ROLAND BERGER STRATEGY CONSULTANTS

think:act CONTENT

Fresh thinking for decision makers

When it comes to asset management | the island of Taiwan offers a large, | growing, and fairly open market | where foreign asset managers have thrived

ASIA ASSET MANAGEMENT:

CONSIDER TAIWAN

Taiwan economic and asset management snapshot

Indicators[1]		Indicators of Taiwan and as a percentage of those of mainland China (%)
Population	23 m	2%
GDP	USD 471 bn	6%
High net worth individuals	~ 70,000	14%
Mutual funds AuM	USD 152 bn	40%

1) 2012 figures excluding high net worth individuals (2010)

Source: EIU, SITCA, CLSA, World Bank

Aside from its electronics and high-tech manufacturers, Taiwan does not garner as much attention as it once did in Asia's economic landscape. With large, rapidly growing neighbors, the island looks at first glance like a lightweight in a region of giants. With 23 million people and a USD 47 billion economy, Taiwan's population is only 2% as large as mainland China's, and has an economy equal to 6% of the mainland's GDP.

In the financial services industry, and indeed in most other industries, a size discrepancy that large is certain to drive strategic priorities. As a result, for over a decade foreign banks and asset managers have quite understandably had their eyes set on mainland China's huge and rapidly growing banking assets and pool of affluent individuals.

But size alone is not everything. A number of international groups operating in mainland China have experienced dashed hopes and unfulfilled promises. For all its affluence, the financial sector in the Chinese mainland remains heavily regulated, increasingly competitive, and not necessarily profitable for foreign players.

Across the strait, Taiwan holds banking assets one-tenth the size of those held in mainland China, but when it comes to asset management, the island offers a fairly open regulatory environment supported by solid economic fundamentals. With numerous available options for growing a local footprint, Taiwan is, in fact, one of Asia's most attractive markets for foreign asset managers.

Taiwan's population is only 2% as large as mainland China's, and has an economy equal to 6% of the mainland's GDP.

1.

Taiwan is

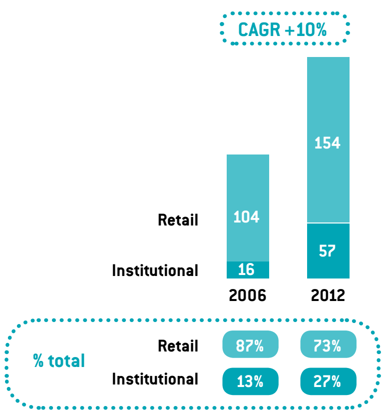
3 times

richer than mainland China in terms of GDP per capita

Over 70 in 1000

people will be HNWIs in Taiwan by 2015, versus a dozen in mainland China

Taiwan retail and institutional AuM in USD bn at year end, 2006-12



Source: SITCA, Labor Pension Fund, Bureau of Labor Insurance, Roland Berger analysis

Taiwan remains one of Asia's most attractive asset management markets for foreign players

a) Strong economic fundamentals

With a per capita GDP of more than USD 20,000 in 2012, Taiwan is on par with South Korea and over three times as wealthy as mainland China, and it is getting richer. The economy rebounded quickly from the 2009 recession, and while growth in 2012 was slow, it is expected to reach 3.4% in 2013 and accelerate to 5% after that. In addition, a deeply rooted household culture of thrift and a rapidly aging population means that much of Taiwan's wealth goes into savings and investments. Taiwan enjoys a fairly stable 30% savings rate, high even by Asian standards.

