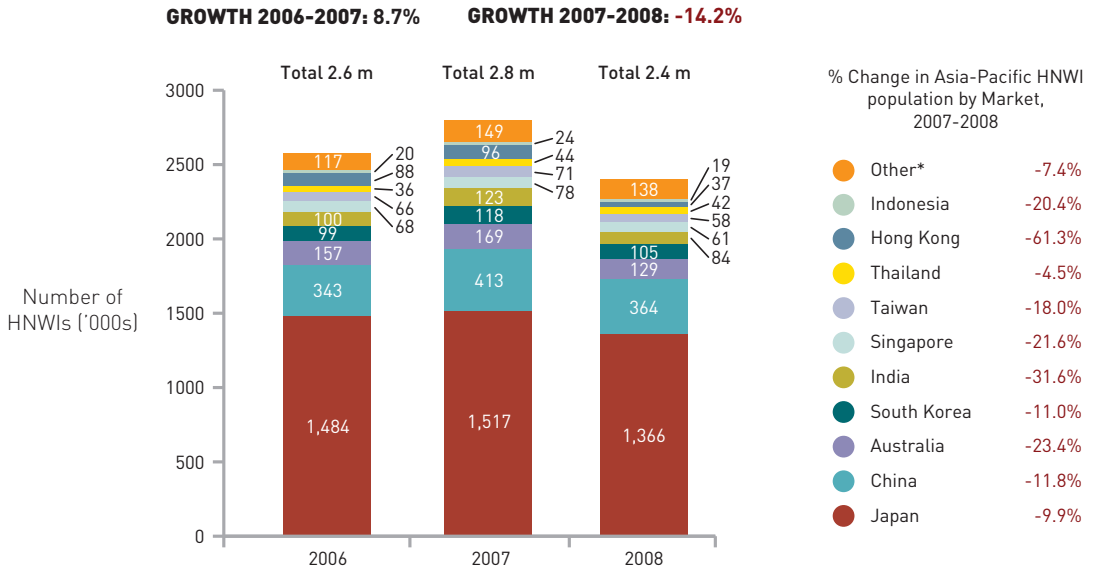
At the end of 2008, Asia-Pacific Ultra-HNWIs accounted for only 0.6% of the region's entire HNWI population, less than in any other region, but the segment still accounted for 22.5% of the region's HNWI wealth (see Figure 2).

[1] HNWIs are defined as those having investable assets of US$1 million or more, excluding primary residence, collectibles, consumables, and consumer durables.

[2] Ultra-HNWIs are defined as those having investable assets of US$30 million or more, excluding primary residence, collectibles, consumables, and consumer durables.

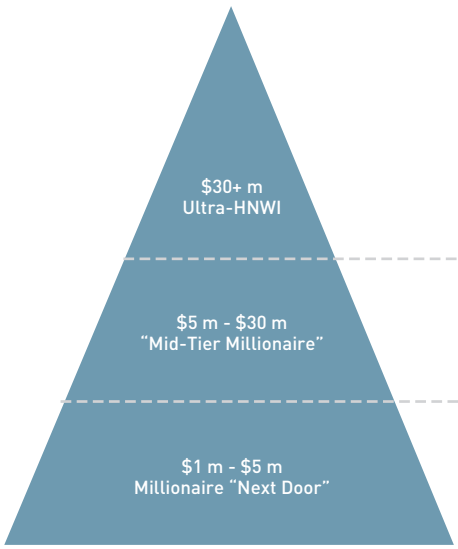
Figure 1. Number of Asia-Pacific HNWIs by Market, 2006-2008

('000s)



Note: * 'Other' category comprises eight markets: Kazakhstan, Malaysia, Myanmar, New Zealand, Pakistan, Philippines, Sri Lanka and Vietnam.
All chart numbers are rounded.
Source: Capgemini Lorenz curve analysis, 2009

Figure 2. Number of HNWIs by Wealth Band, 2007-08 (Global and Asia-Pacific)

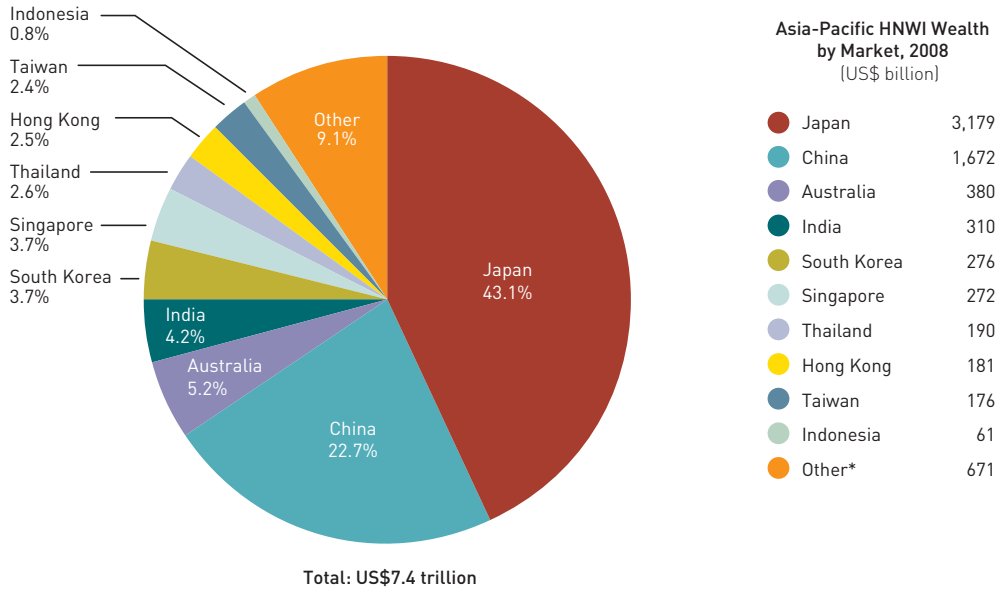


	Number of Individuals 2008		HNWI Population Growth 2007-08		HNWI Wealth Growth 2007-08		% of HNWI Wealth 2008	
	Global	Asia-Pacific	Global	Asia-Pacific	Global	Asia-Pacific	Global	Asia-Pacific
$30+ m Ultra-HNWI	78.0k (0.9% of Total)	14.3k (0.6% of Total)	-24.6%	-29.6%	-24.0%	-35.1%	34.7%	22.5%
$5 m - $30 m "Mid-Tier Millionaire"	759.2k (8.8% of Total)	184.5k (7.7% of Total)	-20.0%	-22.6%	-20.5%	-23.6%	22.0%	23.8%
$1 m - $5 m Millionaire "Next Door"	7,741.7k (90.2% of total)	2,205.0k (91.7% of total)	-14.2%	-13.2%	-14.9%	-14.4%	43.3%	53.6%

Source: Capgemini Lorenz curve analysis, 2009

Figure 3. Distribution of Asia-Pacific HNWI Wealth by Market, 2008

(%)



Note: * 'Other' category comprises eight markets: Kazakhstan, Malaysia, Myanmar, New Zealand, Pakistan, Philippines, Sri Lanka and Vietnam.
All chart numbers are rounded
Source: Capgemini Lorenz curve analysis, 2009

REGION'S HNWIs AND WEALTH ARE HIGHLY CONCENTRATED IN JAPAN AND CHINA

Japan and China together accounted for 71.9% of the total Asia-Pacific HNWI population and 65.8% of its wealth at the end of 2008, up from 68.8% and 62.4% respectively a year before (see Figure 3). The two countries accounted for 51% of the aggregate loss in Asia-Pacific HNWI wealth, but that largely reflects their disproportionate impact on the region's numbers. In fact, their share of the region's wealth actually increased by the end of 2008, because the percentage losses were still milder than in many other countries. Of the region's Ultra-HNWIs, 68.6% were from Japan and China.

Japan, which accounts for more than 50% of the HNWIs in the Asia-Pacific region, suffered relatively mild declines in HNWI population and wealth in 2008. The population shrank 9.9% to 1,366k and wealth by 16.7% to US$3.2 trillion. Those declines were somewhat tempered by historical trends. The expansion of the HNWI population and wealth had already been capped in 2007 by the slowdown in Japan's macroeconomic growth and the weakening of its stock market (capitalization was down 6.1% in 2007). Moreover, Japan's HNWIs have traditionally been relatively conservative investors and that approach helped to limit their losses in 2008. By the end of year, Japan's HNWIs had 54% of their assets in cash-based investments[3].

China's HNWI population surpassed that of the UK in 2008 to become the fourth largest in the world. In 2007, it had surpassed France. China avoided some of the steeper losses elsewhere in the region, because of the closed nature of its markets and the relative strength in the economy. However, China's HNWI population did contract 11.8% to 364k, and HNWI wealth declined 20.7% to US$1.7 trillion.

THE HNWI POPULATION CONTRACTED MOST IN HONG KONG AND INDIA

The HNWI populations in Hong Kong and India experienced the largest percentage declines in the region. This was largely due to factors such as a higher ratio of market capitalization to gross domestic product (GDP), the asset-allocation preferences of HNWIs, and the distribution of HNWI wealth in those countries.

[3] Capgemini/Merrill Lynch Financial Advisor Survey 2009

Hong Kong's HNWI population took the largest hit in percentage terms, with a 61.3% drop to 37k. HNWI wealth suffered the same fate, plunging 65.4% to US$181 billion. Hong Kong is unique in that it is a newly industrialized economy with an extremely high market-capitalization-to-nominal-GDP ratio of 6.2. That ratio indicates Hong Kong is particularly vulnerable to large market-capitalization losses like the one experienced in 2008 (-49.9%). By contrast, the ratio is 1.49 in Singapore and just 1.1 in India. Furthermore, a very large proportion of Hong Kong's HNWIs were in the $1m-$5m wealth band, and market losses knocked many of them below the $1m threshold in 2008.

India's HNWI population shrank 31.6% to 84k, the second-largest percentage decline in the world, after posting the fastest rate of growth (22.7%) in 2007. India, still an emerging economy, suffered declining global demand for its goods and services causing GDP to slow, and a hefty drop in market capitalization (-64.1%) in 2008. At the end of 2008, HNWI wealth was down 29.0% to US$310 billion, with the largest losses among those in the $1m-$5m wealth band (-31.8%).

Elsewhere in the Asia-Pacific region, HNWI populations and wealth also suffered in 2008, though to a lesser degree. For example, **Australia's** HNWI population shrank 23.4% to 129k and its wealth experienced the second largest percentage drop in the region (-29.7% to US$380 billion). **Singapore's** HNWI population and wealth contracted 21.6% and 29.4% respectively as GDP growth slowed and the stock market plunged (market capitalization sank 50.8%).

Thailand and **South Korea** experienced relatively small declines in their HNWI populations -4.5% and -11.0% respectively. This was helped by the very low ratio of market capitalization to GDP in each country of 0.4 and 0.5 respectively vs. Hong Kong's 6.2, which reduced the vulnerability of those countries to the downturn. Moreover, the majority of those wealth losses were among "Mid-Tier millionaires," who have assets of US$5m to US$30m, and Ultra-HNWIs. Investors in those bands can still lose significant amounts of wealth and still qualify as HNWIs.

CHINA, INDIA ECONOMIES ARE LIKELY TO STIMULATE REGION'S HNWI WEALTH MARKEDLY BY 2018

Based on key macroeconomic and other wealth drivers, we estimate the Asia-Pacific region will be one of the strongest drivers of global HNWI financial wealth going forward. Markets such as China and India are forecast to grow faster than their peers within the region and faster even than markets in Latin America, which have themselves been known as engines of growth.

Asia-Pacific's growth will be largely driven by domestic consumption in two of the region's key markets, China and India. In the case of China, some initial signs, including increased consumer demand and a pick-up in investor risk appetites, suggest the economy is positioned to thrive independently of demand from major Western economies. (China's stock market rose 8.4% during the first few months of 2009, outperforming all G7 markets[4]). And the Indian economy is still one of the fastest growing in the world despite the crisis, with recent figures showing relatively better real GDP growth for the 2008[5] financial year and better-than-expected results for the second quarter of 2009[6].

Japan's economic picture remains uncertain, but does not especially restrain the upside forecast for regional HNWI growth since the region's overall HNWI population and wealth have proved they can grow independently of Japan in the past. In 2007, for example, the HNWI population and its wealth grew 7.7% and 12.5% respectively in the region but just 2.2% and 3.2% in Japan. In fact, since current forecasts assume tepid economic and market performance in Japan, any meaningful recovery there could push the growth in the region's HNWI population and wealth significantly higher.

Given this overall assessment, we estimate compound annual growth in Asia-Pacific HNWI wealth of 8.8% from 2008-18, above the global average annual growth of 7.1%.

