

ASIA BANKING AGENDA 2017



INTRODUCTION AND EXECUTIVE SUMMARY

The Asian banking sector¹ can look back at an outstanding trajectory over recent years. The sector has expanded its size, measured in total assets, by about 70 percent since the global financial crisis. After banks in North America and Europe reduced their risk-weighted assets, Asian banks today account for 40 percent of total global assets, compared to 27 percent in 2009.² Asian banks have achieved this top-line growth while maintaining an average return on equity above 10 percent,³ clearly higher than US or European peers.

However, the road ahead looks much less predictable, and several factors make it urgent for many banks in Asia to take action:

- Macroeconomic growth is slowing down
- Past growth has pushed debt-to-GDP ratios into critical territory
- Non-performing loans (NPLs) are rising
- Global trade and capital flows are being challenged by a stronger US dollar and looming protectionism
- Digital disruption is challenging traditional business and operating models

As a result, metrics like net interest margin (NIM) are coming under pressure, and confidence in Asian banking has been dented. Compared to compound annual growth rates (CAGR) in assets of 10 percent in the recent past, these have slipped to around 7 percent.⁴ Banks will need to work with even lower baseline growth scenarios in the next few years – which will cause declines in return on equity (ROE).

To keep growing at a similar pace and maintain ROE above 10% Asian banks have to take action. The core levers for growth will be financial deepening and digital in retail and SME segments and innovation in wholesale banking. While improving capital efficiency through risk management, nimble underwriting and a heightened focus on operational efficiency will contribute to improved economics.

This Oliver Wyman report looks across different markets and segments in Asian banking and attempts to distil a broad banking agenda for the region for 2017. Not every topic will be relevant to every market, segment, and institution. But these themes should be the overarching priorities in 2017 and will decide the winners and losers in the next stage of Asian banking. As such, this report will serve as a reference point for comparison and consideration when shaping an individual bank's agenda. We are confident this agenda can refuel growth and maintain ROE at or above current levels.

1 Scope including the largest bank holding companies in Asia based on total assets. Only banks that provide both loans to retail, SME and corporate clients and take deposits from retail clients are included in this study. The Top 30 ranking does not include foreign-owned banks. Foreign-owned subsidiaries are included in the country breakdown

2 Total bank assets for banks included in MSCI World and respective regional sub-indices for Asia (incl. Japan)

3 Return on Equity for banks included in MSCI World and respective regional sub-indices for Asia (incl. Japan)

4 Based on recent 2013 to 2016 growth of the Asian banking market by assets as reported by Business Monitor International

Taking a wide range of factors into account, our Asia Banking Agenda 2017 carves out five engines of future momentum. Each implies some specific actions:

1. REGAIN CONFIDENCE

Many Asian banks suffer from concerns over the quality and stability of their books because of high corporate and private leverage, rising NPLs in several markets, and potential asset bubbles. To regain confidence, Asian banks should pro-actively provide greater transparency over the quality of their balance sheets; tackle high leverage and NPLs head-on; improve effectiveness and efficiency in their risk, compliance, and audit control infrastructures; move risk management closer to the front office; and engage with regulators and the public about risk culture and ethics.

2. MAKING WHOLESALE NIMBLER AND MORE SOPHISTICATED

Corporate and institutional banking is the backbone of the Asian industry, and has historically been driven by lending to large corporations. Margins are under pressure in plain-vanilla lending, and clients are demanding increasingly sophisticated services. As a result, the traditional wholesale banking model needs to be transformed. The service model and corporate client selection need to become nimbler and more differentiated, and they should include an ecosystem-led approach. Relationship management should be made more effective. Efficiency can be increased through digitisation and the professionalisation of underwriting. Financing should be shifted to capital markets.

3. TAILORING AND DIGITISING CONSUMER AND SME PROPOSITIONS

Retail banking is a main growth area in Asia. It is driven by financial deepening, especially in emerging markets, and by high wealth levels and the evolving demands of changing societies, particularly in more mature markets. Actions to capitalise on these opportunities need to be nimble and tailored to individual markets and segments. Yet four broad imperatives hold across the region: Respond to fast-evolving new consumer demands; better serve small and medium enterprises (SMEs); develop a next-generation wealth- and asset-management offering; and surprise customers with a more emotional experience and by applying digital technology – including Fintech – in all these areas.