As a result, Taiwan represents a large pool of relatively low-debt investors who hold most in their wealth in financial assets. While the mass affluent segment makes up most retail investors, Taiwan is also home to over 70,000 HNWIs, comprising 0.4% of the adult population, a ratio second in Asia only to Singapore and Hong Kong, and well above that of mainland China. The proportion of HNWIs is expected to exceed 0.7% by 2015.

b) Investor appetite for foreign assets

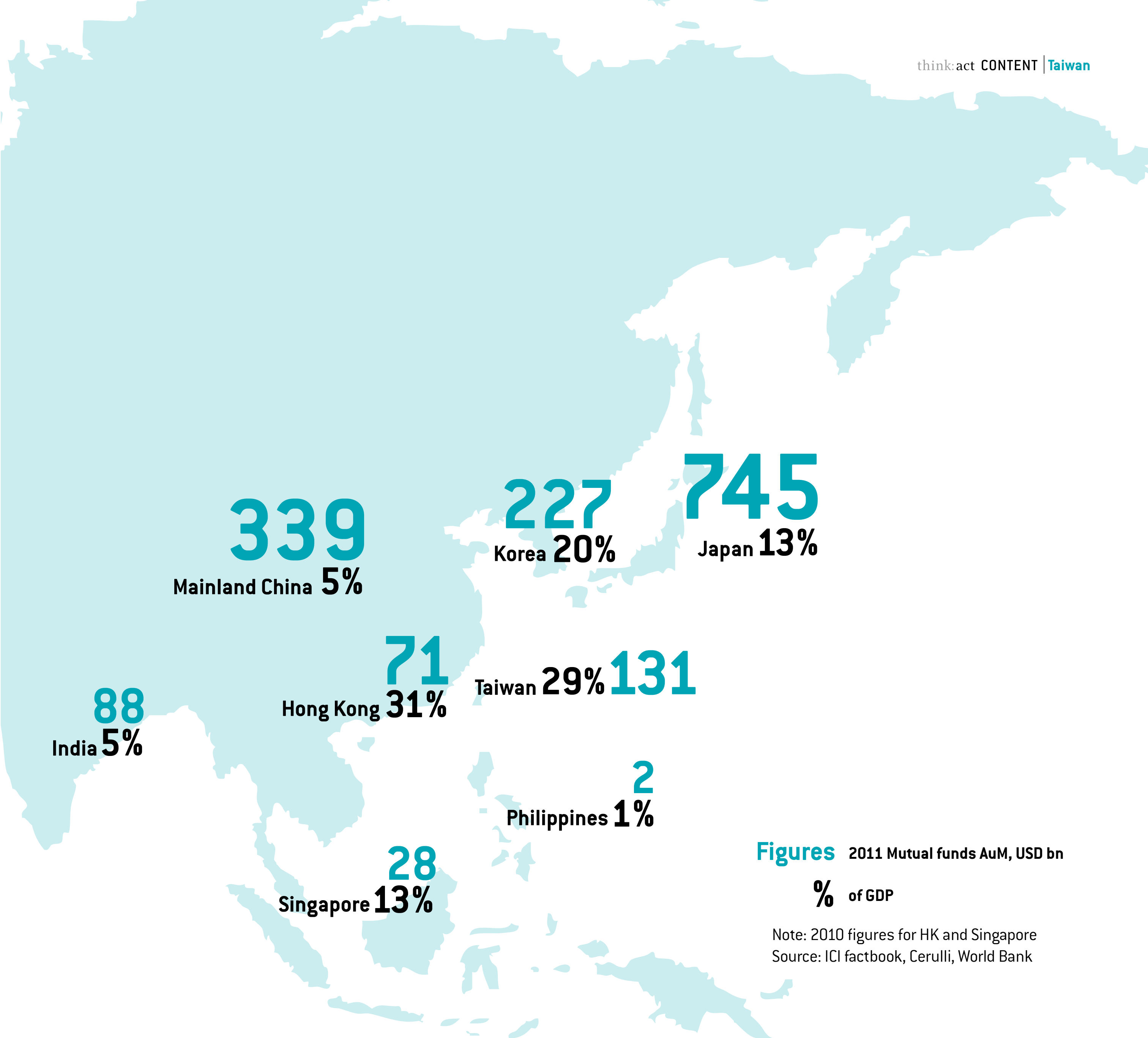
These distinct investor segments naturally display different levels of financial sophistication. Mass affluent investors in particular can be fickle and are often over reliant on past performance and rumors, leading to high assets turnover. Yet, most investor categories share a strong appetite for risky assets.

