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Managing Asia's Private Wealth to Serve the Real Sector

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Key Insights

1. Asia is on track to become the largest pool of private wealth in the world (US$48 trillion; 60 per cent in China). But, wealth is highly concentrated and 90 per cent is held in banks or managed personally.

2. Asia must harness this wealth to support Asia's long-term growth to:

   a. Deepen financial markets;

   b. Provide early stage business financing;

   c. Build Asia's infrastructure and capital base;

   d. Create jobs;

   e. Provide better returns to those who created the wealth; and

   f. Pave the way for steadily greater Asian integration.

3. To develop Asia's nascent private wealth management industry to meet Asia's long-term development needs:

   a. Financial institutions must develop the right business models (Swiss-style relationship banking and/or U.S. brokerage-type approach) to win the trust and confidence of wealthy investors.

   b. Policymakers must balance compliance/regulatory issues with more attention on how to develop private wealth funds to drive innovation and deepen capital markets.

Executive Summary

Asia's economic rise is generating unprecedented levels of financial wealth, creating millionaires and billionaires, as well as spreading increasing wealth to Asia's growing middle classes. Asia ex-Japan is on track to overtake North America to become the world's largest wealth region by 2017, with private financial wealth rising from US$28 trillion to US$48 trillion by one estimate (BCG 2013). Profits earned by institutions serving millionaire households could also rival the profitability of such North American institutions by 2016 (McKinsey 2013). While there will be short-term variations as economic growth slows or strengthens from year to year, the underlying dynamics are clear. Over 90 per cent of this wealth is held onshore, with offshore wealth accounting for 7 per cent of the total. Chinese wealth dominates. Its share of the Asia ex-Japan total is set to rise from just under half to nearly 60 per cent by 2017.

Wealth ownership is highly concentrated with a relatively small number of millionaire households controlling 39 per cent of private financial wealth. The rich are set to get richer. Millionaire households could own around half of all Asian private wealth by 2017, yet the roughly 1.7 millionaire households in Asia (McKinsey 2013; CG /RBC 2013) account for less than 0.2 per cent of Asia's households.

Managing this large pool of Asian wealth effectively will be critical for the region's continued sustainable development. This will mean deploying these funds where they can earn the most attractive returns and meet real financing needs in the economy. It will also mean ensuring that people across society seek the positive and legitimate roles of wealth creation and investment in light of the significant wealth gaps between the richest and the average person.

Today, Asia's wealth management sector is in a nascent phase. There is a great deal of growth and activity, but there remain significant additional opportunities to harness fully the potential of this sector for all stakeholders. The wealthy – who are often first-generation entrepreneurs – have different needs from those in more established markets. As much as 90 per cent of private wealth is held outside of the private banking sector, with the bulk in commercial banks or managed personally. Financial institutions are grappling with developing profitable business models in an environment where many competitors are making land-grabs for business volumes and where each onshore market has important differences and different regulatory and institutional contexts. Regulators and policymakers are addressing issues of compliance and anti-money-laundering (AML), and placing strong pressure on offshore centers to share information. Most importantly, however, there has been much less focus on how to best take advantage of private wealth funds to drive innovation in the finance sector – for example, by creating a larger investor base for

capital markets to support the real economy more broadly through financing and employment in its own right.

Developing the most effective wealth management sector for Asia's future will require ongoing dialogue and cooperation between regulators, financial institutions and wealthy clients at both national and regional levels. Continued focus on compliance, risk management and transparency will remain important within and across borders. However, it will also be critical to ensure that regulations and business models evolve in tandem to support the growth of financial institutions that both meet client needs and offer sustainable profitability. This will also lead to job creation and capable businesses that can attract the wealthy outside of Asia into the region. The opportunity to harness Asia's wealthy investor base to drive innovation and change in the financial sector is also significant. Examples include longer-term investments in infrastructure, development of Asian bond markets and improved early-stage business financing.

This working paper explores these themes under three headings:

I. What is the nature of Asian wealth?

II. How effectively does the finance sector support wealth management in Asia today and for the future?

III. What can policymakers and business leaders do to create the right wealth management sector for Asia's future?

I. What is the Nature of Asian Wealth?

Just as Asia's economies have grown in the past decades, so too has Asian wealth. This new wealth attracts attention from all sectors – businesses that are seeking to serve the newly wealthy, policymakers who want to both support wealth generation and ensure its legitimacy and individuals, some of whom wish to attract this wealth to their businesses and some of whom question the concentrated wealth distribution that is emerging. As a result, there is a significant number of reports that profile Asian wealth (see Bibliography). We start first with some definitions and caveats on available data and then consider four key dimensions to Asia's private wealth:

a. How to define and measure wealth?

b. How large is the wealth? How fast is it growing?

c. Where are the sources of Asian wealth?

d. Where is the wealth being invested?

e. How is the wealth distributed?

a. How to define and measure wealth?

In the broadest terms, wealth can be defined as the value of all of the assets of worth owned by an individual, company, country or community. For example, 'sovereign wealth funds' are created to manage national assets on behalf of a government. For private individual wealth, estimates are available in three categories:

a. Total net household wealth: This considers all of the assets held by individuals, financial and non-financial, netting out debt.

b. Total private financial wealth: This considers only the financial assets of private households.

c. Total millionaire (financial) wealth: Estimates focus predominantly on financial wealth only and consider 'net investable assets'. The term 'net investable assets' focuses on financial assets and excludes an individual's primary residence. It includes wealth in the form of cash and deposits, money market funds, other real estate, listed securities whether held directly or through funds, life insurance, pensions and other vehicles such as hedge funds and private equity. It excludes investors' own businesses unless they are holding a tradable, listed stake. As the US$1 million cut-off has been the convention for many years, the threshold is in fact decreasing in inflation-adjusted terms every year.

In terms of geographic scope, research estimates cover either Asia-Pacific or Asia ex-Japan. The sheer scale of wealth in Japan and its more mature level of development compared to emerging Asia justify separate treatment. The focus of this working paper is Asia ex-Japan.

Finally, within these definitions, measurement is itself not precise. It has been said that someone who knows his own wealth is not truly wealthy. Moreover, the wealthy are generating their assets through a mix of profit generation in new business ventures and rent extraction based on relationships and established positions. The regulatory and reporting frameworks are in the process of being completed. Matching this, the size of the underground economy is significant in many countries. Around the world, there is pressure for greater transparency across offshore centers. These challenges all highlight the difficulties in estimating the scale of wealth. Research in China on 'gray income' in 2010 and 2012 provides an example of the adjustments that need to be made (Credit Suisse 2010; Wang 2012). Professor Wang's most recent work identified RMB 6.2 trillion of hidden income in China that is equivalent to an additional 12 per cent of GDP. The richest 20 per cent of the population accounted for over 70 per cent of this hidden income. Research estimates quoted in this brief make their own adjustments for hidden wealth across Asia and collect a broad range of opinions on market size and growth. However, they do remain just that – estimates.

b. How large is the wealth? How fast is it growing?