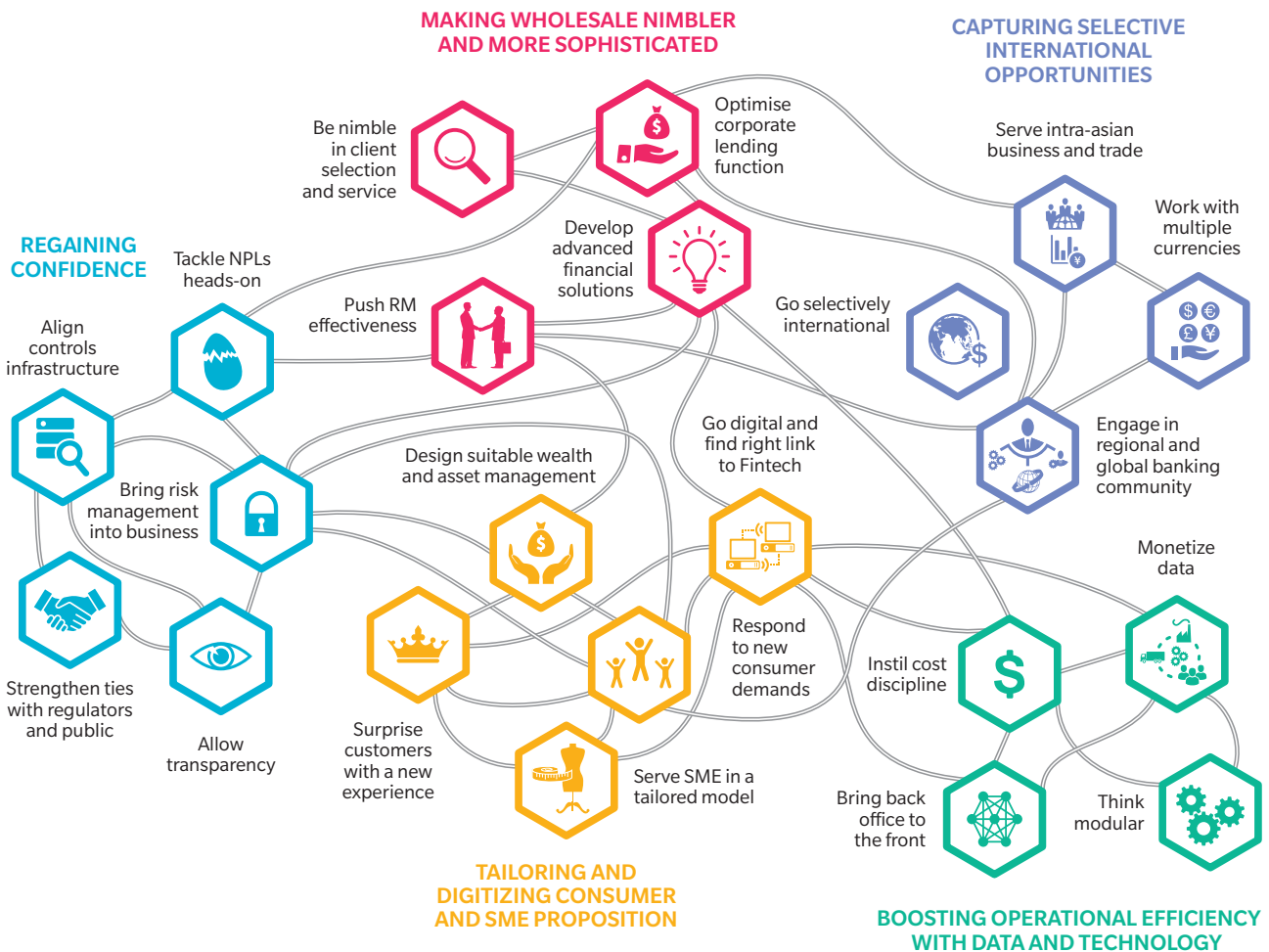
4. CAPTURING SELECTIVE INTERNATIONAL OPPORTUNITIES

Asian banks must design their international strategies amid a changing global political landscape. Global trade and capital flows are being challenged, but Asian commercial integration is continuing, fostered by bold initiatives such as One Belt, One Road (OBOR). Foreign exchange markets have become volatile, and the renminbi's growth as a currency for trade has slowed a bit. Some global banks are retrenching, and many Asian banks have the scale to fill the gaps left over – but they might be hesitant because of mixed experiences in the past. We suggest that Asian banks take a longer view and seize selective international opportunities in four areas: They should serve intra-Asian trade and business connectivity; pursue select international businesses as others retrench with the right mix of acquisition, business development, or partnership; prepare to work with multiple currencies, especially the renminbi; and develop networks in the regional and global banking communities. All this should serve Asian banks' longer-term goal of being ready to capture international opportunities when they arise.

5. BOOSTING OPERATIONAL EFFICIENCY WITH DATA AND TECHNOLOGY

Most Asian banks have benefitted from top-line growth with high, stable NIMs. They have therefore made less of a priority than their European and North American peers of operational efficiency, optimum use of technology along the value chain, and cost discipline. Now that the outlook is potentially more volatile, Asian banks need to make improvements in these areas. In particular, they should take four kinds of action: Integrate the value chain “front-to-back”, think more in modular and agile terms, instil cost discipline, and use data and analytics effectively. Action in all these areas together can sustain top-line momentum and high value creation in Asian banking. This in turn will foster macroeconomic growth and prosperity in the region.

The following sections provide some context on the state of Asian banking. They are followed by greater detail on how each of these five engines can advance the Asia Banking Agenda 2017.



SCENE SETTING: A CASE FOR ACTION TO SUSTAIN MOMENTUM

By most parameters, Asian banking has been a success since the global financial crisis.

Growth champions. Asian banking assets have grown by close to 10 percent annually since 2009. However, banking assets in North America and Europe have stagnated or declined slightly, limiting the growth in overall global banking assets to just 2.5 percent a year.⁵

Big and strong. Asian banks now hold 40 percent of the global total of banking assets. More than half of the 10 largest global banks by assets come from Asia, notably China and Japan.⁶

Profitable. Asian banks have maintained average return on equity levels of above 10 percent, with especially high ROE levels in China and some South East Asian markets. Accordingly, global banking profits have shifted towards Asia, and the market capitalisation of Asian banks has grown substantially in recent years.⁷

Increasingly sophisticated capabilities. Asian banks have adopted international standards in accounting and risk management. They also increasingly deliver best-practice capabilities in sophisticated areas such as structured finance, equity capital markets, and debt capital markets. Many Asian banks and Fintech start-ups are among the world's leaders in innovative marketing and the use of digital tools in customer service and distribution.