[4] MSCI equity indexes for select China and G7 countries from Jan. 1, 2009 to April 10, 2009
[5] Country Data for India, Economist Intelligence Unit, June 2009
[6] "Indian growth unexpectedly strong", BBC News (http://news.bbc.co.uk), May 29 2009

ASIA-PACIFIC QUICKLY FELL VICTIM TO THE FINANCIAL CRISIS BUT IS LIKELY TO RECOVER FASTER THAN THE GLOBAL ECONOMY

- **The Asia-Pacific region was not spared from the effects of the global financial crisis.** The region's sound macroeconomic position of 2007 and its relatively small exposure to complex financial products initially appeared to offer protection against the global economic downturn. However, it soon became clear that trade and financial flows have inextricably integrated the Asia-Pacific region into the world economy and the region began to suffer as the financial crisis progressed.
- **The key drivers of wealth were hit hard by the crisis.** GDP growth slowed down across the Asia-Pacific region in 2008, and even contracted in some countries. Private consumption dropped across the region as consumer confidence waned in late-2008. Market capitalization sank around 50% and housing prices also dropped across the region.
- **Asia-Pacific focused investments suffered significant losses in 2008 and investors moved to safer alternatives.** Asia-Pacific focused hedge funds lost 21% of their value and experienced record redemptions. As a result, a large number of hedge funds faced closure. Uncertainty in the global economy boosted demand for gold in a flight to safety by investors.
- **The region is likely to recover faster than the global economy.** Stronger-than-average growth in emerging Asian economies, notably China and India, is likely to lessen the effects of the global economic crisis on the region in 2009. The region's business outlook also remains positive and unemployment is likely to remain lower than the global average.
- **Domestic-demand growth is expected to accelerate the pace of the recovery.** Domestic-demand growth in the Asia-Pacific region is likely to outpace average domestic-demand growth in the World consistently during the period 2009-2013, and would help in faster economic recovery of the Asia-Pacific region.

ASIA-PACIFIC EXPORTS SANK IN 2008 AS GLOBAL DEMAND COLLAPSED

The growth in exports of goods and services for the Asia-Pacific region dropped from 10.0% in 2007 to 5.2% in 2008[7]. Robust intraregional trade had been a key driver of regional economic growth for decades, suggesting the region was decoupling from the business cycles of developed economies and particularly from the US. However, as global demand sank, it demonstrated that many of the products traded intra-regionally are ultimately destined for consumption outside the region. In fact, the region's total trade exposure to advanced economies was more than 20% of its GDP during the 2000-08 period.

As a result, the collapse in demand from the world's industrialized economies quickly ran through the integrated supply chain and undermined intraregional trade. Moreover, the credit crunch had a direct impact on some of the region's mainstay exports, including electronic goods and motor vehicles – products whose demand tends to rise and fall with economic cycles and relies heavily on financing. Japanese auto exports, for instance, fell by nearly 70% between September 2008 and March 2009[8].

FINANCIAL TIES EXPOSED THE ASIA-PACIFIC REGION TO THE FORCES OF GLOBAL DELEVERAGING

The subprime crisis posed a minimal direct threat to the banking systems of the Asia-Pacific region due to their relatively low exposure to complex financial products, but the

[7] Regional Data, Economist Intelligence Unit, May 2009

[8] "Regional Economic Outlook, Asia and Pacific, Global Crisis: The Asian Context", International Monetary Fund, May 2009

Figure 4. Real GDP Growth Rates, 2007-2009F

Source: Economist Intelligence Unit, August 2009

indirect effects proved to be crippling nonetheless. International bank flows to the region turned negative in the first half of 2008 as banks facing escalating capital losses reduced their exposure to emerging markets.

Access to external bond financing also became tight and only sovereign and top-rated corporate issuers were able to borrow – and even then at wide spreads. Regional equity markets also experienced net outflows as global institutional investors and hedge funds tried to reduce their exposure. For example, hedge funds in the region were managing nearly US$130 billion at the end of 2008, which was nearly a third less than in 2007[9]. The reduced appetite for global risk also contributed to the depreciation of the region's currencies. The shortage of dollar funding led to tensions in regional money markets in late-2008, and was addressed by monetary authorities through massive injections of liquidity into the region's economies. Domestic financing also came under stress as increasingly risk-averse banks tightened their lending standards.

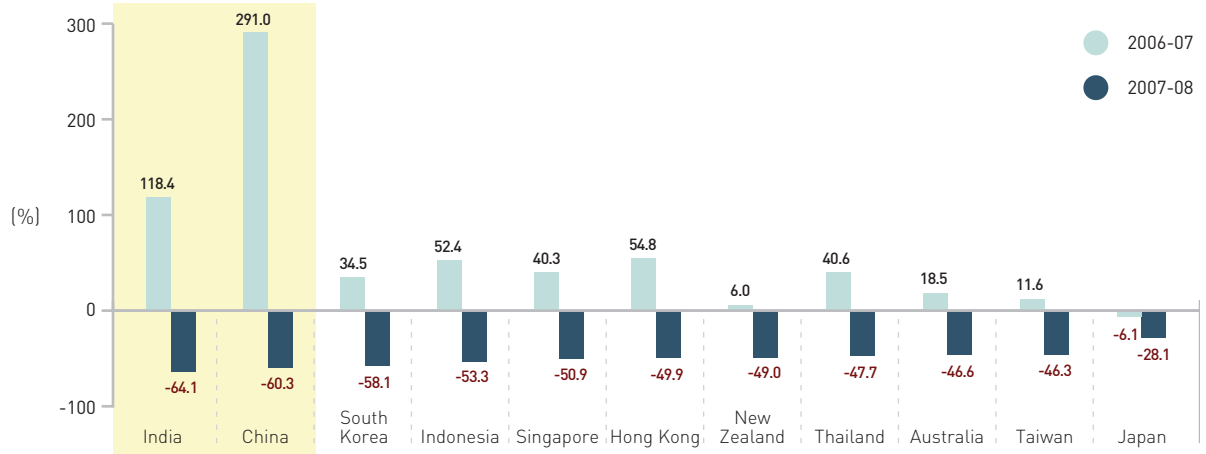
ALL KEY DRIVERS OF ASIA-PACIFIC WEALTH WERE HIT BY THE CRISIS IN 2008

The global financial crisis ultimately affected all the key drivers of wealth in the Asia-Pacific region, namely macroeconomic indicators (GDP, savings and consumption), market performance (fixed income, real estate, market capitalization and alternative investments) and other drivers (commodities and currency fluctuations).

- **GDP mostly grew more slowly and even contracted in some of Industrialized Asia.** In 2008, Emerging Asia[10] experienced the strongest growth within the region, led by China (9.0%, see Figure 4). Growth slowed across Newly Industrialized Economies[11], especially in Singapore, which decelerated from 7.8% in 2007 to 1.2% in 2008, and Taiwan, which dropped from 5.7% to 0.1%. Industrialized Asia[12] was hit hard, with GDP in New Zealand for example contracting by 1.0%, after growth of 3.1% in 2007.

[9] Ibid., 8.
[10] Emerging Asia includes China, India, Indonesia and Vietnam (as per International Monetary Fund definitions)
[11] Newly Industrialized Economies includes Hong Kong, Singapore, South Korea and Taiwan (as per International Monetary Fund definitions)
[12] Industrialized Asia includes Australia, Japan and New Zealand (as per International Monetary Fund definitions)

Figure 5. Percentage Change in Market Capitalization by Country, 2006 – 2008



Source: World Federation of Exchanges, June 2009

- **Private consumption growth slowed as consumer confidence waned in late-2008.** The growth in private consumption slowed across most of the region, but especially in Newly Industrialized Economies. Private consumption growth slumped in Hong Kong from 8.5% in 2007 to 1.8% in 2008 and in South Korea from 5.1% to 0.9%[13]. A key factor was the sharp drop in consumer confidence across the region[14] in the second half of 2008, especially in Newly Industrialized Economies and Industrialized Asia. Private consumption growth in 2008 was strongest in Emerging Asia, led by China (8.0%) and India (6.1%).

- **Region's market capitalization plunged an average 49%.** Global market conditions turned from challenging in the first half of 2008 to extremely distressing in the second as investors dumped equities in a flight to safety and a bid to preserve capital. By the end of the year, market capitalization in the Asia-Pacific region had plunged by an average of 48.6%, wiping out significant amount of gains made during the prior five years[15]. Market capitalization dropped the most in India and China (-64.1% and -60.3% respectively[16], see Figure 5), eroding massive amounts of wealth. The total value of share trading dropped across all major exchanges in the region, with an average drop of 22.6%[17].

- **Housing prices sank throughout the region.** Hong Kong's real estate sector was ravaged in late-2008. By November, the number of residential sales was down 79.3% from a year before and the value of home-sale agreements was down 87.2%[18]. China had not witnessed a property bubble prior to 2008, but it still experienced a slowdown in 2008, largely due to government policy (e.g., high interest rates reduced affordability). In New Zealand, the housing market cooled in response to high financing costs, and in Japan, construction companies had trouble obtaining loans for new construction projects. In Singapore, the housing market suffered in the latter half of 2008, with residential-property prices falling 8.8% for the year[19].

- **Hedge funds scaled back sharply on Asia-Pacific holdings.** The global financial crisis affected the performance of Asia-Pacific focused hedge funds, which lost 21.0% of their value in 2008. These hedge funds were swamped by a wave of redemption orders, leading to withdrawals of $24 billion during the year[20]. Exposure to toxic assets also sparked massive losses at hedge funds, forcing some to shut down for good. Blackstone Group's $25 billion credit hedge fund, GSO Capital Partners LP, shut its Asia investment desk after failing to find attractive investments in the region[21]. The total number of closures of Asia-Pacific focused hedge funds was approximately 129, almost double the number in 2007[22]. Going forward, though, the shakeout is viewed as positive since the managers that survive will represent a new hedge-fund industry for the region – one that is more diverse in strategic makeup and robust in quality.

[13] Economist Intelligence Unit, June 2009
[14] "MasterCard Worldwide Index of Consumer Confidence", Master Intelligence (http://www.masterintelligence.com), June 2009
[15] Market capitalization statistics, World Federation of Exchanges (http://www.world-exchanges.org/statistics), accessed June 2009
[16] Ibid.
[17] Ibid.
[18] Country Report for Hong Kong, Economist Intelligence Unit, March 2009
[19] Variation of monthly prices adjusted for inflation for the December 2007 – December 2008 period, Global Property Guide, 2009
[20] Bei Hu and Tomoko Yamazaki, "About 20% of Asia Hedge Funds Shut Since January 2008", Bloomberg News (http://bloomberg.com), April 27 2009
[21] David Dolan, "More hedge funds, PE firms to scale back in Asia", Reuters (http://reuters.com), March 24 2009
[22] Bei Hu and Tomoko Yamazaki, "About 20% of Asia Hedge Funds Shut Since January 2008", Bloomberg News (http://bloomberg.com), April 27 2009

- **Consumer demand for gold increased in much of the region.** Uncertainty over the global economy boosted demand for gold as net retail investment[23] in 2008, though consumer demand for gold jewelry was also up in some markets. In China, net retail investment surged 169.0% to 68.9 tons[24] while purchases of gold jewelry rose 8.0%. In Thailand, the investment demand for gold skyrocketed from 4.7 tons in 2007 to 46.7 tons. Demand for jewelry in Hong Kong was up 3.0%, though perennial wedding-season interest helped push demand up by 12.0% during the fourth quarter. In Taiwan, jewelry demand fell 17.0%, but net retail investment rose 18.0%. Jewelry demand suffered in Japan and Indonesia in the fourth quarter as concerns over the economic climate weighed on sentiment. The 2008 tonnage off-take in India was down 14.0% from 2007, although this still represented a rise of 13.0% in rupee terms.

- **Most currencies lost value against the dollar.** During the first half of the year, Asia-Pacific currencies displayed mixed results against the US dollar. The Australian dollar and Taiwan dollar appreciated against the US dollar by 7.9% and 6.4% respectively, while the South Korean won and Indian rupee depreciated -11.2% and -8.9% respectively[25]. During the second half, however, most Asia-Pacific currencies depreciated against the US dollar, led by the Australian dollar and New Zealand dollar at -38.1% and -32.1% respectively. The won and rupee continued their depreciation at -20.3% and -15.8% respectively. In late 2008, the US dollar and Japanese yen both surged, fueled in part by widespread purchases from investors unwinding currency carry trades. In the process, the yen appreciated 14.9% against the dollar[26].