Taiwan's domestic investment environment, however, suffers from a general perception of low returns, poor transparency, and an unequal playing field, as well as a diffuse but real uncertainty about Taiwan's economic and political future. Also, the size of Taiwan's financial markets compared to domestic investable wealth is a natural limit.

Overseas assets have therefore benefited from strong demand from retail and institutional investors seeking enhanced yield. In particular, offshore mutual funds have developed as an alternative vehicle to onshore funds, as they can help alleviate currency risk, diversify assets and often provide high-quality customer services.

c) A large and growing asset management market

Backed by these solid economic fundamentals and entrenched investing culture, Taiwan has become a relatively large asset management market over the past 20 years. After 10% growth p.a. for the past 6 years, total AuM exceeded USD 200bn at the end of 2012. Taiwan's asset management market retains a clear retail focus, with mutual funds accounting for almost three-quarters of total assets under management.

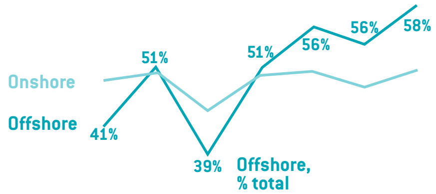


Note: 2010 figures for HK and Singapore
Source: ICI factbook, Cerulli, World Bank

On the retail side, mutual funds AuM were strongly impacted by the 2008 financial crisis, but totaled a record USD 252 bn as of the end of 2012. That is equal to roughly twice the value of mutual funds AuM in Hong Kong and 40% the value of those in mainland China. The figure is also quite high relative to GDP; Taiwan's mutual funds AuM/GDP ratio stood at 29% in 2011, compared to 20% in South Korea, 13% in Japan, and only 5% in mainland China.

Beyond sheer size, what sets Taiwan's retail market apart is the considerable success of offshore funds. Since 2006, offshore funds have captured new assets while onshore AuM have remained flat. As a result, they now represent close to 60% of total mutual funds assets. Unit-linked insurance products, mixing life insurance and mutual funds, have also become a key investment vehicle. And with households still holding 39% of their financial assets in cash and deposits and 25% in shares, retail opportunities still abound.

Taiwan onshore and offshore mutual funds AuM (in USD bn), 2006-2012



Source: SITCA

On the institutional side, though Taiwan's market is small in absolute terms it had posted rapid growth. Indeed, in recent years, major government funds have seen their investable assets swell by 10% p.a., reaching USD 135 bn in 2011. Over the same period, external mandates have grown rapidly due to increasing outsourcing trends, driven primarily by the LFP (Labor Pension Fund).

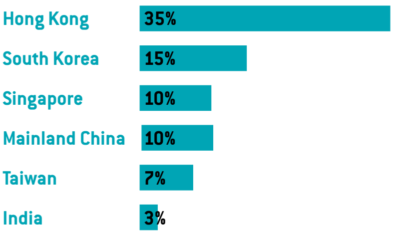
As a result, externally managed assets from government funds have expanded by 40% p.a. since 2006. As a whole, Taiwan's pension funds now allocate almost half of their assets to external managers.

Taiwan, however, still shows further growth potential due to expected additional institutional outsourcing. At the end of 2011, Taiwan's outsourcing ratio was only 7%, compared to 10% in Singapore and mainland China, 15% in South Korea, and 35% in Hong Kong.

Institutional outsourcing in Asia

Taiwan retains a high potential for further institutional outsourcing

Institutional outsourcing ratio in selected Asian countries (2011)



Source: SITCA

Taiwan's asset management industry is not only one of the most dynamic in Asia, but also one of the most open, with only limited differences in the treatment of domestic and foreign companies.