Successful domestic and regional banks. Domestic and regional institutions' share of Asia-Pacific banking is large and has increased substantially. They now have about 75 percent of the total banking market, up from 60 percent in 2009.⁸ Often, these banks have understood how to serve evolving private and corporate needs. They have also benefitted from local regulations and filled gaps left by retrenching global banks.

See our Asian banking factsheet for more detail.

⁵ Total bank assets for banks included in MSCI World and respective regional sub-index for Asia (incl. Japan)

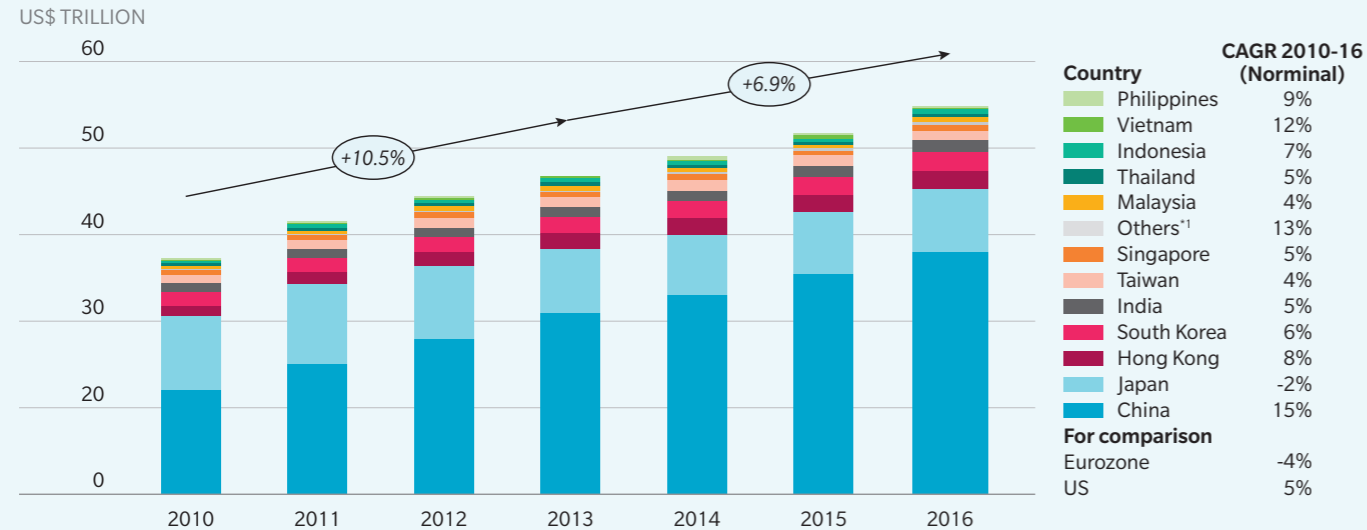
⁶ Based on reported Q2 2016 figures (Source: S&P Global Market Intelligence)

⁷ Based on 2010 to 2015 growth in market capitalisation (Source: S&P Global Market Intelligence)

⁸ APAC regional revenue tracked for representative sample of 36 Asian and non-Asian banks (Sources: S&P Global Market Intelligence, Bloomberg)

ASIAN BANKING FACTSHEET

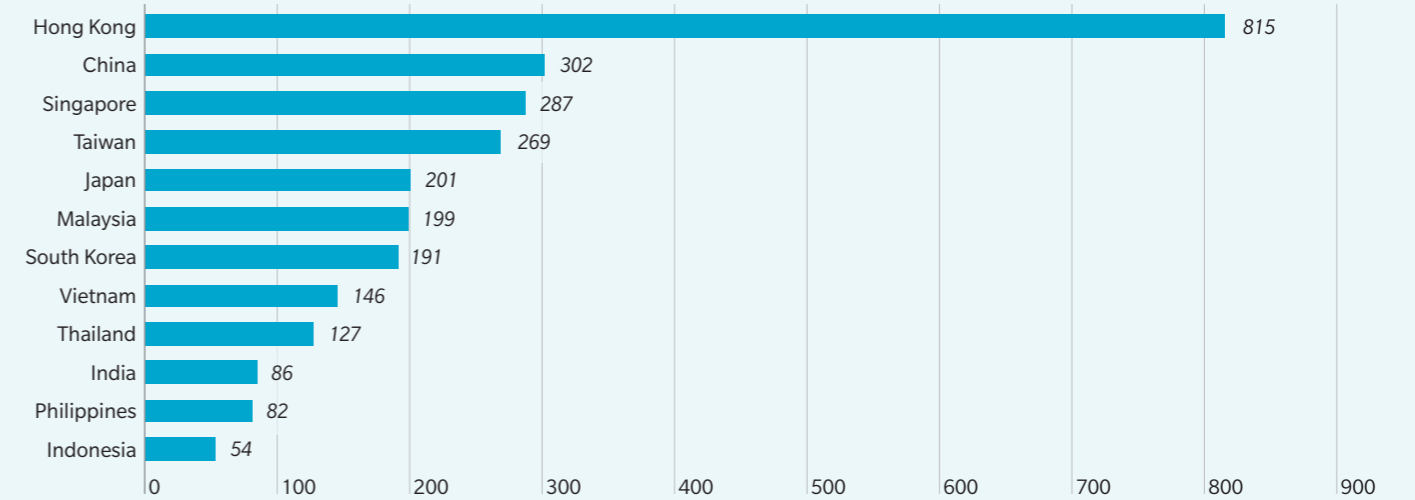
EXHIBIT 1: GROWTH OF THE ASIAN BANKING MARKET (BY ASSETS OVERALL AND BY MAJOR COUNTRY, 2010-2016)