Asia ex-Japan accounts for one-fifth of total global household wealth, considering both financial and non-financial assets

As of mid-2013 total global household wealth covering both financial and non-financial assets amounted to US$241 trillion (Credit Suisse 2013). Asia ex-Japan accounted for just over US$45 trillion or one-fifth of this global total. Work by Professors Anthony Shorrocks and Jim Davies for Credit Suisse based on extensive country-level data analysis and modeling provides the greatest detail on total household wealth. Wealth estimates are split into (gross) financial assets, non-financial assets (principally all housing and privately-owned land) and offset by private household debt. Exhibit A shows the differing compositions by region.

Exhibit A. Global Private Sector Wealth - Regional Comparison

	Trillion US$					Percentage Split (%)			
	Financial	Non-Financial				Financial	Non-Financial		
	Assets	Assets	Debt	Total		Assets	Assets	Debt	Total
N America	62.8	31.4	-15.3	78.9	**N America**	80	40	-19	100
Europe	39.2	51.5	-14.4	76.3	**Europe**	51	67	-19	100
Asia ex-Japan	21.9	28.9	-5.8	45.0	**Asia ex-Japan**	49	64	-13	100
- of which, China	10.7	12.9	-1.4	22.2	- of which, China	48	58	-6	100
Japan	15.6	10.7	-3.7	22.6	**Japan**	69	47	-16	100
Latin America	3.9	6.5	-1.3	9.1	**Latin America**	43	71	-14	100
Africa	1.4	1.5	-0.3	2.7	**Africa**	53	57	-10	100
Middle East/ Other	2.5	4.6	-0.8	6.3	**Other**	40	73	-13	100
TOTAL	**147.4**	**135.0**	**-41.5**	**240.9**	**TOTAL**	**61**	**56**	**-17**	**100**

Asia ex-Japan includes: Australia, China, Hong Kong SAR, India, Indonesia, Malaysia, New Zealand, Pakistan, The Philippines, South Korea, Singapore, Taiwan, Thailand and Vietnam. Middle East/Other includes smaller Asian markets not listed above and Central Asia.

Source: Credit Suisse Global Wealth Databook 2013, FGI analysis.

Both the split between financial and non-financial wealth and the degree of borrowing vary widely across countries and regions. North America stands out with 80 per cent of its net wealth held in gross financial assets. The variations within Asia are also marked, reflecting in large part the different stages of development of the economies and financial markets.

Private financial wealth in Asia is growing rapidly as a share of the global total

Separate estimates put global financial wealth at just under US$140 trillion in 2012 (BCG 2013; Credit Suisse 2013). BCG's 2012 estimates for Asia ex-Japan are higher than Credit Suisse's for mid-2013 (US$28 trillion vs. US$22 trillion) based on higher bottom-up estimates, especially for China and India. These are markets where transparency and data quality are less robust and change is rapid. Exhibit B provides more details at the country level:

Exhibit B. Private Household Wealth - All Wealth Levels (Selected countries, 2012 and mid-2013)

	BCG 2012 Estimates				Credit Suisse Mid-2013 Estimates				
	Trillion US$					Percentage of Net Wealth (%)			
	Financial Wealth	Financial Wealth	Non-Financial Wealth	Debt	Net Wealth	Financial Wealth	Non-Financial Wealth	Debt	Net Wealth
China	13.5	10.7	12.9	-1.4	20.2	49	55	-3	100
Australia	2.9	3.5	4.9	-1.7	6.7	46	81	-27	100
India	2.0	0.5	3.3	-0.2	3.6	17	87	-4	100
South Korea	2.3	2.2	1.9	-1.0	3.1	75	61	-36	100
Taiwan	2.5	2.1	1.2	-0.5	2.8	75	42	-17	100
Indonesia	0.4	0.3	1.6	-0.1	1.9	18	85	-2	100
Singapore	0.7	0.7	0.7	-0.2	1.1	56	61	-18	100
Hong Kong	2.1	0.7	0.6	-0.3	0.9	70	59	-29	100
Malaysia	0.6	0.3	0.3	-0.1	0.5	62	52	-14	100
Thailand	0.5	0.2	0.3	-0.1	0.4	60	56	-15	100
TOTAL	**27.5**	**18.8**	**24.1**	**-4.3**	**38.6**	**49**	**62**	**-11**	**100**

Source: The Boston Consulting Group, Credit Suisse, FGI analysis.

BCG estimates that Asian wealth has grown 12 per cent annually over the past five years, with the next five years also promising 11 per cent annual growth. Oliver Wyman estimates investable wealth held by those in emerging Asia with over US$200,000 in assets at US$14 trillion. Emerging Asia is defined here as Asia-Pacific excluding Japan, Australia and New Zealand.

Its rapid growth means that Asian wealth accounts for an ever-greater share of global financial wealth. BCG estimates that between 2007 and 2012, Asia ex-Japan's share of global wealth rose from 14 per cent to just under 21 per cent and it is forecast to rise to 28 per cent in 2017. Over half of all wealth growth globally between 2012 and 2017 will take place in Asia ex-Japan. Exhibit C provides more detail on the current and future wealth of different Asian countries.

Geographically, China's rapid growth and dominance of the total wealth pool stands out. In 2007, China accounted for 30 per cent of Asian private financial wealth. By 2012, this had risen to 48 per cent and it is set to increase to 57 per cent by 2017. Offshore wealth represents 7 per cent of the total, although it accounts for 14 per cent of millionaire wealth. This share is expected to stay stable.

Within private financial wealth, further estimates are available for millionaire wealth alone. In Asia ex-Japan, millionaire wealth is estimated at between US$9-11 trillion in 2012, forecast to grow at around 15 per cent annually over the next five years (BCG 2013; McKinsey 2013).

Exhibit C. Asia Ex-Japan Financial Wealth with Growth Forecasts: Country Details

	Ranking within Asia Pacific (ex Japan)		Future Regional Private Wealth Trillion US$		CAGR (%)	Percentage to Asia Total Private Wealth	
	2017	2012	2012	2017	2012 - 2017	2012	2017
China	1	(1)	13.5	27.5	**15.3**	48.2	**57.3**
India	2	(6)	2.0	4.5	**17.8**	7.1	**9.4**
Australia	3	(2)	2.9	3.6	4.7	10.3	7.6
Taiwan	4	(3)	2.5	3.0	3.2	9.0	6.2
South Korea	5	(4)	2.3	2.9	4.1	8.4	6.0
Hong Kong	6	(5)	2.1	2.8	5.5	7.6	5.8
Singapore	7	(7)	0.7	1.0	6.3	2.5	2.0
Indonesia	8	(9)	0.4	0.9	15.2	1.6	1.9
Malaysia	9	(8)	0.6	0.9	6.1	2.3	1.8
Thailand	10	(10)	0.3	0.5	8.6	1.1	0.9
Rest of Asia	-	(-)	0.5	0.6	3.3	1.9	1.3
TOTAL			**28**	**48**	**11.4**		

Source: The Boston Consulting Group, 2013.

c. Where are the sources of Asian wealth?