Registration with SITCA, Taiwan's industry body, is open to all asset managers, and there are no foreign ownership caps. Regulations also enable foreign companies to choose from a wide range of setups, from simple registration and no or minimum local investment to a full-blown onshore presence.

Taiwan is quite open to offshore funds, which have been distributed there for over 20 years. Foreign companies can choose between two basic models to distribute offshore funds:

1. Companies aiming to limited their investment in Taiwan can partner with a local "master agent," which then uses its own set of distributors to market the funds for a commission;

2. More committed managers can set up a local structure and apply for their own master agent license, thereby obtaining higher control over their distribution.

Additionally, foreign players are also allowed to manufacture and distribute onshore funds through a local SITE , and many actually do so.

2.

Opportunities for foreign players

a) Foreign players have conquered Taiwan's retail market

Thanks to its large market and favorable regulatory environment, Taiwan has attracted all types of asset management houses in the past decade, from large global managers to smaller foreign players. As of 2012, 67 foreign managers operated in Taiwan under various setups, of which 19 have a full-range of offshore and onshore capabilities. Others mostly focus on offshore funds.

Leading asset management houses entered Taiwan's market early, building significant market share over the years. Today, most of the top 20 global asset managers, such as BlackRock, Allianz, Fidelity, J.P. Morgan, and Amundi, are active in the retail segment.

In fact, foreign managers have been so successful that 8 of the top 10 retail players are foreign, while only 2 are domestic (Yuanta and Capital). Overall, foreign players controlled almost three-quarters of mutual funds AuM at the end of 2012, versus two-thirds in 2006.

b) Key success factors for global players

The success of foreign asset managers in some ways reflects the limited size of domestic financial markets, the poor performance of domestic stocks, and low domestic bond yields. However, it is mostly the result of a skillfully planned, successfully executed strategy. Key success factors include:

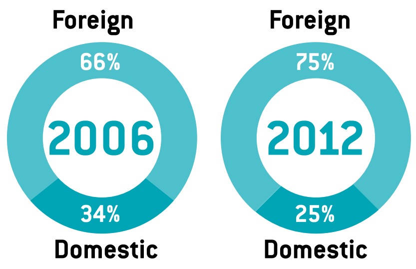
> Continuous investment: Top players have a master agent license and can therefore distribute their own and third-party offshore funds. They have also invested in relationships with sub-distributors, primarily by paying commissions up to 100% higher than those offered by onshore funds managers.

> Large, broad distribution networks for both onshore and offshore funds: These allow players to leverage local capabilities and typically between 30 and 50 sub-distributors.

> Product and services differentiation: Players continuously offer new performing funds (mainly equity and fixed-income), as well as high-quality services through dedicated local staff and value-added end-customer platforms.

> Operating history and market commitment: All of the top 5 players have built strong franchises over 10 to 20 years in Taiwan.

Taiwan retail AuM by manager origin



Source: SITCA

> Onshore presence: Successful managers have established a local presence, and some foreign players such as J.P. Morgan and Allianz have, in addition to offshore funds, gained sizeable shares of the onshore funds market.

While historical leaders top the rankings, more recent foreign entrants have also managed to build strong retail positions over the past five to six years by following a similar strategy. Pioneer Investments is a prime example. Starting as a mid-sized manager with no significant base in Asia and no presence in Taiwan until 2005, Pioneer now ranks 6th or 7th among the offshore funds players, with around USD 4 bn AuM at the end of 2012. While it now offers 18 offshore funds through its master agent, ING, virtually all of AuM has gone to just two highly performing bond funds focused on high-yield securities. Taiwan, therefore, offers significant potential for rapid growth for good products that are backed by the right distribution strategy.