THE ASIA-PACIFIC ECONOMY IS LIKELY TO RECOVER FASTER THAN THE GLOBAL ECONOMY

The financial crisis has proved that the Asia-Pacific region is deeply integrated into the global economy and cannot remain totally insulated from its weakness. However, there are signs that the region is emerging relatively quickly from the global slump and will ultimately suffer less severe detrimental effects from the crisis than other regions of the world.

- **Regional economy will likely contract less than the World economy in 2009.** Asia-Pacific's GDP is expected to contract 0.9% in 2009, less than the 2.7% contraction forecast for World GDP[27]. The region's recovery is also expected to outpace the world economy by 2010 – with growth of 3.5% vs. the forecast of 1.6% growth for the World[28]. Stronger-than-average growth in Emerging Asia, notably China and India, is likely to lessen the effect of global economic crisis on the region in 2009 and significantly contribute to its overall growth in 2010. The 2008-09 government policy response of both China and India, particularly fiscal stimulus, is expected to lend significant support to those economies in 2009-10. However, growth in India could be undermined by drought. Below-normal monsoon rains in 2009 have pushed around 40% of the country's districts into drought-like conditions, which are likely to affect farm output and trigger a sharp rise in food prices[29].

- **Growth in China is likely to remain strong in 2009.** China is forecast to register growth of 8.0% in 2009. The key driver of this growth is China's 4 trillion yuan ($585 billion) stimulus package, which helped to trigger record loans and surging investment in the first five months of 2009[30].

  Market-based investments continue to lag, because of the squeeze on margins amid spare capacity in many manufacturing sectors, but strong government spending is likely to sustain high growth rates for China over the next few years.

- **Region's business outlook has held its own despite the global slowdown.** Companies decide whether to do business and invest in certain countries based on a wide variety of factors. The economic crisis has changed many of these variables, but the overall business outlook for the Asia-Pacific region still remains promising.

  The business environment in China and India is likely to improve significantly during the period 2009-2013. For example, according to the Economist Intelligence Unit's Business Environment Rankings (BER), China ranks 11 places higher for the 2009-13 forecast period than it did for 2004-08[31]. That is one of the biggest improvements globally, and is largely due to the relative strength of the country's underlying economy.

  The rankings of heavily trade-exposed economies like Singapore and Hong Kong have shown tangible declines, but nonetheless they still retain their dominant position in the region. The overall average business environment score for the Asia-Pacific region has deteriorated only marginally from 6.60 for 2004-08 to 6.58 for 2009-13[32], while the World average

[23] Major components of net retail investment are bars for hoarding, official coins, medals / imitation coins
[24] "Gold Demand Trends: Full and Fourth Quarter 2008", World Gold Council and GFMS Ltd., February 2009
[25] Historical data for select currencies against the U.S. dollar, Ozforex (http://www.ozforex.com), May 2009
[26] Ibid.
[27] Regional Data, Economist Intelligence Unit, August 2009
[28] Ibid.
[29] Ravish Tiwari,"40 pc dists now stare at drought", *IndianExpress.com*, August 19, 2009
[30] Timothy R. Homan, "World Bank Raises China 2009 Growth Forecast to 7.2%", Bloomberg News (http://bloomberg.com), June 18 2009
[31] "Globalisation stalled: How global economic upheaval will hit business environment", Economic Intelligence Unit, May 2009
[32] Ibid.

business environment score is down from 6.72 to 6.61. Many governments across the Asia-Pacific region are also looking to improve their business environment in an effort to increase foreign direct investment (FDI) and support their economies.

- **Unemployment in Asia-Pacific is expected to be lower than the global average.** Jobless rates in the Asia-Pacific region were lower than in other regions in 2008 and will remain so in 2009 – when the global unemployment rate is expected to grow from 5.9% in 2008 to 6.8%. The unemployment rate is forecast[33] to grow in 2009 by 4.6% in East Asia[34], by 6.0% in Southeast Asia and the Pacific[35], and by 5.4% in South Asia[36].

  Efforts to increase employment are under way across the region, helping to underpin the region's independent economic recovery. For example, the Singapore government introduced a special Risk-Sharing Initiative in 2009 to encourage bank lending and increase access for small and medium-sized enterprises (SMEs) to credit. Measures to curb the jobless rate and increase employment are critical because unemployment has a negative multiplier effect on GDP.

- **Focus on domestic-demand can accelerate the pace of economic recovery in the region.** Domestic-demand growth in the Asia-Pacific region is likely to outpace the average domestic-demand growth in the World consistently during the period 2009-2013[37], and would help in faster economic recovery of the Asia-Pacific region. The highest domestic-demand growth in the Asia-Pacific region is likely to be experienced by China and India, which is forecast to grow at a compound annual growth rate of 9.7% and 7.9% respectively during 2009-2013. The region is expected to focus on domestic-demand to reduce its reliance on exports of goods and services for growth. Exports of goods and services as a percentage of GDP for the Asia-Pacific region is forecast to drop from 37.2% in 2008 to 29.3% in 2009.

  The region can further focus on domestic-demand growth by building stronger social protection systems and reducing the pressure on individuals to save for their health, education and retirement needs[38]. Such efforts would help to increase consumer confidence and stimulate private consumption. At the same time, Asia-Pacific countries could allow their domestic currencies to appreciate as this would provide an incentive for companies to increase production for domestic consumption. Exchange-rate appreciation would also result in increased real household income – and drive increased consumption. Stronger regional co-operation and integration can help to expand regional trade and reduce the region's reliance on external demand.

[33] Global Employment Trends Update, International Labor Organization (International Labor Office – Geneva), May 2009
[34] East Asia includes China, Hong Kong, Japan, South Korea, Taiwan among others
[35] Southeast Asia and the Pacific includes Thailand, Indonesia, Singapore, Australia and New Zealand among others
[36] South Asia includes India, Pakistan, Sri Lanka and Bangladesh among others
[37] Regional Data, Economist Intelligence Unit, August 2009
[38] Regional Economic Outlook, Asia and Pacific, Global Crisis: The Asian Context, International Monetary Fund, May 2009

ASIA-PACIFIC HNWIs WIDELY FLED TO SAFETY AS CRISIS MOUNTED

HNWIs in the Asia-Pacific region are a highly diverse group. In 2008, as the financial crisis progressed, different investor preferences and styles helped to compound the losses suffered by some and mitigate losses experienced by others. However, there was a clear, region-wide flight to safety among HNWIs and some trends in asset reallocation were evident. In particular:

- **Uncertain market conditions led many to retrench to cash/deposits.** Asia-Pacific HNWIs allocated far more to cash/deposits (29%) than their peers in other regions (21%).
- **Slightly more financial assets (22%) were allocated to real estate holdings than the average among HNWIs globally (18%),** but the region's property markets only really started to sink toward the end of 2008.
- **Exposure to equities shrank as the region's markets recorded the world's second largest drop in market capitalization (-48.6%).** By the end of 2008, equities accounted for 23% of total Asia-Pacific HNWI financial assets, down from 26% a year earlier.
- **Global market uncertainty and tighter credit conditions prompted HNWIs to favor investments closer to home.** Asia-Pacific HNWIs increased their allocations to home-region markets to 67% in 2008 from 53% in 2007.
- **Asia-Pacific HNWIs are expected to maintain a cautious approach to asset allocation in the short term with capital preservation as their prime objective.** However, we forecast a more balanced investment approach over the long run.

ASIA-PACIFIC HNWIs FAVORED SAFETY AND LIQUIDITY IN CASH-BASED INVESTMENTS IN 2008

HNWIs in the Asia-Pacific region have always tended to favor cash-based investments more than their peers in other regions, but that preference was compounded by the economic uncertainty of 2008. By the end of the year, Asia-Pacific HNWIs had allocated 29% of their assets to cash/deposits (see Figure 6), compared with the 21% global HNWI average, as they sought to minimize their risk exposure, increase portfolio liquidity and create more flexibility for managing their assets.

However, that regional average is somewhat inflated by Japan, whose HNWIs account for more than 43% of the region's overall HNWI financial wealth. Japanese HNWIs have long held their financial institutions in high regard and view domestic banks as a safe haven in times of economic downturn. As a result, they are willing to hold cash/deposits in Japanese institutions despite yields being close to zero. Japan's HNWIs again held more of their financial wealth in cash/deposits (30%, see Figure 7) than any other asset class in 2008. Excluding Japan, Asia-Pacific HNWIs allocated 26% of assets to cash/deposits.

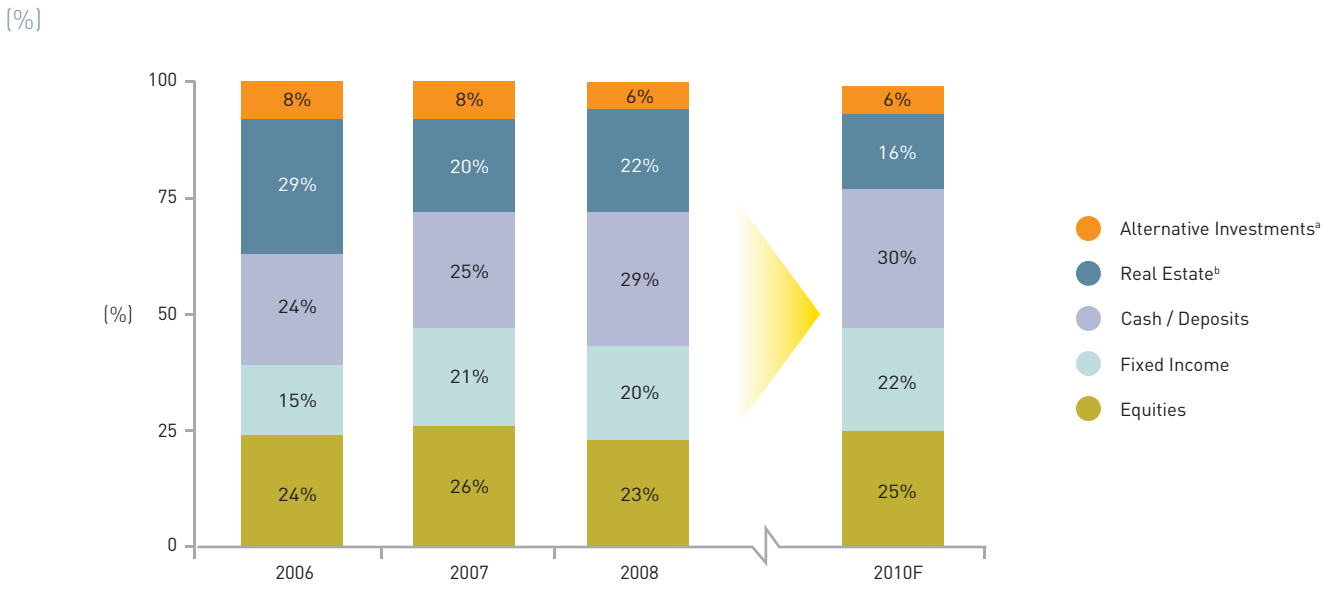
HNWIs in Taiwan had the highest cash/deposit allocations (41%). The Taiwanese stock markets plummeted (-46.3%[39]) in 2008, so HNWIs sought refuge in more conservative investment vehicles in a bid to preserve capital.

In a few countries, cash/deposit allocations are significantly lower than the regional average, including Australia (19%) and India (13%), where other assets typically yield higher returns (such as real estate in Australia and fixed maturity plans in India).

In Asia excluding Japan, 29% of cash-based investments were held outside of the formal banking system (e.g., in a vault) at the end of 2008, compared with the global average of 19%. This largely reflects the lack of confidence HNWIs have in the region's emerging-market banking systems, which tend to be less transparent than those in more developed markets.