First-generation entrepreneurs are creating much of the new wealth

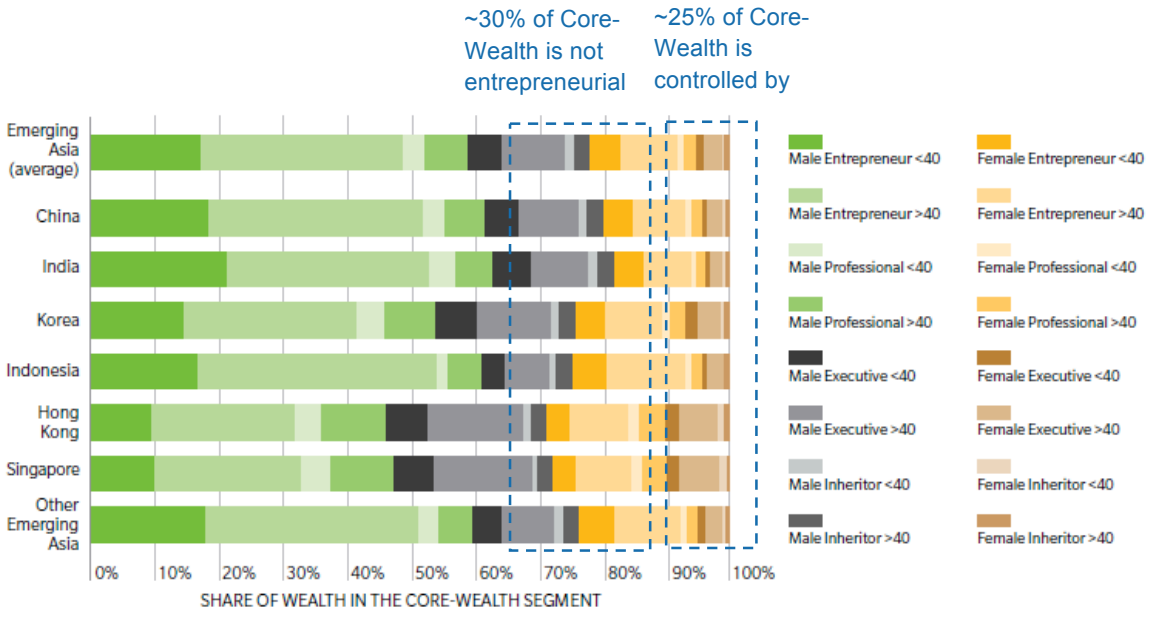
At its simplest, Asia's growth is generating substantial new wealth from business and economic activity, often created by first-generation business entrepreneurs and leaders. This first generation of wealthy is typically relatively young. In the U.S. and Europe, by contrast, wealth growth results to a larger extent from returns on existing financial wealth. The wealthy in those markets include a larger proportion of later-generation family business owners and professional managers who are on average older. From 2012 to 2017, around 85 per cent of Asian wealth creation will come from new wealth, rather than returns on existing financial wealth. This compares with a 50-50 split between new wealth creation and reaping returns on existing financial wealth in developed markets (BCG 2013).

The profile of the wealthy is rapidly becoming more diverse

Asia continues to evolve rapidly and the profile of the wealthy is becoming more diverse. Japan provides one indicator of the future where second- and third-generation business owners now hold the bulk of the wealth.

Exhibit D shows one set of detailed estimates on the sources of wealth across emerging Asia (Oliver Wyman 2012). Around 70 per cent of wealth is entrepreneurial and 30 per cent from other sources. Another study in China found that 59 per cent of the wealth came from running a business, 14 per cent from real estate, 12 per cent from financial market investments and only 10 per cent and 5 per cent, respectively, from salaries and family inheritance (CCB/BCG 2011).

Exhibit D. Sources of Wealth across Asia



Note: Taiwan is included with "Other Emerging Asia" markets.
Source: Oliver Wyman modeling and analysis.

d. Where is the wealth being invested?

Asia's asset allocation choices are similar to global averages, though bond component is low

Where wealth is invested depends on a number of factors: the products available, their expected risk/return and the preferences and experiences of the wealthy. Products can range from very large sums placed in traditional bank deposits to equities and bonds held either directly or via funds and specialist private equity funds and complex structured products developed by

investment banks. By its very nature, it is challenging to estimate asset allocation choices for a certain segment on a consistent basis.

Exhibit E summarizes recent estimates of asset allocation in the aggregate portfolios for Asian and North American millionaires. While different definitions make direct comparison difficult, there are a number of consistent themes that emerge.

Exhibit E. Comparison of Asset Allocation for Millionaire Wealth: Asia vs. North America

Boston Consulting Group, 2012			Capgemini/RBC, Q1 2013			McKinsey, 2012		
	Asia (ex-Japan)	North America		Asia (ex-Japan)	North America		Asia	North America
Cash and deposits	49%	30%	**Cash and deposits**	23%	21%	**Cash and equivalent**	32%	22%
Managed Funds	17%	28%	**Real estate (a)**	25%	14%	**Equities**	36%	35%
Direct Equities	19%	27%	**Equities**	22%	37%	**Bonds**	18%	25%
Direct Bonds	6%	15%	**Bonds**	17%	19%	**Other/ balanced**	7%	8%
Alternatives	9%	-	**Alternatives (b)**	14%	9%	**Alternatives**	6%	10%
TOTAL	**100%**	**100%**	**TOTAL**	**100%**	**100%**	**TOTAL**	**100%**	**100%**

Note: (a) Excludes primary residence; (b) Includes structured products, hedge funds, derivatives, FX, commodities, private equity.

Sources: BCG, Global Wealth 2012: The Battle to Regain Strength.
Capgemini/RBC, World Wealth Report 2013.
Mckinsey Global Wealth Database.

Asian millionaires hold a greater portion of their wealth in cash and cash equivalents in comparison to those in North America. The variation in the estimates for Asian deposit holdings is quite striking. Equity holdings are significantly lower in two of three estimates. Bond holdings are lower in all cases, with a very large difference in two estimates. Real estate investments are significantly higher than in North America, in the one source where a breakdown is available. Alternatives are quite established in Asia and have strong growth prospects.