*1 Others includes Bangladesh, Pakistan, Sri Lanka
Source: Business Monitor International

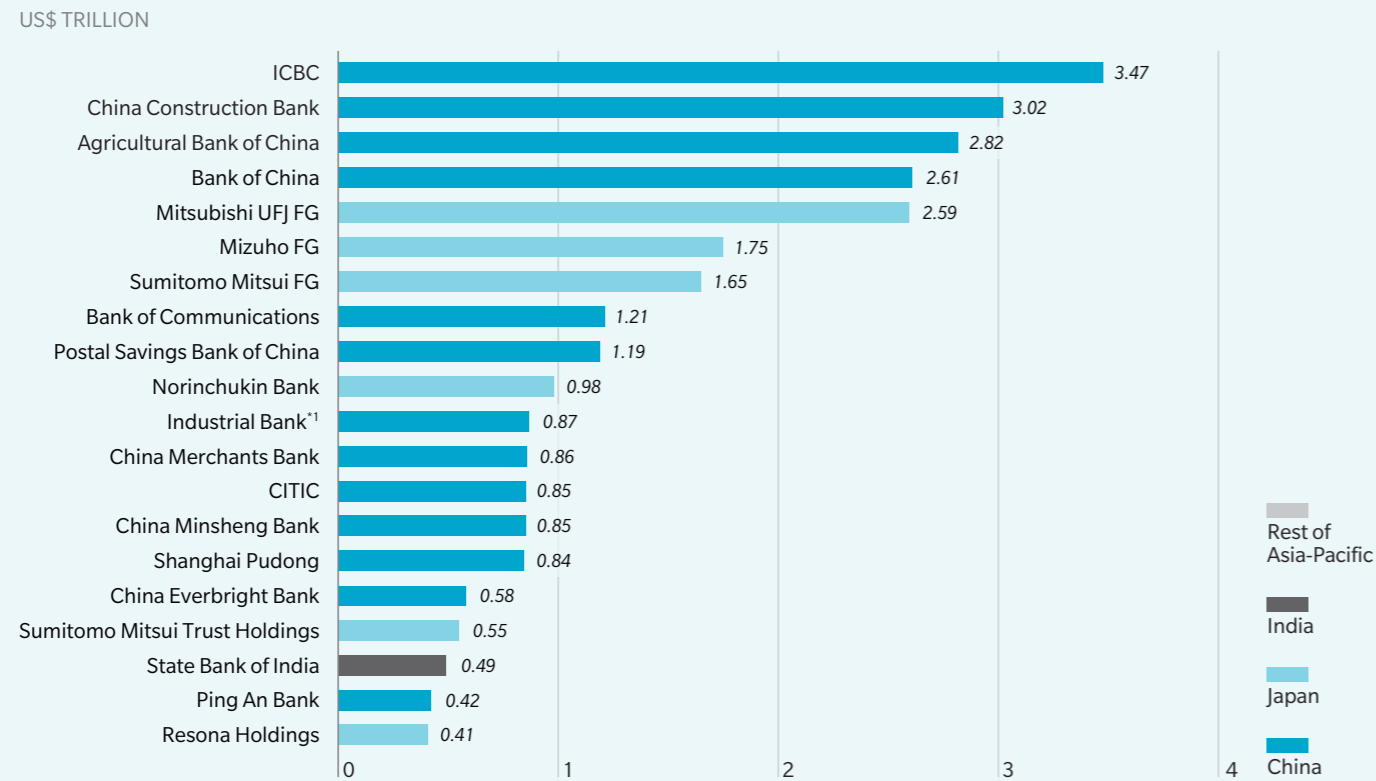
EXHIBIT 3: MATURITY STAGE OF ASIAN BANKING MARKETS

BANKING ASSETS AS PERCENTAGE OF NOMINAL GDP IN 2016 BY COUNTRY