Pioneer's top offshore funds in Taiwan

Global High Yield
> Inception: 2004/2006
> Total size: USD 3,414 mn
> Taiwan investors holdings: 59%
> Type: Bond
> 3-year returns: +11.9%
> Objective: Invest primarily in sub-investment grad debt and debt-related instruments of capital worldwide

Strategic Income
> Inception: 2003/04
> Total size: USD 3,502mn
> Taiwan investors holdings: 42%
> Type: Bond
> 3-year returns: +9.7%
> Objective: Provide a high level of current income in the medium to long term by investing at least 80% of its assets in debt and debt-related instruments including mortgage-related and asset-backed securities

Source: Pioneer Investments

3.

Recent developments and new challenges for foreign players

a) Regulatory changes favor onshore retail

To some extent, offshore funds have become victims of their own success. Indeed, Taiwanese authorities make no secret of their dissatisfaction with the foreign-dominated retail industry status quo. Having opened the market to international competition, powerful global houses with strong brands, considerable means, and unmatched investment capabilities have snatched up ever greater amounts of Taiwanese assets.

Most notably, authorities have made it more difficult to register offshore funds locally, placed 70% cap on Taiwanese investments in offshore funds, and required full disclosure of all commission fees paid to sub-distributors. This last measure aims to make the higher commissions paid by offshore funds to sub-distributors more transparent.

While these regulatory initiatives have not significantly impacted flows to offshore funds yet, they could lower long-term profitability for foreign managers.

b) Heightened competition and consolidation

At the same time, the largest offshore retail players continue to gain market share at the expense of smaller competitors. Of the 54 active managers offering over 1,000 offshore funds, the top five firms (Fidelity, AllianceBernstein, Franklin Templeton, BlackRock, and J.P. Morgan) hold two-thirds of the market, totally USD 54 bn in AuM. The 14 tier-two players are global managers with between 1% and 6% market share, and the remaining 7% of offshore funds AuM are being fought over by more than 30 players.

In onshore retail, foreign players have been resorting to M&A as a way to speed up localization, while domestic managers have acquired competitors to enhance capabilities, expand platforms, and reach critical scale. In 2011 alone, AllianceBernstein snapped up Taiwan International Investment Management, Mirae Asset acquired 60% of TGL Asset Management, and Yuanta acquired Polaris, its domestic competitor, becoming the top onshore funds house. Onshore consolidation has started to gather momentum; the top ten onshore players held 63% of total AuM at the end of 2012, up from 59% in 2010.

Taiwan's retail market has thus become more difficult for foreign managers that do not have critical scale or clearly differentiated products. Even global managers with otherwise strong expertise and products have failed to realize most of their growth potential.

Top 5 players
offshore retail
Control 2/3 of AuM

Top 10 players
onshore retail
Control 2/3 of AuM

(figures as of end 2012)

c) What's next for foreign asset managers?

However, even without a presence in Taiwan, product expertise, a strong performance track record, specialization, and providing offerings that are tailored to institutions' changing needs remain the key criteria for winning mandates.

Taiwan's retail market requires a more complex approach. While other managers' experiences may not be fully replicable in today's market, the key pillars of success remain in place:

- Leverage core product strengths by marketing the best performing funds.
- Focus on products and/or customer niches where competition is less intense.
- Build a strong distribution network that balances capabilities and those of partners.
- Last, but not least, build up brand equity.

One of the key attractions of Taiwan's retail market is the flexibility of available business models. Foreign players can adopt the setup that best matches their current strengths and strategic goals, but keep the option to change that setup in due time. For instance, managers with strong products but no significant resources to invest in Taiwan can engineer a light setup through a master agent agreement with a third party, which provides good market exposure at a limited cost. Other managers ready to invest additional resources may consider developing a local sales force to support marketing efforts.

A footprint in Taiwan can, therefore, be established step by step, starting with a limited local presence to get a sense of the market and possibly then expanding local capabilities.

With its large, growing, and open market, Taiwan is a valuable bright spot for foreign asset managers establishing an Asian footprints. The island, though economically small in comparison to the giant that is mainland China, certainly deserves a greater share of the world's attention.

IF YOU HAVE ANY QUESTIONS, PLEASE FEEL FREE TO CONTACT US:

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