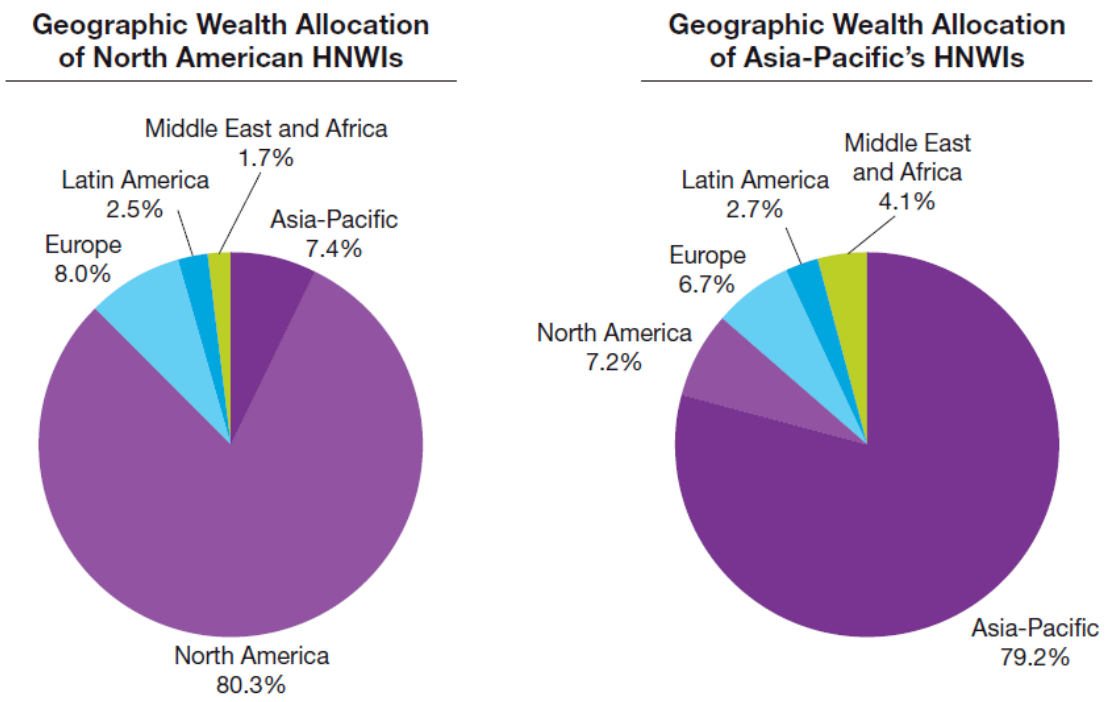
Within these aggregate numbers, there are always significant differences between individuals in their risk appetite, degree of investment sophistication and time horizon. Many Asian entrepreneurs have high return expectations given the returns that they have realized in their own businesses and the often-strong growth in domestic real estate markets. This is in contrast to a more common focus on wealth preservation in the U.S. and Europe and with those having longer-held 'older' wealth. Real estate investments in Asia are typically 'direct', into individual buildings rather than through funds or REITs (real estate investment trusts). Investment in equities is however significant and growing. There is some appetite for higher risk structured products that

offer a 'bet' and can also be seen as a competitor product for a trip to Macau or Las Vegas, though there has been increasing concern about the fee levels embedded in these products.

Wealth mostly stays at home, but there is scope for increasing cross-border investments

Globally, the wealthy today invest an overwhelming majority of their wealth in their home region. For example, 80 per cent of North American wealth is invested in North America, 74 per cent of European wealth in Europe and 79 per cent of Asian Pacific wealth in Asia Pacific (CG /RBC 2013). Exhibit F provides a comparison of the geographic investment profile for the wealthy in North America and Asia Pacific.

Exhibit F. Comparison of Geographic Holdings for North America and Asia



Source: Capgemini/RBC, World Wealth Report 2013.

Note: HNWI stands for "high net worth individuals."

Within Asia, it is likely that the wealthy hold their wealth even closer to home, in their own country rather than at the regional level. Capital controls in markets such as China and Korea play a critical role, though varying levels of investor sophistication and currency risk also contribute.

Many wealthy also find ways to place a portion of their wealth offshore through the invoicing practices in their business or through underground channels.

One survey (CMB/McKinsey 2012) found that 60 per cent of the Chinese wealthy hold overseas investments and for those 60 per cent, only around 10 per cent of wealth was held outside of China. Across Asia ex-Japan, only US$1.8 trillion of the US$11 trillion in millionaire wealth (16 per cent) is invested offshore with an estimated US$830 billion placed in Hong Kong and Singapore (BCG 2013). The remaining destinations for Asian offshore money are outside of Asia, with Switzerland and the U.K. leading the charge.

Experience in the U.S. and in European markets indicates that a substantial 'home country' bias will persist even as and when capital controls are removed. Nonetheless, there is significant scope for increasing integration of wealth flows across Asia. Research indicates significant pent-up demand by the Chinese wealthy to increase their holdings of overseas investments beyond current levels. In a survey (CMB/McKinsey 2012), 60 per cent of those interviewed wished to increase their overseas investments in the next five years for reasons of both risk diversification and product selection.

The other side of cross-border investment flows is the investments made by the non-Asian wealthy in Asia. This is particularly relevant in light of the strong economic trajectory and investment opportunities that Asia offers. Today, Asia Pacific's share of non-Asian wealth is broadly in line with the corresponding numbers for other regions – it is low. They invest 7.2 per cent of their wealth in North America and 6.7 per cent in Europe. By comparison, Europeans place 10 per cent of their wealth in Asia Pacific and 7.5 per cent in North America. North Americans place 7.4 per cent in Asia Pacific and 8 per cent in Europe. Attracting non-Asian wealth to invest in domestic Asian markets with the right products and financial markets is an important opportunity.

e. How is the wealth distributed?

Millionaires hold around 40% of private financial wealth globally and in Asia

Globally, private financial wealth is highly concentrated. BCG estimates that fourteen million millionaires – or just less than one per cent of all households – hold 40 per cent of global private wealth. For emerging Asia, the wealth is even more concentrated given the lower average GDP levels. Fewer than two million millionaires – or just under 0.2 per cent of all households – hold 39 per cent of private financial wealth (BCG 2013). When taking into account both financial and non-financial wealth, another study estimates that 4.7 per cent of adults have over US$1 million in wealth in the U.S., whereas in China only 0.1 per cent of adults are in this category (Credit Suisse

2012). Exhibit G shows that the share held by millionaires varies significantly among different countries.

The wide spread of private financial wealth in Australia means that many individuals have assets of up to, but less than, US$1 million. As a result, the proportion of the total held by millionaires of 19 per cent is significantly lower than the Asian and global averages. South Korea has also made a similar transition so that significant 'mass affluent' wealth exists alongside millionaire wealth and millionaires account for only 21 per cent of total wealth.

Exhibit G. Asian Wealth Concentration

	Percentage of Wealth Held by Millionaires (%)
China	40
India	36
Australia	19
Taiwan	39
South Korea	21
Hong Kong	83
Singapore	49
Indonesia	54
Malaysia	37
Thailand	33
Other Asia ex-Japan	38
TOTAL	**39**

Source: The Boston Consulting Group.

Asian wealth concentration is expected to increase – the rich will get richer

The outlook for the next five years, however, is that overall concentration in Asia ex-Japan will increase – the rich will get richer. Or more precisely, there will be increasing numbers of millionaires who account for a greater share of a growing private wealth pie. The mass affluent segment of those with personal wealth under US$1 million will grow too, but will not keep pace. The Boston Consulting Group estimates that millionaire households will account for 48 per cent of Asian financial wealth in 2017, up from 39 per cent today. While private financial wealth is estimated to grow 11 per cent annually until 2017, wealth held by those with US$5-100 million in assets is set to grow at 17 per cent annually. Wealth held by those with over US$100 million is forecast to grow over 22 per cent annually.