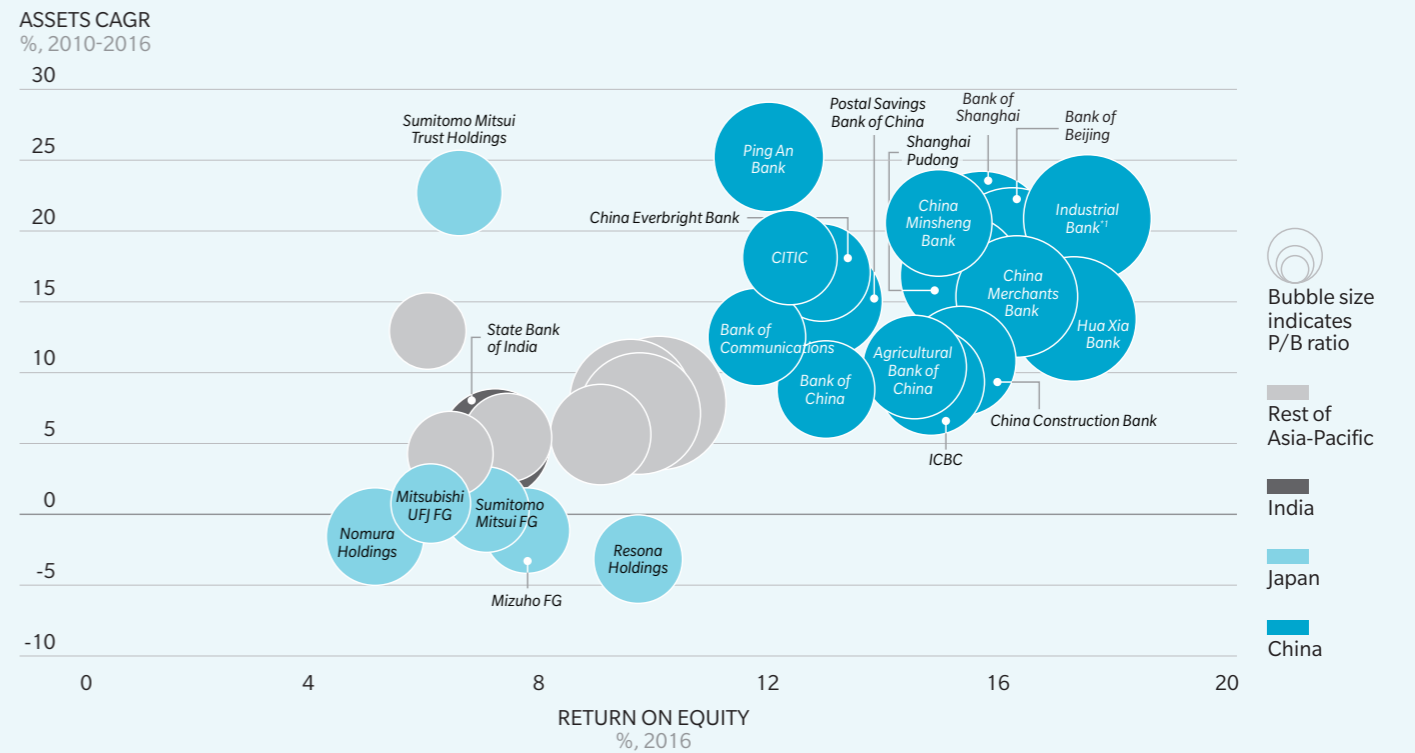
Source: Business Monitor International

EXHIBIT 2: TOP 20 BANKS IN ASIA BY TOTAL ASSETS AS OF YEAR ENDED 2016



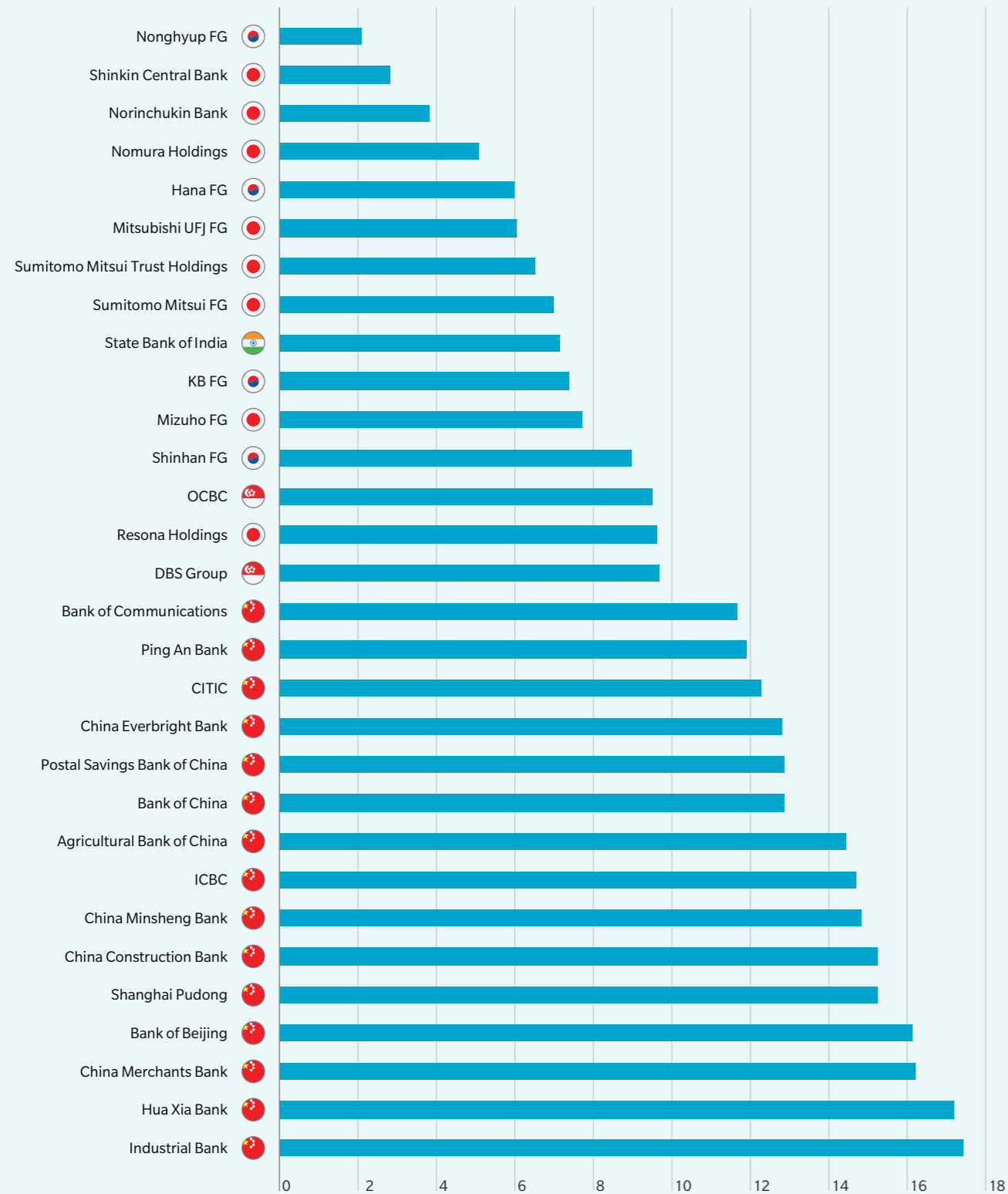
*1 Data as of Sep 30, 2016
Source: S&P Global Market Intelligence