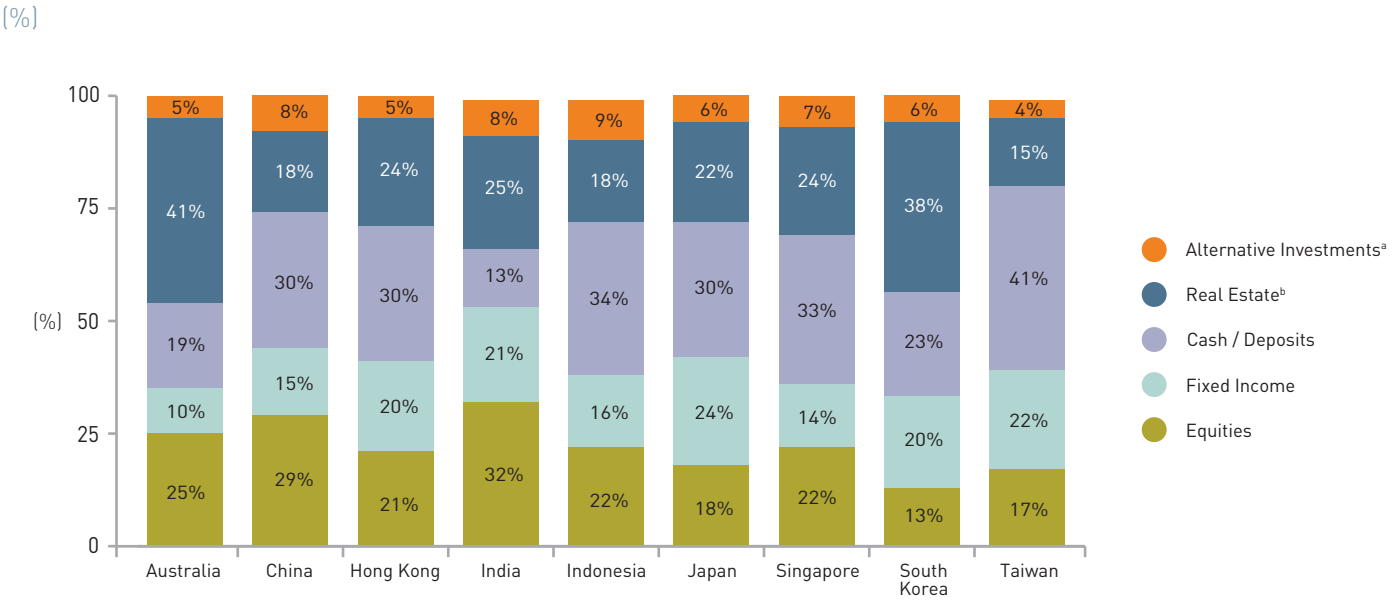
[39] Market capitalization statistics, World Federation of Exchanges (http://www.world-exchanges.org/statistics), accessed April 2009

Figure 6. Breakdown of Asia-Pacific HNWI Financial Assets, 2006 – 2010F



[a] Includes structured products, hedge funds, derivatives, foreign currency, commodities, private equity, venture capital
[b] Comprises commercial real estate, real estate investment trusts (REITs), residential real estate (excluding primary residence), undeveloped property, farmland and "other"
Note: Percentages may not total 100% due to rounding
Source: Capgemini/ Merrill Lynch Financial Advisor Survey, March 2007, April 2008 , March 2009

Figure 7. Breakdown of Asia-Pacific HNWI Financial Assets by Market, 2008



[a] Includes structured products, hedge funds, derivatives, foreign currency, commodities, private equity, venture capital.
[b] Comprises commercial real estate, real estate investment trusts (REITs), residential real estate (excluding primary residence), undeveloped property, farmland and "Other"
Note: Percentages may not total 100% due to rounding
Source: Capgemini/ Merrill Lynch Financial Advisor Survey, March 2009

Fixed-income holdings remained lower than the global average among Asia-Pacific HNWIs (20% vs. 29%). Traditionally, fixed-income securities have not represented an important asset class to Asian investors, as many regional bond markets are underdeveloped relative to other regions – and any fixed-income investment is typically allocated to the mature markets of North America and Europe. Chinese HNWIs, for instance, tend to favor structured products packaged around fixed income rather than directly investing in fixed-income securities. As an asset class, fixed income is less attractive to HNWIs in China given that issuance is limited, few types of securities are available and returns are relatively low.

ALLOCATIONS TO REAL ESTATE INCREASED SLIGHTLY

Whether inherited or acquired, real estate holdings have been a significant source of wealth in the Asia-Pacific region. As a result, the region's HNWIs have traditionally held a large portion of their financial assets in real estate. In 2008, those investments accounted for 22% of all Asia-Pacific HNWI financial assets, up slightly from 20% in 2007 – when the share had dropped 9 percentage points from the year before. However, Asian property markets did not show signs of entering a major downward cycle until toward the end of the year. The increase in real estate allocations reflected the preference of HNWIs for tangible assets, as well as a trend toward opportunistic buying as prices started to plummet. Investors were actively looking for bargains as some credit-short developers and institutional investors faced a liquidity crunch. Hedging against inflation may also have spurred some buying interest.[40]

Of their total real estate investments[41], Asia-Pacific HNWIs favored residential (55%) more than HNWIs in other regions (45%). HNWI holdings of commercial real estate dropped to 26% of the region's overall HNWI real estate holdings from 32% in 2007. Corporate downsizing and cost rationalization affected commercial real estate rentals and capital values. Rentals in the commercial hubs of the region, such as Singapore and Hong Kong, dropped significantly as a number of sizeable multinational tenants started returning some of their committed space to the market.[42] Declining rentals, increased vacancy rates and low demand for commercial properties all contributed to the decline of HNWI allocations to commercial real estate.

Asian real estate investment trust (REIT) markets suffered their steepest ever decline in the second half of 2008, when REIT market capitalization shrank by almost one third to around US$48 billion as prices took a deep dive and new listings dried up. Investor concerns about the ability of Asian REITs to obtain enough financing to survive the crisis had a significant impact. By the end of 2008, Asia-Pacific HNWIs had only 9% of their financial assets in REITs, down from 18% a year before.

HNWIs from Australia had a very high real-estate allocation (41%) as nominal values there bucked forecasts of a heavy decline and dropped only modestly (-3.3%).[43] The commercial real estate market in Australia witnessed low vacancy rates and the demand for quality office space continued. Many institutional buyers took to the sidelines as they faced growing liquidity pressures amid the global credit crunch. Private investors took advantage of their absence to secure a significant volume of office and industrial developments[44], aware that the government is championing infrastructure projects as part of its stimulus efforts.

HNWIs in South Korea allocated 38% of their holdings to real estate, which has long been a major source of South Korean HNWI wealth. However, that was down 2 percentage points from 2007, due in part to decreased market values. The South Korean real estate market remains relatively illiquid and corresponding products are considered long-term investments, helping to explain why the allocation decrease was relatively mild[45].

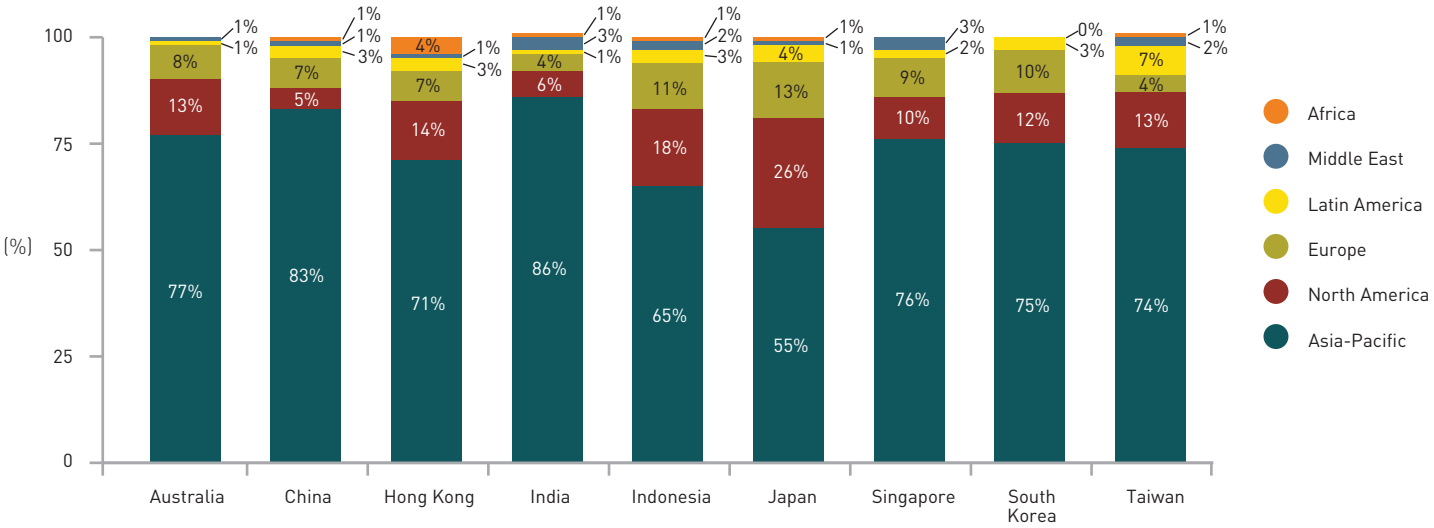
EQUITY HOLDINGS SANK AS MARKETS PLUMMETED

In 2008, Asia-Pacific markets plunged 48.6%, the world's second largest drop in market capitalization (vs. the Americas[46], -42.9% and EMEA[47], -49.3%). Asia-Pacific HNWIs joined in the global equity sell-off and by the end of the year had 23% of all their financial assets allocated to equities, down 3 percentage points from a year before.

HNWIs in India had the highest equities allocation (33%). That was down from 2007 (37%) as market capitalization sank (-64.1%[48]), but the allocation remained relatively large as India's HNWIs have become very comfortable with equities and prefer direct investments in the equity market – especially given the stellar performance of the local equity market in recent years. (Market capitalization was up 118.4% and 49.0% in 2007 and 2006 respectively[49]). In 2008, HNWIs from

[40] "Asia Investment Market View 2H 2008", CB Richard Ellis (http://asia.cbre.com.hk), June 11 2009
[41] Total real estate investments include residential real estate (excluding primary residence), commercial real estate, real estate investment trusts (REITs), undeveloped property, farmland among others
[42] "Asia Pacific Real Estate Investment Market Bulletin, Quarterly Update April 2009", Colliers International (http://www.colliers.com), June 11 2009
[43] HPI average of 8 capital cities (Sydney, Melbourne, Brisbane, Adelaide, Perth, Hobart, Darwin, Canberra), 2007-08 annual growth, Global Property Guide, 2009
[44] "Asia Pacific Real Estate Investment Market Bulletin, Quarterly Update April 2009", Colliers International (http://www.colliers.com), June 11 2009
[45] Capgemini analysis based on interviews with industry experts, Asia-Pacific, July 2009
[46] Includes North, Central and South America
[47] Europe, Middle East and Africa
[48] Market capitalization statistics, World Federation of Exchanges (http://www.world-exchanges.org/statistics), accessed June 2009
[49] Ibid.

Figure 8. Breakdown of Asia-Pacific HNWI Geographic Asset Allocation by Market, 2008



Note: Percentages may not total 100% due to rounding
Source: Capgemini/ Merrill Lynch Financial Advisor Survey, March 2009

Hong Kong significantly reduced their allocations to equities (to 21% from 33%), as did those from Australia (to 25% from 38%). Uncertain market conditions led to heavy declines in the capitalization of local markets in both countries (-49.9% in Hong Kong and -46.6% in Australia[50]).

EXPOSURE TO ALTERNATIVE INVESTMENTS WAS REDUCED

Asia-Pacific HNWIs reduced their holdings of alternative investments in 2008 to 6% of all financial assets from 8% in 2007 as HNWIs became more hesitant to trust these sometimes opaque and volatile products amid the market's turbulence. Foreign currency was the top (25%) alternative investment for HNWIs in Asia-Pacific excluding Japan – used to hedge against currency fluctuations as the majority of assets in the region are held in local currency. HNWIs in Japan and India preferred investments in structured products (38% and 30% respectively), particularly those with provisions that protected capital, as opposed to complex, opaque structures, as they sought to capture superior returns to conventional fixed-income investments.

Asia-Pacific HNWIs allocated less to hedge funds than their peers in other regions. Market volatility may have prompted investors to adjust their allocations as the Asian hedge fund industry has a higher percentage of equity hedge strategy funds, which are susceptible to greater declines in volatile markets, and a lower percentage of macro hedge strategies.

ASIA-PACIFIC HNWIs FAVORED HOME-REGION INVESTMENT EVEN MORE AMID GLOBAL TURMOIL

Home-region and domestic investment within the Asia-Pacific region began to rise in 2006, reflecting an opportunistic pursuit of high returns. That "home bias" became even more pronounced in 2008, but for a different reason – namely, global market uncertainty and tightening credit conditions deterred Asia-Pacific HNWIs from investing in other regions. As a result, Asia-Pacific HNWIs increased their allocations to home-region and domestic markets to 67% in 2008 from 53% in 2007.

The geographic distribution of investments (see Figure 8) was most diversified among HNWIs from Japan, who are more likely than their peers in the rest of Asia to diversify their regional investments across diverse types of economies such as emerging, newly industrialized and industrialized, to mitigate their risk exposure. At the same time, though, Japan's HNWIs tend to be highly conservative and in 2008 allocated 64% of their regional investments solely to domestic assets in pursuit of stable returns and capital preservation.