In light of this growing concentration and the even greater disparity in average income levels that exist in Asia, the deployment of this wealth to support and fund the real economy and benefit the whole population will be an important policy consideration. At the same time, it will be important to continue to support attractive returns to the owners of this wealth and encourage further wealth generation. This has implications for business leaders and regulators in the wealth management sector, and more broadly for policy decisions on fiscal policy and business transparency.

II. How Effectively Does the Financial Sector Support Wealth Management in Asia Today and for the Future?

Sustainability requires a sector that meets the needs of clients and the real economy more broadly while generating profits for financial institutions

An effective wealth management sector needs to fulfill multiple roles. It needs to serve the needs of its wealthy clients by providing advice and investment offerings that yield attractive returns. To be sustainable, financial institutions need to be able to generate profit for themselves within the prevailing regulatory framework and with appropriate risk management. And for true sustainability, the sector needs to generate those returns for clients and themselves by primarily supporting the real economy rather than through speculation. This allows society as a whole to benefit from the pools of concentrated wealth.

Wealthy investors are small in number but have significant assets that can help shape both the development of the economy and of the financial sector itself. The wealth sector can also make a significant contribution to jobs and GDP through its own successful activity and employment. Policy and regulation certainly need to address issues of prudential risk management, transparency and legitimacy. But in addition, policymakers need to put in place a framework that enables innovation in products and services in order to take best advantage of the private wealth pools for the development of the financial sector. This framework needs to recognize both the differing investment profiles of the wealthy and the fact that different wealthy individuals can have markedly different degrees of financial knowledge.

So where do things stand today? The growth in Asian wealth has been rapid and recent. The same is true of the Asian wealth sector. It is still nascent in terms of both appropriate business models and its regulatory frameworks. Businesses and regulators alike are grappling with finding the right approach. Doing a better job and supporting the continued strong growth in Asian wealth effectively will require an integrated perspective between wealth managers, regulators and policymakers. This needs to take account of the needs and specific investment preferences of the wealthy, the role that wealth plays in society as a whole and the need to address issues of risk and legitimacy. There are both national and cross-border dimensions, including the evolution of offshore centers. A review of the needs of the wealthy, the business models of financial institutions and the state of regulation and policy provides more details on both the issues and opportunities.

a. What are wealthy clients looking for and how is it changing?

Clients often remain skeptical of 'wealth management' and what it has to offer

Globally, research suggests that private banks manage around US$16 trillion of private wealth (Scorpio Partnership 2012). This is equivalent to 30 per cent of the private wealth held by millionaires around the world. Penetration of private banking in emerging Asia is certainly lower. One estimate is that US$11.4 trillion or nearly 90 per cent of private wealth in emerging Asia is unmanaged, using a US$200,000 cutoff for wealth (Oliver Wyman 2012). Penetration is estimated to be lowest for those with US$1-5 million in assets. This relatively low usage of distinct private banking services reflects both supply and demand side factors. On the supply side, regulations, capital requirements and resource constraints limit how, where and how fast private banks can expand their offerings and how well they meet client needs. On the demand side, some of the newly wealthy lack awareness of what wealth managers can do, while others do not see wealth managers as fully meeting their investment needs or bringing the right relationship management capabilities and experience.

Naturally, there are other routes for managing wealth than traditional private banks. All wealth is 'managed' in some sense, even if it is in a passive way or through a series of different relationships with banks, securities firms and trust companies. For example, Exhibit H shows the strong preference of Chinese millionaires for investing via banks:

Exhibit H. Preferred Investment Channels for Chinese Millionaires

Channels	Percentage (%)
Domestic Bank	68
Foreign Bank	39
Securities Company	16
Third Party Wealth Manager	13
Fund Management Company	8
Trust Company	6

Source: Hurun Report.

While there are many satisfied clients, private bank relationship managers have found that client trust fell sharply in the wake of the 2008 financial crisis. This collapse in trust stemmed to an extent from experiencing investment losses after many years of gains that in turn led to a closer questioning of decisions and fees. There are now signs that this trust is recovering. However, disclosures about the incentives and fees earned by relationship managers and their investment

banks through the aggressive selling of complex structured products had played an important role. Fee levels were often not transparent. There is a fundamental tension between relationship manager revenue targets and their product sales incentives on the one hand, and client needs for impartial advice on the other. One consequence is the growth in Asia (as in Europe) of external asset managers and multi-family offices that act as an intermediary between the wealthiest investors and the larger private banks. First-generation entrepreneurs also typically have different needs than those with inherited wealth in more established markets. They are often used to being very hands-on in investment decisions and have experienced high returns. They expect relationship managers to be older, have more practical experience and give pragmatic advice to address their circumstances. For global banks, this can require a change in approach.

The wealthy have many distinct needs that will continue to grow – for advice and for investment products

A healthy wealth sector will need to meet the distinct needs of the Asian wealthy now and in the future. Of course, the wealthy can have significantly differing objectives and attitudes to wealth management, in terms of risk appetite, time horizon and desire to delegate or actively manage. Fundamentally, however, in aggregate and for a portion of their portfolio, the wealthy are able to take a longer-term perspective, make less liquid investments, and take on greater, though still measured, risk. They will also seek increasing geographic variation to diversify investments and access additional opportunities. This creates a need for tax and investment advice across borders. Where their wealth comes and continues to come from their own businesses, they need advice on the interplay between personal and business wealth. Some will seek to manage this in an integrated way. Others will want to make ever-clearer separations between the management of personal and business assets, for example, by strengthening corporate governance and bringing in new shareholders through an initial public offering. As the new wealthy grow older, there will be a significant need for support and advice in managing transitions across generations. This demand is already growing rapidly across Asia. To prosper, financial institutions will need to develop business models that meet all of these needs profitably.

b. How are financial institutions responding and what is the business model?