EXHIBIT 4: MAPPING THE TOP 30 ASIAN BANKS BY ASSET GROWTH, ROE AND PRICE-TO-BOOK RATIO (P/B)



Note: List of top 30 banks includes only publically listed banks for which data on RoE, Asset growth and P/B ratio were available. RoE is calculated based on fiscal year ended 2016
Sources: S&P Global Market Intelligence

EXHIBIT 5: RETURN ON EQUITY FOR TOP 30 ASIAN BANKS (% , 2016)



Note: Figures are for fiscal year ended 2016
Sources: S&P Global Market Intelligence

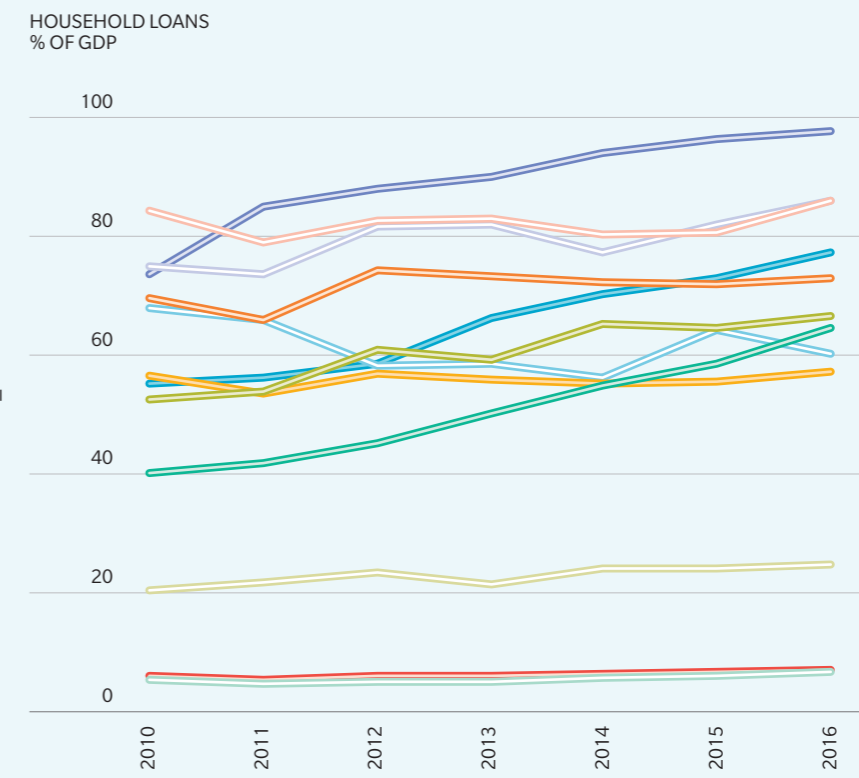
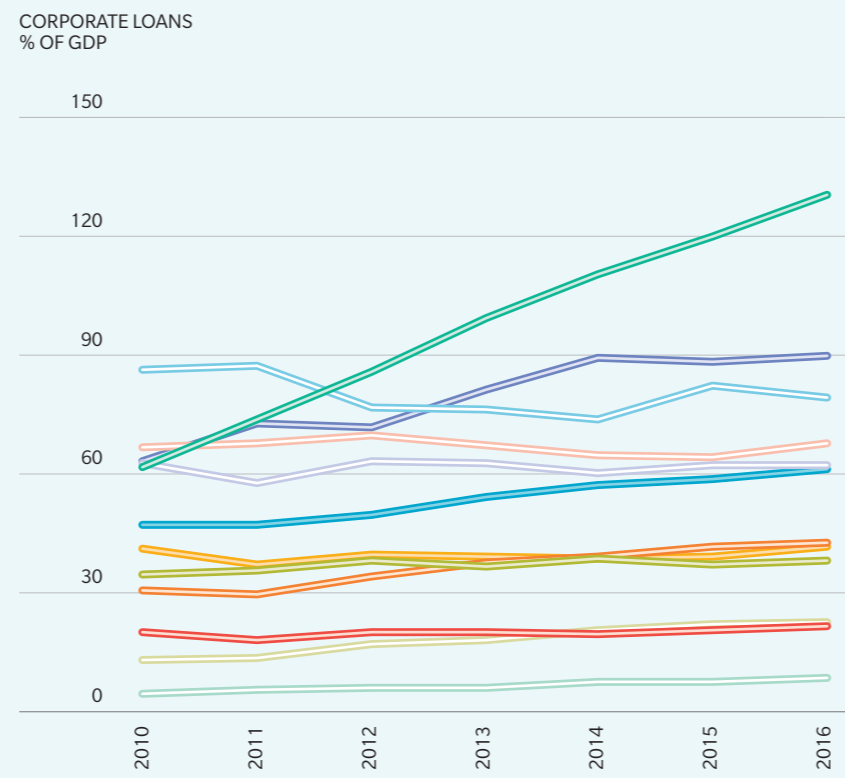
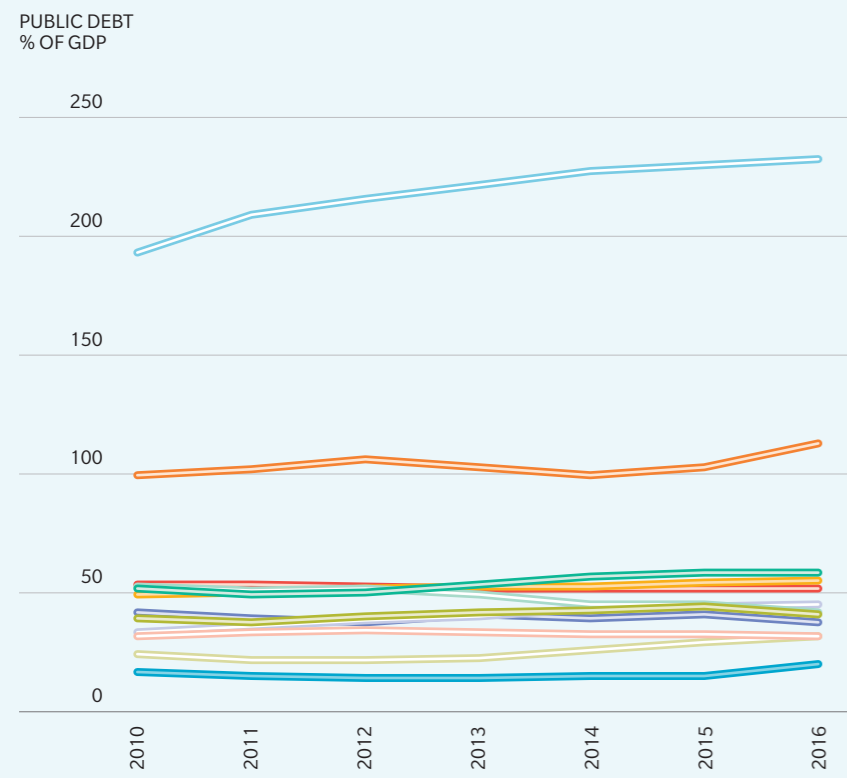
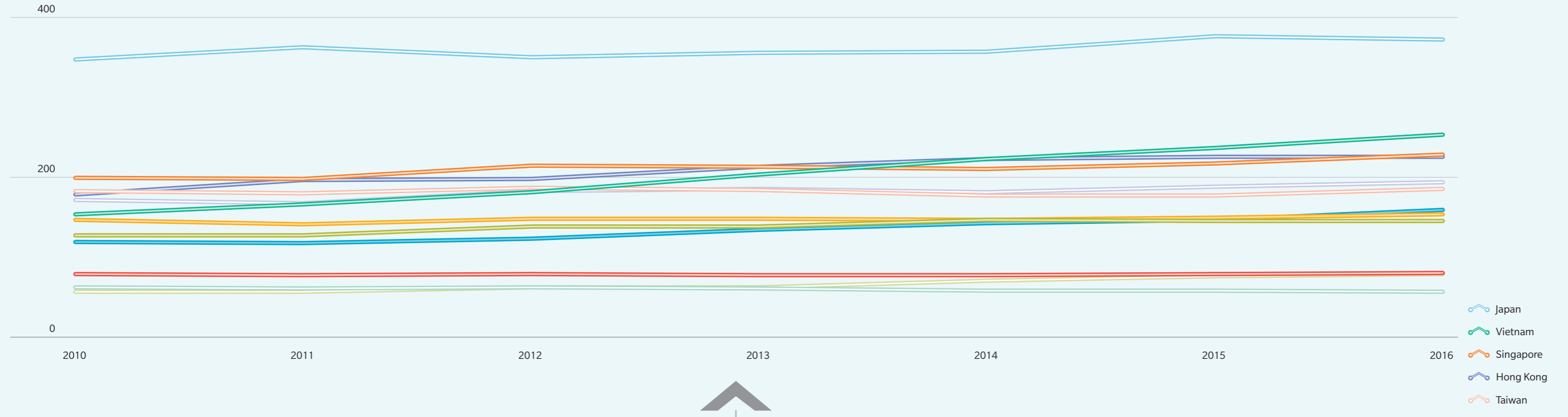
EXHIBIT 6: LIST OF THE TOP 5 BANKS BY ASSETS IN SELECTED ASIAN COUNTRIES (US\$ BILLIONS, 2016)



*1 Data as of Sep 30, 2016
*2 Data as of Jun 30, 2016
*3 Data as of Dec 31, 2015
Note: Figures are for year ended 2016 unless otherwise noted
Source: S&P Global Market Intelligence

EXHIBIT 7: EVOLUTION OF DEBT BY MARKET IN ASIA (BY TYPE, AS PERCENTAGE OF GDP, 2010-2016)

PUBLIC DEBTS + CORPORATE LOANS + HOUSEHOLD LOANS AS A % OF GDP



Source: Economist Intelligence Unit

However, past and present success is not a good guide to the future. Every country, every sector and every institution has its own unique set of challenges. But we see five broad themes across the region that require attention in order for banking in Asia to maintain its momentum.