The geographic distribution of investments was least diversified among HNWIs from India and China. Among the region's non-Japanese HNWIs as a whole, the majority (64%) focused their investments in specific regional markets, which is consistent with their strategy for pursuing higher returns. Notably, non-Japanese HNWIs opted first for fast-growing China

[50] Market capitalization statistics, World Federation of Exchanges (http://www.world-exchanges.org/statistics), accessed June 2009

(which accounted for 30% of all regional investments as of the end of 2008).

ASIA-PACIFIC HNWIs ARE LIKELY TO REGAIN SOME RISK APPETITE AFTER NEAR-TERM CAUTION

We expect Asia-Pacific HNWIs to have a conservative outlook in the short term when their prime focus will be protecting their financial assets, rather than pursuing high returns. This is not surprising given the significant erosion of wealth they have experienced. However, by 2010, we expect Asia-Pacific HNWIs to take advantage of buying opportunities in equities as those markets rebound and HNWIs regain their appetite for risk amid portfolio liquidity increases. However, we also expect the allocation to fixed income and cash/deposits to increase as HNWIs seek a balanced investment approach and try to maintain liquidity while buying equities. Real estate allocations are expected to decline, aligning more closely with the projected global average allocation, as retail and commercial property investment is hit by tight credit conditions and a drop in the amount of new offerings.

The share of Asia-Pacific HNWIs' financial assets allocated to domestic and home-region investments is expected to shrink slightly by 2010 as markets in other regions start to recover from the financial crisis. Allocations to the mature markets of North America and Europe are likely to increase gradually as HNWIs try to achieve stable returns and manage risk exposure through geographic portfolio diversification.

SPOTLIGHT:

WEALTH MANAGEMENT FIRMS ARE BEING CHALLENGED POST-CRISIS TO REFINE BUSINESS MODELS AND ROUND OUT CAPABILITIES

THE WEALTH MANAGEMENT INDUSTRY IN ASIA-PACIFIC IS ENTERING A NEW STAGE IN ITS EVOLUTION

The global economic crisis has sent shudders throughout the world's financial markets, but for wealth management firms in the Asia-Pacific region, the crisis and its fallout are making it even harder to define and execute a winning strategy in what was already a very complex and competitive environment.

Before the financial crisis, the potential of the region's wealth management markets had attracted many new entrants, especially international firms, and the competition to drive revenues had become intense. When the crisis erased massive amounts of wealth for HNWI clients, it reduced assets under management (AuM) and margins for firms and damaged the trust HNWIs placed in their Advisors, firms, and the financial system.

Our research[51] shows both global and regional/local players suffered, and all now need to adapt to changing client needs and enhance advisor models, as well as realign business and operating models. Firms will also need to deal with wholesale shifts in the operating environment, in particular changes in the competitive landscape and new regulatory barriers that directly affect market potential.

The challenges are not insignificant, but the crisis actually offers firms a prime opportunity to reposition their capabilities and strategies to better serve their HNWI clients and capture market-share growth in the future. In short, the crisis represents a turning point for the wealth management industry in the Asia-Pacific region.

FIRMS WERE DASHING INTO ASIA-PACIFIC WEALTH MANAGEMENT BEFORE THE CRISIS

In the five or so years before the financial crisis, the region's wealth management markets showed robust growth, and the industry was transforming into a dynamic and extremely competitive one. There was a rapid influx of new entrants, especially international firms, lured by increasingly favorable political, economic and social conditions.

Key markets like China and India had become more politically stable, and the region's regulators and governments were generally leaning toward market liberalization. At the same time, the Asia-Pacific's GDP growth was robust, market capitalization and trading were booming, and the level of wealth and number of HNWIs was on the rise.

Moreover, investors had started to trust in the ability of the financial system to generate returns, and felt secure enough to take on more risk and leverage, albeit often by trading in home-region or domestic markets to pursue short-term profits.

In response, international firms extended their footprints and operational functions, regional banks expanded into wealth management, and some specialist boutique firms also entered the market. Industry competition ramped up, and the cost of doing business rose as firms undertook aggressive marketing campaigns and hired more Advisors.

But while the industry was growing fast, few firms managed to round out their capabilities or tap the market's full potential. International firms, for instance, tended to excel in enabling Advisors (e.g., providing them with top-notch tools), but it was regional/local firms that typically had more robust client networks.

At the same time, business models focused heavily on product sales, rather than full-service offerings, and many firms extended their reach down into the mass affluent segment in pursuit of clients. HNWIs, meanwhile, had plenty of providers to choose from and many diversified by establishing relationships with a variety of firms.

[51] This research is both quantitative and qualitative, primary and secondary. Tools included a survey of more than 400 Advisors across 16 countries in the Asia-Pacific region and interviews with 20 senior wealth management executives at firms across the region.

FINANCIAL CRISIS LAID BARE THE INDUSTRY'S IMMATURITY

The impact of the financial crisis on these still evolving business models and relationships was sudden and sharp. HNWIs in the region, especially those outside Japan, suffered even greater losses of wealth than the global average. The losses fueled distrust in the entire financial system and prompted attrition. Indeed, 65% of surveyed Advisors in the region excluding Japan said they experienced significant withdrawals of HNWI assets in 2008 (vs. 54% in Japan, where HNWIs tend to be more conservative and losses were smaller).

In effect, the crisis was exposing the weaknesses in the capabilities of the region's wealth management firms and especially revealed the disparate strengths and weakness of international firms vs. regional and local competitors.

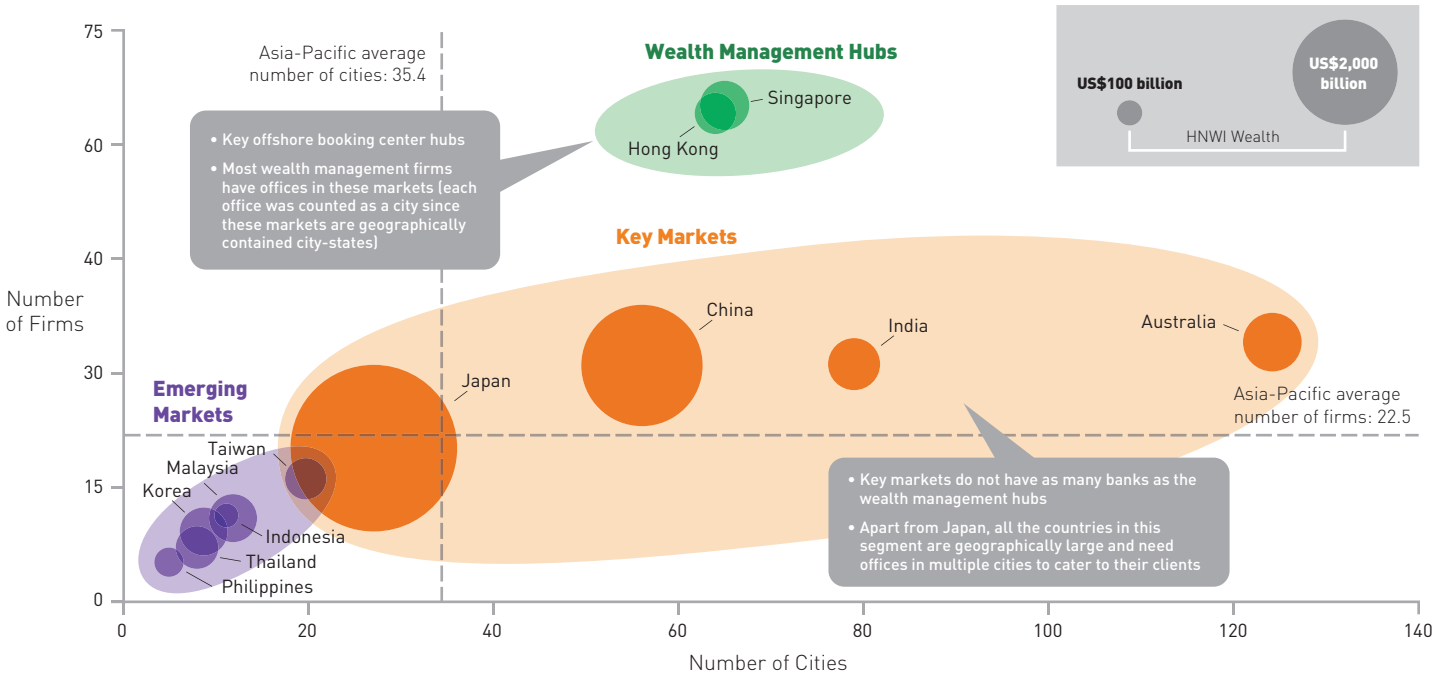
For example, while regional/local firms had more extensive client networks, many lacked the kind of experienced Advisors or the efficient advisory service models able to assuage jittery HNWIs and stem client attrition (also see section on Advisor capabilities). But international firms also lost clients, despite their greater global experience and more robust advisor service models, as nervous HNWIs transferred assets to local firms.

Now, the region's wealth management firms must overcome the effects of the crisis and position themselves to capture the significant opportunity that lies ahead for the region - while operating within new crisis-driven limits on their business.

FIRMS ARE FOCUSING ON KEY MARKETS BUT EXPECT INTENSE COMPETITION

One of the initial decisions for every firm is where and how to focus their energies. Our research shows most firms are investing in key markets (Japan, China, India and Australia, see Figure 9), where the geographic scale and/or distribution of wealth require an extensive presence (e.g., in multiple cities) to cater effectively to HNWI clients. In Australia for example, there are more wealth management firms across more cities than the average in Asia-Pacific. Conversely, China has approximately the same number of wealth management firms, but their reach is across fewer cities. Notably, these markets so far have far fewer banks than the established wealth manage-

Figure 9. Asia Pacific Wealth Management Landscape, 2008-09



Note: The size of each bubble denotes the market size for that country on the basis of wealth. The reach of wealth management firms is based on presence across markets and cities.
Source: Capgemini analysis, 2009; Company annual reports, 2007-08

ment hubs of Singapore and Hong Kong, which are and will remain important offshore centers in which most firms maintain a robust presence.

The focus on key markets aligns with the bullish outlook for wealth expansion in the region, in which the emergent HNWI populations in China and India arguably represent the pinnacle of the potential (see Sidebar: Many Firms are Seeking an Early Foothold in China and India).

However, while the focus on key markets is a common one, international and regional/local firms will generally be navigating from different starting points.

Some international firms curtailed their regional growth plans or retreated back to home markets as the financial crisis mounted. Some were driven by fears of client attrition, while others retrenched because of tightening margins and/or the need to preserve capital on their own balance sheets. Many firms postponed plans to enter new markets and sought to reduce the scale of their operations and headcount. There were some notable exceptions, however. Some large players and a few boutique firms continued to expand during the crisis. They have bolstered their reputations around innovative and tailored client offerings and service, putting them in a strong position to capture market share in key markets going forward.

Regional/local firms meanwhile have tried to take advantage of the retreat by some international firms, cognizant that HNWIs are currently primed to favor the safety of local investments and firms. However, while AuMs have certainly flowed from international firms into regional/local ones, those funds have often headed into transparent and simple products and may not represent a long-term shift, especially if regional/local firms cannot provide a complete wealth management offering for HNWI clients going forward.

BUSINESS MODELS MUST REALIGN TO RESONATE WITH HNWIs STUNG BY THE CRISIS

Whatever the market, wealth management executives agree one of the major trends ahead for the region's industry is the shift (or for some the return) to more specialized HNWI service offerings, and away from the more retail business models many firms adopted in the rush to acquire clients in the pre-crisis years.

The transformation could require both international firms and regional/local firms to adjust a whole host of business practices, especially as they deal too with changes in the demands and preferences of HNWIs that have been fueled by the crisis. Our research shows many firms have already attained a degree of maturity in a number of key practice areas, but refinements will be needed nonetheless.

Products and Advisory Services. Firms need a wide range of offerings to cater to Asia-Pacific HNWIs, which are a highly diverse group. The choice of products should also be relevant for changing market conditions, especially as clients that have retreated to home-region and lower-risk investments start to expand their horizons again. Products also need to be economically viable for the firm (e.g., in a lower-margin environment). A shift toward more advisory-focused service models will be necessary to cater to the more sophisticated demands of HNWIs (an especially big shift for firms traditionally focused on retail) and to help rebuild client trust.