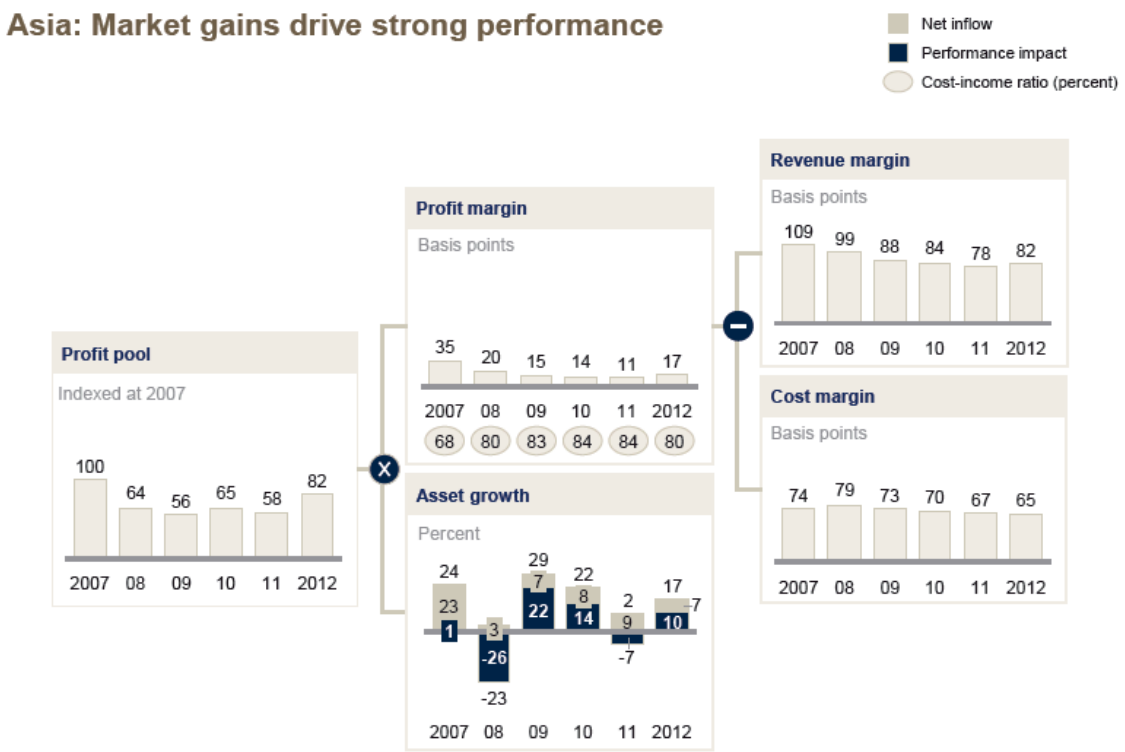
The growth of Asian wealth and the distinct needs that the Asian wealthy have are well known to global and local financial institutions alike. The opportunity is clear. Moreover, the low capital requirements of wealth management are attractive in the context of increasing global capital requirements in the banking sector. Global private banks and local banks, securities companies and insurers are keen to build wealth management businesses. Many have announced significant growth plans and expanded their business. But for many, profitability remains elusive as they

seek to build relationship management capabilities and product offerings that meet market needs in a complicated and fragmented regulatory environment.

Profitability remains challenging, with some recovery underway

Despite market growth, profitability has been under pressure – although 2012 has seen an improvement over 2011. Research by industry consultants tells a consistent story. In 2012, total private banking profits in Asia were 18 per cent below 2007 levels, with profit margins falling from 35 to 17 basis points and a cost-income ratio rising from 68 to 80 per cent (McKinsey 2013). In 2011, the corresponding numbers were 40 per cent below 2007 levels, profit margins of 11 basis points and a cost-income ratio of 84 per cent. Declining revenue margins have offset growth in assets. The revenue margin in 2007 was 109 basis points, falling to 78 and 82 basis points in 2011 and 2012, respectively. Exhibit I provides more details.

Exhibit I. Revenue, Cost and Profit of Private Banking in Asia



Source: Mckinsey Global Private Banking Survey 2013.

Wealth managers continue to be caught between revenue and cost pressures. Clients can be highly demanding in what they seek from relationship managers while balking at fee levels. The desire of so many competitors to capture market opportunities can lead to a willingness to yield on price. There is now, however, a much tighter focus on profitability. There is greater transparency and questioning about fee structures and how the bank earns its money. The potential sources of revenue remain the same and include fee for advice, a percentage of assets under management, commission charges on sales and trading, performance fees and spreads on deposit products. All wealth managers need to find some mix of these that enables them to earn profits while aligning incentives with fully serving client needs.

Some institutions offer a menu of pricing including fee for advice, flat charges as a percentage of assets under management and performance-based mandates. Nonetheless, the challenge of creating business models where the bank's and relationship manager's incentives are aligned with client needs in a way with which both sides are comfortable still remains.

Talent scarcity, investments needed for onshore expansion and regulation will continue to place stress on business economics

Rapid growth continues to create aggressive competition for talent. This is especially the case in relationship management, compliance and risk management. The result is higher compensation and higher cost-income ratios coupled with retention challenges as people move from bank to bank. Experienced talent is understandably scarce given the recent emergence of the sector, yet clients are, if anything, even more demanding of capabilities than in more established markets. Capital controls, regulations and country differences mean that the bulk of the market opportunity is onshore not offshore. Each onshore market has different regulatory and institutional contexts. Domestic players are often the best positioned for success and profit today, even if they lack some of the product and relationship capabilities of global wealth managers. Success in each market will require dedicated infrastructure, investment and management attention.

Investment attractiveness for global and local players rests on finding profitable business models that meet client needs. This in turn requires a product mix with attractive margins and a supporting cost base that has sufficient scale and productivity to leave a net profit. Wealthy clients typically seek an integrated, client-centric offer across all types of financial products. This broad product range is also important in allowing the bank to turn a profit. However, this can be in conflict with the separate licensing and ownership regulations for different products in a number of markets.

China – accounting for nearly 60 per cent of Asian wealth by 2017 – is a particular challenge for foreign players. Capital requirements for local banking incorporation, ownership limits on joint

ventures and the separated regulation and licensing of banking, securities and insurance all play a role. Commercial banks are unable to earn sufficient revenues from deposits alone and are not able to easily offer securities trading as part of their offering. Securities houses and trust companies that also target wealthy clients face their own constraints on product range and distribution – and, for foreign players, there is no straightforward route to a business with management control.

c. How effective are regulation and policy? Where should the focus be for the future?

In light of the rapid emergence and growth of Asian wealth, policymakers and regulators also face challenges in their approach to wealth management. The wealthy have only recently become a sizeable group in their own right within the financial sector. Regulation has often not needed to treat this group differently and as a consequence has often not done so. Regulators are grappling with how best to address risks and enforce compliance in fast-changing environments where transparency has historically been low. Critically, however, there has been much less focus on how to take advantage of private wealth funds to drive innovation in the finance sector – for example, by creating a larger investor base for capital markets, and supporting the real economy more broadly through financing and through job creation.

Strong regulator focus on compliance, information exchange and offshore centers

Globally and in each country, regulators have placed a strong emphasis on defining and fully implementing KYC (Know-Your-Client) and AML (Anti-Money laundering) processes for all clients. This implementation can be difficult in fast-growing economies where business and legal frameworks have also been evolving. For financial institutions, compliance issues now bring increasingly severe regulatory sanctions and reputational problems. In Singapore, for example, Monetary Authority Singapore (MAS) requires wealth managers to provide assurances that client money has been declared to the appropriate tax authorities and taxes have been paid accordingly. Seen more broadly, for Asia, these measures form part of a transition process to a more highly structured and formalized business environment. They may also go along with increased taxation scrutiny. Given the scale of private wealth, it is natural that such transparency increases. At the same time, such measures need to balance benefits against any losses from decreasing entrepreneurial activity.

On a global level, offshore centers have felt the greatest pressure. Worldwide, offshore wealth is estimated to amount to US$8.5 trillion (BCG 2013), with US$2.1 trillion originating from the Asian wealthy. Historically, an important part of the value proposition for many offshore centers was complete confidentiality, and thus the potential for money laundering and tax evasion. This has become unacceptable to major economies over the past several years for reasons both of

national security and fiscal policy. Disclosures on WikiLeaks of offshore accounts (for example, account details of prominent Koreans), and the payment by European tax authorities for clients' offshore account details have had a further impact. Cross-border cooperation with increased information flows on investment and tax compliance is a major focus for the OECD and G-20. It will only increase in the future.

In Asia, Singapore and Hong Kong are the major offshore centers. They have gained wealth inflows from Europe, at least in part due to a loosening of confidentiality conditions in Swiss banking. Critically, however, these centers have also been at the forefront of actions to maintain and grow offshore wealth activity based on capabilities and full compliance.

Domestic regulation at the institutional level often does not take into consideration distinct needs of wealth management

Domestically, most prudential regulation operates at the level of an institution, a bank, an insurer, a securities firm, and others. The customer base of each contains wealthy clients with distinct needs. These clients are generally not the prime focus of any regulation and so can end up treated with a 'one size fits all' approach more suitable for serving the less wealthy. It also means that less attention is paid to the economic viability of business models that result from the regulatory framework. The wealthy have a particularly strong need for advice and access to products across the full spectrum of financial services. Separate regulation by type of institution can either prohibit or make it uneconomic for institutions to offer the full range, either in-house or through referrals.

Regulations may need changing to support differences between types of investor. One example would be in which institutions are able to sell emerging financial products such as private equity or hedge funds. Similarly, investor protection regulation is often designed to protect the average investor with limited investment experience. Client qualification processes for wealthy investors need to incorporate concepts of 'sophisticated' or 'professional' investors to make allowance for differing levels of financial knowledge and risk appetite. At the same time, regulation needs to provide protection to wealthier investors who may still lack investment experience. Recent measures proposed by Hong Kong provide an example of consultations between regulators and industry, leading to different client risk profiling and simplified review processes for designated "Private Banking Customers" (HKMA 2012).

Less attention has been paid to wealth management as a means to shape financial and economic development

Beyond prudential regulation, Asian wealth offers a significant opportunity to shape financial reform, contribute to economic growth and generate employment. It is the offshore centers of

Singapore and, more recently, Hong Kong that have seen most clearly the opportunities that a vibrant wealth sector can bring. In 2002, Singapore's Economic Review Committee identified wealth and asset management as major growth areas for Singapore and proposed various policies to support this. These included support to small and mid-sized asset managers, favorable tax treatment and the strategic use of external asset management mandates by GIC and Temasek. As onshore markets account for the largest pools of wealth, the opportunity to create a vibrant wealth sector is open to all sizeable economies. Other countries also need to create strong wealth sectors that keep capital at home and attract overseas capital by virtue of the investment opportunities offered, rather than relying on capital controls alone to steer capital flows. This will also create jobs.

Across Asia, policymakers need to form a view on how best to mobilize and provide attractive investment vehicles for the wealthy that also meet financing needs in the real economy. Based on this, regulators can adjust product regulation and institutional license definitions as appropriate. Key aspects include a streamlined approach to product innovation, improved capital markets infrastructure and standards, and investor protection regulation appropriate to wealth investors. Across Asia, for example, the wealthy currently have high holdings of bank deposits. According to one estimate (Rutkowski 2013), around 54 per cent of Chinese deposits sit in the largest 0.2 per cent of bank accounts. The comparable number for the U.S. is 21 per cent of deposits. While around 35 per cent of deposits belong to non-financial enterprises, the proportion held by a small number of the wealthy remains significant. Shifting these large deposits into capital markets instruments will be an important element in rebalancing the Asian financial system towards larger capital markets alongside the banking sector.

The recent growth of wealth management products (WMPs) in China is an example of the rapid change that this can entail. With the advent of WMPs, attracting traditional deposits that are subject to an interest rate ceiling has become more challenging. Funds have flowed into less well-regulated off-balance sheet products with both shorter and longer-term maturities. Increased regulation now means that many of these WMPs do appear on both sides of the balance sheet, sometimes recorded as de facto deposits and sometimes not. By late 2012, WMPs were equivalent to 9 per cent of the banking system's deposit base and 15 per cent of new deposits, while small and medium sized banks relied on WMPs for 27 per cent of new deposits (HSBC 2013). Recognizing the benefits of innovation in strengthening non-bank financing channels, regulators are now addressing the risks entailed with these products.

The need to address the role that the wealthy can play remains, independent of the state of cross-border capital controls. Where cross-border flows are limited, capital is being wasted if the domestic sector is not playing the right role in channeling and allocating it between the owners

and users of capital. Where capital flows are liberalized, there is, if anything, an even greater imperative: a strong, domestic sector will help keep domestic capital at home, deployed for the benefit of the broader economy as an entry point for foreign private wealth to access and fund attractive opportunities. Capital controls are in any event increasingly difficult to police and are a poor means of keeping capital within domestic markets.

Some of the reluctance to put a spotlight on the wealth sector may flow from unease about the sources and legitimacy of some wealth and concerns in the population about the rich-poor divide. The extreme concentration of wealth in emerging Asia does indeed risk becoming a more politically sensitive issue, especially in times of weaker growth. Debates about transparency, ensuring the legitimacy of wealth gains and the appropriate level of taxation and tax compliance will persist. Continued wealth creation support will have a critical role in economic development. Used correctly, the wealth of the wealthy can also contribute to broad-based development of the financial markets.

III. What Can Policymakers and Business Leaders do to Create the Right Wealth Management Sector for Asia's Future?

The scale and significance of the growth in Asian wealth is undoubted. A strong wealth management sector will both generate investment returns for wealthy clients and make available significant financing for economic development. As Asian economic integration increases, there will be important opportunities nationally, across borders within Asia and to and from other regions. However, these benefits will not be realized without the clear development of a regulatory and policy framework that meets the needs of clients, financial institutions and broader society at the same time.

a. Policymakers need to create a regulatory framework appropriate to the needs of wealth management, making best use of Asian wealth in supporting development

For many good reasons, regulators pay greatest attention to the regulation of the largest financial institutions and to protecting the interests of the mass of consumers.

Wealth management divisions are either small parts of large global institutions or relatively small organizations, as in the case of Swiss private banks. As we have seen, the wealthy account for under 0.5 per cent of the Asian population, yet they have very different needs and often have different levels of financial knowledge than the rest of the population. However, the sheer scale of millionaire wealth (40 per cent of total private wealth) justifies a distinct approach that is both prudential and encourages the wealth to be deployed in ways that support the real economy.