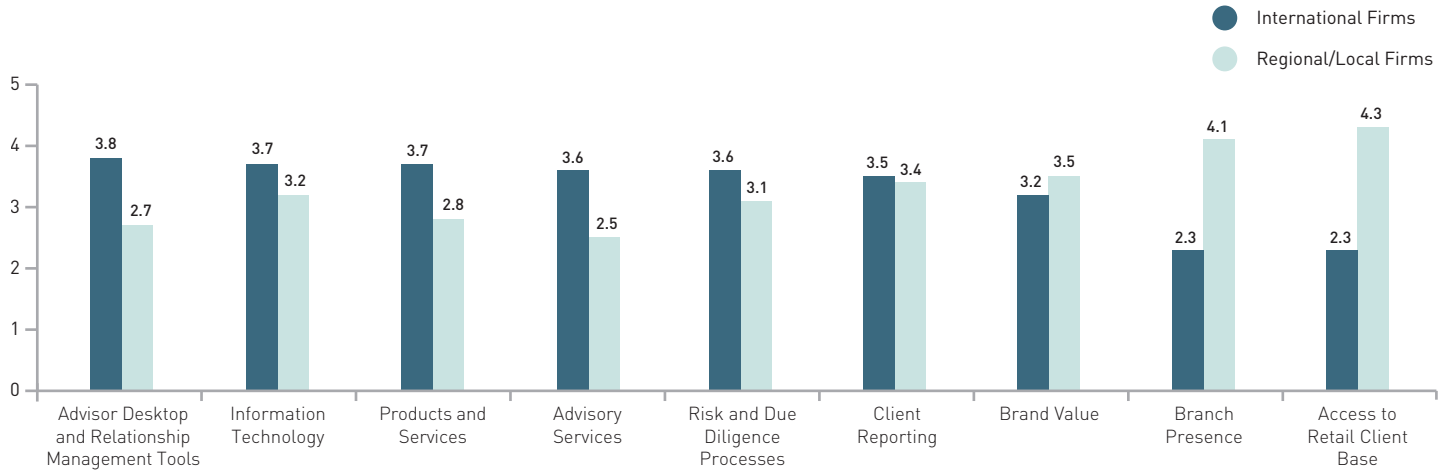
Product and service offerings are certainly among the top priorities among wealth management executives in the region. Of those surveyed, 45% said they would be working on some resolutions to the issue in 2009.

Client Analytics and Market Reach. To achieve sustainable growth, firms will have to identify and target different client segments and understand the needs of each. This could be highly challenging in the Asia-Pacific region, where so much of the potential for the wealth management industry lies in emergent wealth and potentially new segments altogether. Firms may benefit from cooperating with sister divisions (e.g., retail banking arms) or collaborating with other firms to widen their access to and understanding of new and growing segments as well as existing HNWIs. Aggressive communication and marketing plans, driven by the proper tools, will be beneficial.

Operational Efficiency and Tools are important enablers of service quality and advisor enablement, as well as profitability. As firms become more focused on HNWIs (and less on retail) their Advisors will require greater and more specialized support, as well as access to a broad range of information and experts. Clients themselves are also likely to demand greater technology-driven service options, especially since technology is so widely embraced in the region. Fee structures could also become an issue, especially for clients used to a more retail offering. Firms will need to ensure transparency in product pricing, and actively manage fee and/or profit allocation issues where access to clients and leads are shared.

Figure 10. Capabilities of Asia-Pacific Wealth Management Firms, 2009

(Average Ranking 1 low – 5 high scale)



Source: Capgemini analysis, 2009

EVOLUTION OF INTERNATIONAL AND REGIONAL/LOCAL FIRMS WILL BE DIFFERENT

For individual firms, the evolution in business and operating models will depend heavily on their starting point in terms of capabilities. Our in-depth interviews with executives in the region suggest the relative strengths and weaknesses of international and regional/local firms are currently quite tangible (see Figure 10).

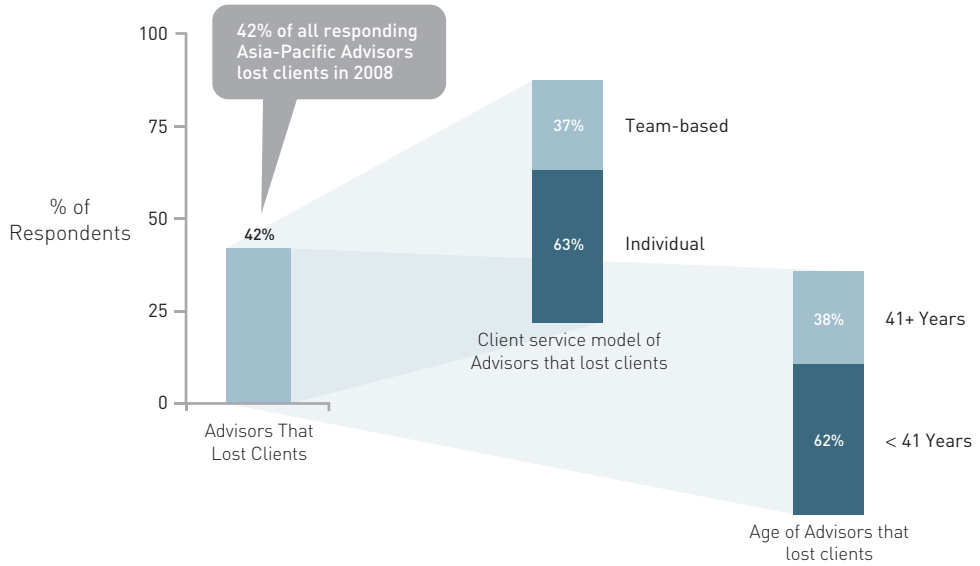
Advisor desktop and relationship management tools and information technology (IT) tend to be superior at international firms, which can import from more developed markets the kinds of tools and IT that have proven effective in supporting high-touch client service advisory models. This capability is likely to become even more important as Asia-Pacific service offerings evolve. Regional/local firms have invested relatively little in enablement tools, technology, and research given their focus on retail and transaction-based activities, so they will need to address this gap in the future.

Products and services and advisory services. International firms have a wider array of products and services and greater advisory competencies, executives agree. Notably, regional firms are not so convinced that international firms are superior in terms of products and services, but that may be because HNWIs shunned the type of complex products in which global firms excel during the crisis. However, international firms clearly have extensive experience of catering to HNWIs in more mature markets and of delivering relevant products in particular. That expertise will be paramount in the medium to long term as existing HNWIs regain their risk appetite, and as the HNWI population and its needs expand in the region.

In product risk and due diligence processes, international firms view themselves as tangibly superior, although regional/local firms believe themselves to be just as capable. It is important to note though that regional/local firms have had far less experience in this area than international firms. Oversight in the Asia-Pacific region is very stringent in terms of the universal oversight of operational and technology practices, especially for foreign firms, but it tends to be less prescriptive on product risk management. Moreover, international firms are used to developing and marketing innovative, diverse and complex products that require top-notch risk management and due diligence capabilities. Accordingly, it is fair to say this is a strength for international firms, and will become even more important as product offerings evolve, and as the region's regulators inevitably become even more demanding in light of the financial crisis.

Brand. The financial crisis undermined the trust of HNWIs in international firms, whose reputation was built in complex products and distant markets. Many HNWIs sought solace at firms with roots in their home country or region. These firms were deemed just as capable, if not more so, of handling the reallocation of HNWI assets to more conservative and home-region investments. However, the pull-back from international firms is expected to reverse as the financial crisis fades.

Figure 11. Age and Client Service Model of Asia-Pacific Advisors that Lost Clients in 2008



Source: Capgemini Analysis, 2009

Access to retail clients and branch presence have long been controlled by regulators and governments in the Asia-Pacific region, allowing regional/local firms to widen their reach more easily than international firms, potentially giving them an advantage in client acquisition. However, while the limits on "foreign" firms are certainly a key factor in how international firms enter and serve financial services markets in general, the real advantage for regional/local firms is in the retail and mass-affluent markets, not in wealth management. In fact, the transaction-based, retail focus of most regional/local firms will need to be transformed to accommodate an effective specialized offering for HNWIs in future.

Notably, **client reporting** (online and statements) is the only area in which executives rank international firms and regional firms almost equally, especially in larger markets. However, it should be noted that HNWIs' standards for client reporting are already higher than those of retail clients, so executives may not rank firms as highly when they must cater more specifically to HNWIs than retail. Moreover, in light of lessons learned from the crisis, HNWIs are likely to demand even greater transparency into their portfolio holdings and management (including fees) and more real-time access to information, so standards for client reporting may rise in the future.

Going forward, firms will need to assess which capabilities are most critical to their business proposition and address any gaps accordingly.

REBUILDING CLIENT TRUST AND INVESTING IN ADVISOR CAPABILITIES ARE VITAL IN A POST-CRISIS ENVIRONMENT

With the wealth management industry expected to increase in size and sophistication in the next few years, one of the most critical links between business goals and capabilities emerges around the issue of rebuilding client trust in the post-crisis environment.

Surveyed executives and Advisors in the region all agree HNWI clients have lost trust in firms, Advisors, financial markets and regulators in the region because of the crisis. The region's wealth management executives are especially concerned, although many seem to think the distrust is targeted more at the system than the firm or individual Advisors. Forty-eight percent of executives said their clients in the region had lost trust in financial markets (31% of Advisors said the same), but only 10% of executives said HNWIs had lost trust in their Advisors (vs. just 3% of Advisors).

Nevertheless, there is clearly room for all firms to reassure clients and work on restoring their confidence. Indeed, 85% of executives said maintaining client trust/client retention were among the top two challenges faced by Asia-Pacific wealth management firms in 2008-09, and 40% said client trust was among the top three issues they intended to resolve in 2009.

Advisor training is likely to be one way in which firms try to position themselves to regain client trust and confidence. Among responding executives, 55% said Advisor training is among the top three issues requiring resolution in 2009, making it the most frequently chosen imperative.

This is consistent with the needs identified in our research, which shows few Advisors were ably qualified to manage the impact of the crisis on HNWI portfolios or psychology. More than 40% of all surveyed Advisors in the region said they witnessed significant client attrition in 2008, but few apparently had any first-hand experience of the kind of down-market dynamics seen in the crisis. (The average Advisor in the region has just 9.7 years of experience, which is far less than the 13.3-year global average.) Younger Advisors (those under 41 years of age) were also more likely to lose clients, as were Advisors working alone (see Figure 11).

Advisor enablement tools and initiatives can help to bolster capabilities, and create an indirect effect on the economics of the business, our research shows.

Advisors that were satisfied[52] with the service and support enablement provided by their firms in 2008 were able to retain more than twice as many clients as dissatisfied Advisors. And 74% of Advisors who were dissatisfied lost clients in 2008.

Both international and regional/local firms will clearly need to determine the appropriate mix of advisor-enablement tools going forward, though this decision too will have to be aligned with overarching business and operating models.

FIRMS MUST ALSO TAKE A STRATEGIC APPROACH TO MANAGING REGULATORY CHANGE

Regulation is another dimension in flux in the region's wealth management space. It is tempting to dismiss the latest tide of regulatory rigor as a crisis-driven reflex that will reverse in time, but oversight in the Asia-Pacific region often targets very specific aspects of the business that have long been unfettered in more developed markets.

In particular, regulation tends to translate into direct limits on key aspects of business and product development, including:

- Product due diligence
- New product and service offerings
- Foreign ownership of financial services firms
- Revenue/fee structures
- Credit and margin lending
- Branches/network reach.

As such, regulation represents a barrier to entry for international firms that affects market potential (see Sidebar: Regulation is Influencing the Feasibility of Market Entry in Asia-Pacific). Accordingly, firms will need to take a far more strategic approach to regulatory change than has been typical in the past.

[52] Advisors were classified as "dissatisfied" if they voiced some degree of dissatisfaction over major enablement tools provided by firms (i.e., tools/capabilities over which Advisors have least control, such as 'Advisor desktop' and 'client relationship management' tools).

REGULATION IS INFLUENCING THE FEASIBILITY OF MARKET ENTRY IN ASIA-PACIFIC

The Asia-Pacific region includes many of the most heavily regulated markets in the world. The financial crisis that occurred in 2008-09 has prompted a few (Japan, South Korea, Thailand and Malaysia) to relax certain banking restrictions in hopes of spurring economic growth, but the crisis has generally been a driver of more not less regulation in the region.

Regulators have been especially concerned about the performance and health of foreign banks, and some countries have decided to shelve or delay measures that had been expected to open up banking to foreign players. Many have also tightened regulations on wealth management funds and structured products. In an already challenging environment, these types of limits make it harder for firms to introduce new products.

We conducted an analysis of the region's markets to gauge the conditions for firms operating from an onshore base, based on a combination of business and regulatory scores. The scores take into account a variety of operating parameters, including banking regulations, restrictions on foreign banks, product offerings, entry barriers, the overall maturity and outlook of the market and other business environment scores. The analysis revealed four distinct wealth management segments (see Figure 12).