More concretely, this implies a need to:

1. Create an institutional regulatory framework that supports development of capable wealth management businesses to meet the full range of client needs. There are two key dimensions, namely the product range that a single institution is able to offer and the process for new product innovation. Although the details can differ, a broader product offering under a single institutional umbrella not only meets the needs of many wealthy clients for integrated service, but also provides a broader base for business model profitability. Given the sources of wealth creation in Asia, it is particularly important to take account of business linkages to capital markets and investment banking development as new businesses seek listings and generate liquid wealth.

2. Tailor KYC and product sales processes to investor experience. This can allow for different approaches for experienced wealthy investors, while recognizing that not all wealthy investors are experienced.

3. Encourage the development of products that match the investment profiles of the wealthy investor with the needs of the real economy. For at least a portion of their portfolio, the wealthy are natural owners of longer-term and more illiquid assets with potential for a greater risk tolerance. Investment vehicles, such as private equity funds, bonds, venture capital and infrastructure funds, harness this profile for the benefit of the real economy. Angel investing can also help companies in their earliest stages. In many Asian markets, the institutional investor base is in an early stage of development. Millionaire wealth offers an additional source of significant assets that can help drive investment and liquidity in new financial instruments and capital markets. For example, Asian millionaire portfolios have relatively low bond holdings compared to those in other regions, reflecting the early stage of development of Asian bond markets. On the other hand, excessively complex structured products that essentially offer ways to place bets on future stock price and market index movements often bring little benefit to the real economy.

4. Work with industry to create training, increase the talent pool, and raise standards in relationship management, risk and compliance. The supply of talent is a critical constraint in offering high wealth management services that build client trust and manage risk and regulatory compliance. In 2003, Singapore increased its talent pool by establishing its successful Wealth Management Institute, working closely with industry partners and offering training programs and Master's degrees in wealth management. In Hong Kong, the Hong Kong Securities Institute has introduced the Certified International Wealth Manager program with the same objectives.

5. Engage with industry on how global experience can best be adapted to local markets and help build onshore wealth sectors with appropriate business models. There will be no 'one-size-fits-all' answer as the institutional contexts vary. However, elements of wealth management will be increasingly global and there is benefit in sharing experience across countries.

6. Continue to push towards full compliance and proactive engagement in TIEAs (Tax Information Exchange Agreements) across borders. Additionally, regulators will need to develop greater transparency on business and individual wealth holdings over time. They will also need to develop and enforce fully appropriate taxation for wealth in the context of overall fiscal policy and the country's stance on managing wealth creation and distribution.

7. Ensure regulations are appropriately customized to the specifics of wealth management (versus other segments) in offshore centers. Offshore centers have a strong future as centers of excellence for smaller economies that will not develop significant onshore markets and as a platform to access and integrate investments across Asia. This will

require the continued development of a regulatory platform that facilitates management and integration of investments across countries, while taking advantage of well-established rule of law and risk management.

8. Recognize the two-way nature of wealth flows (in and out), and manage opening of capital account flows in this context. For example, consider ways to attract additional, long-term investment flows from the wealthy overseas.

b. Financial institutions need to develop business models that fit the different contexts of wealth management across Asia

Mention of wealth management often conjures up images of discreet Swiss bankers and 'private banking', images that can seem detached from the bulk of the financial sector. Increasingly, however, wealth management is an important business opportunity for many different types of institutions. In Singapore, one in six people is a U.S.-dollar millionaire. Insurers, commercial bankers, and brokerage firms can all find opportunities to serve the wealthy. There will be a range of successful business models from boutique advisory to dedicated relationship management in a larger institution to close integration with investment banking operations and brokerage. Indeed, this diversity will help ensure not just competitive success, but also aid the stability of the financial system and its ability to react with resilience to future changes.

Senior leaders of financial institutions are well versed in the steps needed to develop profitable businesses within a defined regulatory framework. Given diverse client needs, diverse market contexts and the different starting points of the financial institutions active in Asia, a range of business models is likely to prosper. There is a debate about how successful "Swiss-style" relationship banking will be compared with brokerage-type approaches as in the U.S. and Japan. The scale and diversity of Asia will likely accommodate both approaches and others too. Domestic players will continue to have the advantage in onshore markets. Competitive pressures in offshore markets will only intensify as emerging Asian financial institutions also bulk up in these locations. For global wealth managers, network connectivity offers a source of advantage over purely domestic players. For example, a relatively limited onshore China presence together with a strong offshore presence can still be sufficient to serve the overseas wealth of Chinese clients. This is especially true for entrepreneurs, where there may be a broader corporate banking relationship.

Financial institutions also have an opportunity to engage more actively with regulators so as to ensure that the wealth management sector contributes the most it can to the economy in terms of products and jobs. Four areas of potential engagement stand out:

1. Be ready to experiment in combining experience from markets around the world and the specific conditions of different Asian countries. Demonstrate to policymakers how this experience and a global network can help create vibrant onshore financial sectors through practical suggestions that take into account local policy objectives and stage of financial sector development.

2. Lead rather than lag on all aspects of compliance and risk management, while making the link to business economics explicit. This has rapidly become a core element of business survival and reputation with regulators and the public. While facing many regulatory pressures, it will also be important to contribute specifically to the debate on how regulations should evolve further. Even more, financial institutions need to articulate clearly how regulations shape their ability to build profitable businesses. It requires step-by-step dialogue based on facts to increase mutual understanding between regulators and industry.

3. Engage with regulators to ensure that the contribution of the wealth management sector to the real economy is maximized. Policy in wealth management will inevitably involve questions of how society views income and wealth generation and distribution. Perceptions will play an important role. By engaging in proactive and fact-based discussion, wealth managers can help to clarify how appropriate regulation can support financing of the real economy and a strong wealth sector that contributes to jobs and GDP, while managing risks. Together, industry and regulators can create training, increase the talent pool and raise standards in relationship management, risk and compliance.

4. Look for opportunities to engage the wealthy on issues of philanthropy and corporate governance in their businesses. Philanthropy provides an additional route to broadening the way that wealth can have broader impact in society. It is currently at low levels in Asia, although it is starting to gain traction. Private banks can help the rise of philanthropy through their client discussions. As wealth matures and spreads across generations, helping clients strengthen corporate governance plays an important role in institution building across Asia. While not relevant in every situation, measures such as these help position private sector wealth as a constructive contributor to social, economic and institutional development on multiple dimensions.

Conclusion

Based on current forecasts, by 2017, Asian wealth will represent the largest pool of private wealth in the world. As the nature and scale of this wealth grows and changes, policymakers and businesses together have the opportunity to harness it to support and shape Asia's further growth. Developing the most effective wealth management sector for Asia's future will require ongoing dialogue and cooperation at both national and regional levels. Continued focus on compliance, risk management and transparency needs to go hand-in-hand with regulatory change that supports a focus on attracting wealthy investors, innovation and profitability. This will also lead to job creation and capable businesses that can attract the wealthy outside of Asia to invest in the region. The alternative is that capital flows increase away from domestic economies to offshore centers. The opportunity to harness Asia's wealthy investor base to drive innovation and change in the financial sector is significant and must be grasped.

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