'Easy-to-Enter' Hong Kong and Singapore have the most favorable business conditions and regulations, and have become global wealth management hubs. These markets have the most liberal regulations and policies in the Asia-Pacific region and this has driven most international wealth management firms to establish a presence there. Both regulatory and business scores are high, reflecting for example the tough bank-secrecy laws, reliable legal systems, highly efficient governments and well-regulated financial sectors. With the European Union stepping up its scrutiny of European tax havens, wealthy Europeans are increasingly looking at Singapore and Hong Kong as offshore investment centers. These factors have elevated Singapore and Hong Kong into global wealth management hubs – and not just entry points for wealth coming into the region.

'Accessible' markets (Australia, New Zealand, Malaysia and Taiwan) have relatively favorable business environments and less stringent regulations, making it easy for foreign banks to enter. Malaysia and Taiwan offer huge potential for foreign firms. Malaysia has stepped up its bid to become an international center for Islamic investments and is allowing foreign firms to start up operations. Taiwan is also encouraging foreign-bank entrants by lifting limits on branch banking and NT dollar deposits. By contrast, the wealth management markets in Australia and New Zealand are mature, but dominated by local wealth management and boutique firms. Unlike Malaysia and Taiwan, foreign banks entering into Australia and New Zealand would have to contend with stiff competition from local firms.

'Challenging' markets (China, India, Thailand, South Korea and Indonesia) have stringent regulations, but are the key markets in the Asia-Pacific region, with high growth potential for wealth management. Recent developments in China and India show the enduring restraints on foreign-bank activities. For example:

- China recently tightened rules on wealth-management funds and banned banks from investing these funds into secondary market stocks and complicated high-risk products. Moreover, regulations require banks to be incorporated locally if they want to offer a full range of products and services. This has forced many foreign banks to establish locally so as to provide an expanded range of products.
- In India, the much-awaited easing of regulations for foreign banks was deferred by the Reserve Bank of India (RBI)[53] in April, 2009. As a result, wholly owned subsidiaries of foreign banks are still not treated in the same manner as local Indian banks and cannot acquire controlling stakes in Indian private banks. The ongoing limits are a dampener for foreign banks that had thought they would soon be allowed to expand their operations and tap into the growing wealth management market.

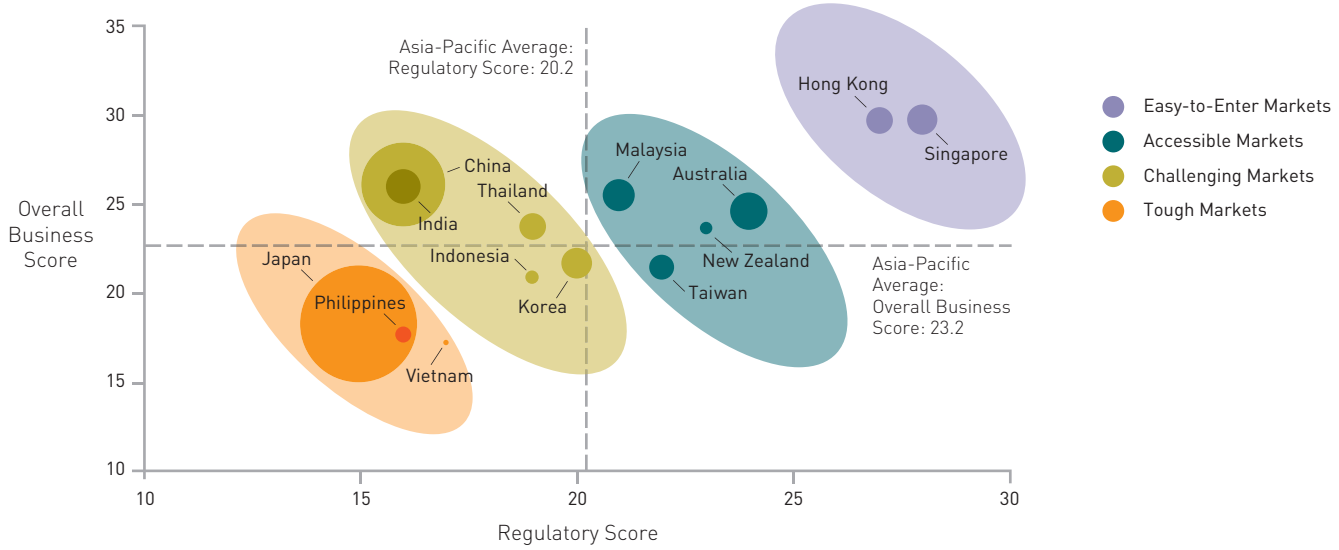
Nevertheless, the wealth management segments in China and India both have high growth potential so they remain attractive markets even though regulations are very stringent. (See Sidebar: Many Firms are Seeking an Early Foothold in China and India.)

In South Korea, FSCMA (Financial Investment Services and Capital Markets Act) became effective in February 2009[54]. The new law is expected to contribute to an increase in merger and acquisition (M&A) activity in the financial services industry and help financial institutions to expand their business lines and product offerings. Indonesia recently introduced stricter

[53] Vaibhav Aggarwal, "Foreign Banks to reconsider growth plans for India", Rupee times (http://www.rupeetimes.com), April 2009

[54] "South Korea: Buckling the trend", International Financial Law Review (http://www.iflr.com), June 2009

Figure 12. Segmentation of Asia-Pacific Markets by Overall Business and Regulatory Scores, 2009



Note: The size of each bubble depicts the size of that wealth management market in 2009
Source: Capgemini Analysis, 2009

limits on foreign exchange transactions to provide easier options for banks in settling transactions. Regulation is also very tight in South Korea and Thailand, though both countries are trying to ease regulations to accelerate the growth of their economies.

'Tough' markets (Japan, Vietnam and Philippines) have the tightest regulations in the region and are difficult to penetrate. Japan, for instance, has historically been a very tough market for Western banks as the market is dominated by local players. Foreign banks can emphasize their global reach and product expertise, but lack the branch networks and local resources of their Japanese rivals. The local wealth management segment has always been short of expert capabilities, products and services, but foreign players are still unable to win the complete trust and confidence of Japanese clients. Foreign banks did get somewhat of a respite recently when the Financial Services Agency (FSA) eased regulations regarding how banks can interact with their securities arms. Previously, banks had been barred even from recommending services among sister divisions. The new regulation presents a major boost to foreign banks, which had been most disadvantaged by the regulation, as they lacked the same holding-company structure as local banks[55].

Regulations in Vietnam and the Philippines are also stringent, making these markets tough to enter. Vietnam recently revised its credit law, and has put tough restrictions on credit and bank-equity ownership. Foreign banks are concerned this law could hamper their future growth plans in Vietnam. The Philippines also puts substantial limits on the local operations of foreign wealth management firms, so many are largely operating from offshore locations.

CONCLUSION

The financial crisis has generally prompted more not less regulation for the Asia-Pacific wealth management industry and that shift has directly changed the feasibility of entering certain markets. Singapore and Hong Kong still remain regional centers of wealth management, but China and India are clearly the future engines of growth.

To succeed in the region, global banks will need to make strategic adjustments to realign their business models to regulatory realities. For example, they will have to pace their entries into high-potential but stringently overseen markets like China and India, taking advantage of piecemeal changes in regulation while they wait for more wholesale liberalization. One example is the current potential, facilitated by regulation and client needs, for banks to serve the burgeoning market for non-resident Indians.

Firms will also need to work closely with industry regulators to keep abreast of potential regulatory changes, and participate in the dialogue to help ensure new measures are not overly restrictive. Wealth management executives agree that regulation is likely to expand across the region, so firms should do what they can to anticipate the effects and mitigate the impact of regulation on their firm's growth strategy.

[55] "Knocking down the wall", Economist (http://www.economist.com), July 2009

MANY FIRMS ARE SEEKING AN EARLY FOOTHOLD IN CHINA AND INDIA

The net growth in global financial wealth is projected to be largely driven by China, India and Japan over the next few years, leaving those countries with a substantially larger share of global wealth within the next decade (see Figure 13). While Japan will still play a central role as a key market in the region, India and China are projected to display far higher wealth growth rates (~14% and ~12%, respectively, compared to ~7% for Japan)[56]. With China and India having the highest GDP growth rates in the region, they maintain their status as prime markets to invest for the long-term. Wealth management firms that are able to secure an early presence in these already booming, but still nascent markets will be in a unique position to capture future opportunities there.

Indeed, many global wealth management firms have entered China or India since 2008, and local banks and wealth management firms are expanding their operations by focusing on two main business opportunities:

- Untapped market potential
- Potential for innovation around product mix and/or new customer segments

However, wealth management firms must thoroughly understand these key drivers of growth, and how they intersect with the regulatory regime, in order to make the right tactical and strategic decisions to capture the opportunity in these still-challenging markets.

China has tremendous growth potential in the region. By 2018, the HNWI population is expected to be more than triple the size it was in 2008[57], but the geographic distribution of HNWIs is likely to change as the country's smaller cities expand and the amount of wealth residing outside the largest cities increases. Shifts in the geographic distribution of wealth are already becoming evident in the consumer and mass affluent population, with a significant portion of the growth coming from areas outside the four largest cities of Shanghai, Beijing, Guangzhou and Shenzhen by 2015[58]. We expect the HNWI segment to follow a similar trend.

The HNWI population is also relatively young and aggressive in its investment approach. By comparison, 41% of Japan's HNWI population is over 66 years of age and tend to favor conservative, low-margin products, while only 2% of China's HNWI population is similarly aged. In fact, 47% of HNWIs in China are in the 46-55 years age range[59]. Moreover, only 4% of Chinese HNWIs have inherited their wealth[60] vs. 22% in Japan. These characteristics in China's HNWIs contribute to a relatively high tolerance for risk in pursuit of maximum returns and suggest there is significant potential for the HNWI segment to grow[61].

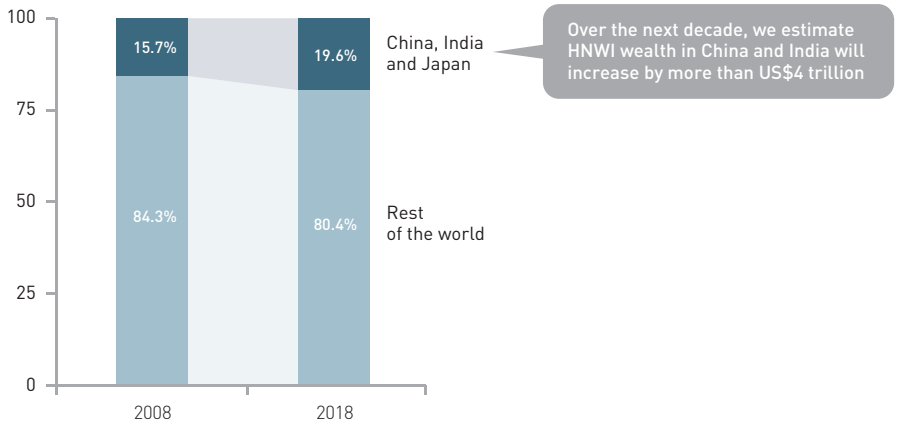
Firms are also leveraging specific product opportunities that arise in the gaps of broad regulations. For example, banks are expected to focus on developing their Private Banking businesses, which are exempt from recent curbs imposed by the China Banking and Regulatory Commission (CBRC) on investing in riskier assets. Similarly, some firms are expected to leverage trusts as vehicles for higher-risk investments (as opposed to investing directly in those products)[62]. A clear example of this is recent efforts from some banks to launch investment products in GEB-listed[63] stocks, which have very positive growth prospects and would otherwise be inaccessible to HNWIs.

Other significant opportunities exist around product offerings, whether aimed at protecting principal (a short-term trend)[64] or satisfying the demand of the emergent wealth classes and a more globalized approach to investments (more of a medium/long-term trend). Furthermore, Chinese HNWIs are expected to increase the allocation of their portfolios invested outside the Asia-Pacific region in 2010, to 29% from 17% in 2008[65].

India's potential for HNWI growth and expansion is also evident. The HNWI population in India is also expected to be more than triple the size in 2018 that it was in 2008[66], with emergent wealth playing a key role. Like China, relatively few among the current HNWI population (13%, compared to 22% in Japan) have inherited their wealth and few (9%) are over the age of 66, suggesting economic growth has the potential to boost the size of the HNWI population. Wealth is also likely to extend beyond metropolitan areas. India currently has a middle class of 80 million households and only 25 million reside in Tier I cities like Mumbai and Delhi, while many others live in smaller cities and beyond. And there are already 51 districts that have twice the market potential of the four metros

[56] Capgemini Lorenz Curve Analysis, 2009
[57] Ibid.
[58] "The Coming of Age: China's New Class of Wealthy Consumers", McKinsey Insights China (http://mckinsey.com), April 2009
[59] Capgemini/Merrill Lynch Financial Advisor Survey, 2009
[60] Ibid.
[61] Ibid.
[62] "Lenders turning to wealth management products for growth", China Daily (http://www.chinadaily.com.cn), August 7 2009
[63] The Growth Enterprise Board (GEB) is a NASDAQ-style second board that is expected to commence operations later this year and is has positive growth prospects for investors
[64] Survey of Asia-Pacific's leading wealth managers, Barclays Capital, April 2009
[65] Capgemini/Merrill Lynch Financial Advisor Survey, 2009
[66] Capgemini Lorenz Curve analysis, 2009

Figure 13. Relative Participation of China, India and Japan to Global Wealth, 2008 vs. 2018



Source: Capgemini Analysis, 2009

combined[67], illustrating the potential for HNWI wealth to be even more geographically dispersed in the future.

Firms in India also have an important and unique opportunity to serve the offshore segment, as the remittances ceiling has been progressively raised over the last five years: from US$25,000 in 2004 to US$200,000 per person in 2009[68]. Moreover, the Securities and Exchange Board of India (SEBI) recently eliminated the entry load for mutual fund distributors, which is expected to encourage firms to adopt a more advisory-based model with increased transparency[69].

Likewise, non-resident Indians (NRIs) represent a huge potential client segment for wealth management firms: NRI deposits grew from US$36.1 billion in December 2008 to US$39.2 billion in May 2009[70], while remittances, estimated at US$49 billion in 2008 are projected to reach US$56 billion in 2013. By contrast, China's remittances were US$37 billion in 2008 and are projected to be US$48 billion in 2013[71]. This is particularly significant given that 15%-25% of NRI portfolios are invested in India[72]. Outside of Asia-Pacific, the Middle East and North America are the regions with the highest NRI populations[73]. Together, they submit close to 70% of NRI remittances coming from outside of Asia-Pacific[74].

CONCLUSION

Wealth management firms need to navigate the evolving China and India markets carefully, particularly the regulatory environment, and the challenge is most notably for foreign wealth management firms, given that many are still feeling the ripple effects from the crisis and face a more skeptical client base.

To position themselves to capture market share as these markets grow and liberalize, firms will need to pursue a graduated strategy that can leverage individual short-term opportunities in HNWI products and segments, despite regulatory constraints, while aiming for comprehensive coverage that can open the door to cross-selling and up-selling as the HNWI population grows and changes in the future.

Granular segmentation will also be important to understand the characteristics and needs of emergent HNWI segments, particularly given the variety of dialects across different regions in China and India. While local firms have a better understanding of client preferences and needs, both India and China are relatively short on wealth-management talent as the markets have yet to develop extensively. This shortage could put local firms at a disadvantage to international firms, which tend to have a more extensive network of expert Advisors.

Wealth management firms will need scalable solutions in China and India to implement the proper mix of centralized locations and regional branches as they expand their reach. This scalability will be necessary to achieve productivity and growth without overly increasing risk or overheads. Specific measures may also be needed to mitigate cost pressures in the short term, such as moving low-touch, high-cost activities from the front to the middle and back offices, as Chinese and Indian HNWIs are not expected to execute substantial changes in their portfolio allocations to fixed income and cash/deposits before 2011[75].

[67] "An Increasingly Affluent Middle India is Harder to Ignore", Knowledge at Wharton (http://knowledge.wharton.upenn.edu), July 10 2008
[68] "Master Circular on Miscellaneous Remittances from India – Facilities for Residents", Reserve Bank of India (http://www.rbi.org.in/), July 1 2009
[69] "Advisories to benefit from MF entry load removal", The Economic Times (http://economictimes.indiatimes.com), June 24 2009
[70] "Outlook for Remittance Flows 2009-2011", World Bank (http://siteresources.worldbank.org/), July 13 2009
[71] Country Data for India and China, Economist Intelligence Unit, August 2009
[72] Tom Burroughes, "Seize Indian Wealth Market Opportunities Now - New Report", Wealth Briefing Asia (http://wealthbriefingasia.com), March 2009
[73] "Spread of the Indian Diaspora" - country-specific data for the Middle East region, Overseas Indian Facilitation Centre (http://www.oifc.in), accessed August 20 2009
[74] "Cost of NRI Remittances", Report of the Working Group submitted to Reserve Bank of India, May 2006
[75] Capgemini/Merrill Lynch Financial Advisor Survey, 2009

THE WAY FORWARD: ACHIEVING LONG-TERM AND ORGANIC GROWTH

Many firms are already gearing up to exploit the opportunities in the wealth management markets of the Asia-Pacific, but it will be a challenge to establish and maintain meaningful and value-added HNWI relationships in a cost-effective way, especially when margins and revenues are being tightly squeezed as they are now.

HNWI clients have become far more discerning as a result of the financial crisis. They expect firms and Advisors to be transparent and communicative, trustworthy and capable, but they also want product excellence and innovation. As a result, HNWIs are likely to spread their assets among several providers. Quite soon, though, the region's HNWIs are likely to start regaining their appetite for risk. They will seek to diversify across the region and into less mainstream products in pursuit of returns, offering new opportunities and margin-improvement potential, especially for experienced global firms.

However, the future landscape will clearly differ from the pre-crisis years. International firms will ultimately regain client confidence and assets by leveraging their strong product expertise and offerings, but they are likely to find the competition from regional and local firms is much greater than it once was. As competition intensifies, consolidation is inevitable, along with joint ventures designed to strengthen client bases and revenues. Organic growth will also be an important route to building a business proposition that can expand and evolve with the emerging HNWI populations in the region.

During our research, we discovered two cases that illustrate the kinds of business, operating and service models that are delivering results in the Asia-Pacific wealth management markets right now.

Case 1: Leading Wealth Management Firm - Singapore

Business Model
- Focus is on developing long-term client relationships.
- Strategy is to leverage extensive offshore expertise to take onshore a suite of products that is relevant to the local markets.
- Firm recognizes clients are likely to use multiple providers – and believes clients that seek advice from competing firms will actually be better able to articulate their needs and will help the firm to tailor a more meaningful offering.

Advisory Model
- Team-based approach reflects firm's opinion that a single advisor cannot properly understand and market every product or adequately manage risk for HNWI clients.
- Significant investment in Advisor training is aimed in particular at strengthening sales and communication skills, and making sure Advisors are capable of developing customized investment strategies tailored to HNWI client goals.

Operating Model
- Technology investment is targeted on Advisor enablement and developing better customer experience capabilities.
- Technology is deployed to ensure continuous monitoring and analysis of client portfolios.
- Service Oriented Architecture (SOA, package of services) is implemented to provide greater business flexibility and higher efficiency.

Case 2: Leading Wealth Management Firm - India

Business Model
- Firm moved from 'boutique' model to selling a wider range of products from across segments, helping to capture a larger client base and providing greater diversification in the challenging business environment.
- Aims to achieve traction in client relationships and become a 'one-stop shop' for all client needs.
- Plans to grow through distribution so is expanding beyond metro areas.
- Operates like a global Private Bank, leveraging strength in cross-border accounting, which is a weakness among regional/local firms.

Advisory Model
- Team-based model offering clients access to a wide range of experts.

Operating Model
- Seeks to capture economies of scale by leveraging existing capabilities, such as using existing core banking systems for asset allocation, triggers, and so on.
- Middle and back-office optimization helps to drive profitability.

More broadly, our research suggests there are four key success factors for achieving sustained and organic growth in the Asia-Pacific wealth management space going forward:

1. **Aligning practice models to HNWI market needs,** now and in the future. Wealth management business models in the Asia-Pacific region were diluted in the years prior to the financial crisis. As firms battled for clients, many headed farther into retail territory and focused heavily on transactions. Now firms need to refocus their strategies and accordingly align their business models to serve HNWIs. While firms will want to target increased wallet share of existing HNWI segments, they must equally position themselves to capture emergent HNWI segments and AuM. At the same time, there must be an effective cost model to help preserve and drive margins and revenues in a service-oriented practice – and within the confines of whatever regulatory limits do or will exist.

2. **Targeting new markets and segments.** As is the case with any growth strategy, it will be important to identify and size the potential in new markets, and plot a strategy for entering effectively. In the Asia-Pacific region, this means weighing the regulatory restraints and operating challenges against the potential returns – and plotting a strategy that is viable amid the competitive constraints for the short, medium and long term. Ahead of time, and once in a market, firms also need to develop and iterate their understanding of current and emerging HNWI client segments and needs. It will require a complex and granular analysis of demographics, economics, politics, regulation, and investor preferences to develop a tailored but economically viable approach for each HNWI segment.

3. **Offering an effective product mix.** In the short term at least, HNWIs are still feeling risk-averse and margins are being squeezed, so firms will need to have transparent and simple product offerings that offer wide appeal, probably with a focus on home-region products with which HNWIs are more comfortable right now. However, firms must be able to innovate and develop products that evolve as risk appetites return – ultimately offering clients an array of products that includes more complex (and higher-margin) and global products, without sacrificing the transparency HNWIs have come to appreciate. Evaluating and communicating product risk will become increasingly important.

4. **Enhancing client advisory services.** For many firms in the Asia-Pacific region, it will be a major shift to move away from their traditionally transaction-based models to more advisory-focused client service models. It is likely to require, for instance, a more team-based service model to mitigate risk and provide clients with access to a range of experts – and fee structures will probably need to be revamped accordingly. Firms may also need to hire more experienced Advisors, especially to help instill customer trust and confidence, but this will require a deliberate talent-management strategy. In the exuberant pre-crisis years, rampant and aggressive hiring helped ratchet up the cost of doing business – a cost firms cannot afford in today's low-margin environment.

Wealth management firms that effectively address these critical success factors should be in a good position to gain competitive advantage in attracting and retaining Asia-Pacific HNWI clients and building a responsive and prosperous business in the region over time.

APPENDIX A: METHODOLOGY

The 2009 *Asia-Pacific Wealth Report* focuses on 11 core markets: Australia, China, Hong Kong, India, Indonesia, Japan, New Zealand, Singapore, South Korea, Taiwan, and Thailand. These markets together account for 95.3% of the regions gross domestic product (GDP).

The market-sizing model includes 18 countries and territories in its Asia-Pacific coverage. We estimate the size and growth of wealth in various regions using the Capgemini Lorenz curve methodology, which was originally developed during consulting engagements with Merrill Lynch in the 1980s. It is updated on an annual basis to calculate the value of HNWI financial wealth at a macro level.

The model is built in two stages: first, the estimation of total wealth by country/market, and second, the distribution of this wealth across the adult population in that market. Total wealth levels by country are estimated using national account statistics from recognized sources, such as the International Monetary Fund and the World Bank, to identify the total amount of national savings in each year. These are summed over time to arrive at total accumulated country wealth. As this captures financial assets at book value, the final figures are adjusted based on world stock indexes to reflect the market value of the equity portion of HNWI wealth. Select historical figures have been updated since publication in previous reports.

In 2005, we revised the methodology to move from reporting only annual regional findings to include country level information. Wealth distribution is based on formulized relationships between wealth and income. Underlying data is provided by the World Bank, Global Insight, Economist Intelligence Unit and sources of official national statistics. We then use the resulting Lorenz curves to distribute wealth across the adult population in each country. To arrive at financial wealth as a proportion of total wealth, we use statistics from countries with available data to calculate their financial wealth figures and extrapolate these findings to the rest of the world. Each year, we work with colleagues around the globe from several firms to enhance our modeling and better account for the impact of domestic, fiscal and monetary policies over time on HNWI wealth generation.

The financial asset wealth figures we publish include the values of private equity holdings stated at book value as well as all forms of publicly quoted equities, bonds, funds and cash deposits. It excludes collectibles, consumables, consumer durables and real estate used for primary residences. Offshore investments are theoretically accounted for, but only insofar as countries are able to make accurate estimates of relative flows of property and investment in and out of their jurisdictions. We account for undeclared savings in the report.

Given exchange rate fluctuations over the past years, especially with respect to the U.S. dollar, we assess the impact of currency fluctuations on our results. From our analysis, we conclude that our methodology is robust and exchange rate fluctuations do not have a significant impact on the results.

The translation to U.S. dollars is made using a yearly average exchange rate. The WWR model calculates cumulative wealth in U.S. dollar terms using a time series going back over 100 years, so the impact of a sharp currency appreciation for a year or two has a negligible effect. For example, our analysis shows that if 2008 exchange rates had remained at the same level as in 2007, global HNWI wealth in 2008 would have been only 0.2% lower than our reported figure of US$32.8 trillion.

The information contained herein was obtained from various sources; we do not guarantee its accuracy or completeness nor the accuracy or completeness of the analysis relating thereto. This research report is for general circulation and is provided for general information only; any party relying on the contents hereof does so at its own risk.

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