The traditional funding and lending model is running out of steam. On a regional scale, growth has been fuelled by increasing corporate leverage, which led to a rise in private income levels. These, combined with the availability of plain-vanilla funding from high private and corporate savings ratios, have enabled banks to expand their balance sheets substantially. However, this model is running out of steam: Leverage in many countries is reaching a level for concern, and funding from deposits is reaching a limit, as loan-deposit ratios have risen in many countries. Overall, the business of funding has become more demanding in the region.

Concern is rising over NPLs and asset bubbles. Concerns have increased over the underlying credit and asset quality in some Asian markets. China is in the centre of the discussion, but we see similar trends in India, Indonesia, and other markets. While the current negative sentiment may be exaggerated and published NPL ratios are at relatively low levels, the trend is still evident.

The needs of complex economies and societies are underserved. Asian private and corporate clients are getting richer, more diverse, and more demanding. Some of the biggest growth opportunities are found in new areas beyond the past and current core propositions. Examples include serving the affluent client segment with products beyond deposits and mortgages; creating affordable banking for the lower-middle-class segment; providing more sophisticated financial solutions for corporates, including derivatives and structured finance; further tailoring wealth and asset management to preferences in Asian markets; and developing a service offering for the large and – in many markets – still underserved SME segment. Serving these various needs can fuel future growth and diversify banks' exposures. But it will require a wide set of capabilities.






Digital disruption is coming. While digital disruption affects all aspects of society and business, banking in Asia may face special challenges. One is that its services are not entrenched, so banks cannot rely on a strong installed base of customers that would bear high switching costs or face exit barriers due to regulation and emotional ties. As some of the most innovative digital financial services offerings are being generated in Asia – notably in China – Asian banks need to digitise their businesses and find the right responses to Fintech.

Politics, commerce, and capital markets are being recalibrated globally. 2016 brought major political surprises that may have impacts on global commerce and capital markets, for example foreign exchange, bond markets, and capital flows. Financial services in Asia could be affected, so banks in the region should prepare to take opportunities as they are thrown up. Public initiatives are increasingly led domestically, like India's demonetisation programme, or regionally focused, like "One Belt One Road." Asian banks need to develop scenarios for these recalibrations and respond quickly as shifts occur.

Increasing, more local regulatory requirements. Many Asian regulators and central banks are increasing their oversight efforts and sometimes also their interventions. Asian banks will need to respond to the new requirements and set up effective internal control mechanisms in risk management, audit, and compliance. Risk culture and ethics will take on greater importance as the backbones of banks' conduct. We see a strong case for many Asian banks to take action to sustain momentum in the coming years. In particular, Asian banks can act out of a position of strength and confidence.

Asia Banking Agenda 2017 distils a wide range of context factors, and carves out five engines of future momentum. Each of these features specific actions, which are outlined in the following sections.

1. REGAINING CONFIDENCE

AGENDA		KEY CONSIDERATION
Allow transparency		<ul style="list-style-type: none"> Funding and asset quality Risk profile and stress testing Governance and “3 lines of defence”
Tackle NPLs head-on		<ul style="list-style-type: none"> NPL management kit Distressed debt restructuring
Align controls infrastructure		<ul style="list-style-type: none"> Optimising risk/compliance/audit Clear scope, consistent process and methodologies, coordinated resources and consolidated data and systems
Bring risk management into business		<ul style="list-style-type: none"> Risk culture in the business frontline Insight and tools to understand risk and risk/return Empowering “1st line of defence”
Strengthen ties with regulators and public		<ul style="list-style-type: none"> Mutual understanding Contribution to regulatory design

Rightly or wrongly, perceptions sometimes turn into reality. And parts of Asian banking are currently seen as risky and opaque. The clearest example is the concerns over China’s credit quality, where analysts are speculating about the true NPL ratio: Estimates range from 5 to 20 percent.⁹ Some banks in China have shifted loans into wealth management products known as directional asset management plans (DAMP) or trust beneficiary rights (TBR), which may be subject to less scrutiny and reduce the banks’ capital requirements. As a result of the concerns, many Chinese banks are traded at price-to-book (P/B) ratios of substantially below one in spite of good ROE levels.

We recommend that Asian banks facing such concerns tackle the issues head-on through five main actions.

ALLOW TRANSPARENCY

A bank balance sheet is complex and has the potential to raise many questions. So, banks should explain more about what they do, how and why they book specific types of businesses in a certain way, how they measure and assess their risks, how different scenarios and stress tests could play out, and how they are protecting the stability of their capital and earnings bases. Such explanation also serves as a strong internal calibration. It should correspond to the level of scrutiny that an external observer would bring.

We do not expect regulators or central banks to enforce greater transparency in the same way as in the United States or the eurozone. Therefore it is up to individual banks to drive their own efforts to increase internal and external transparency, clarity, and communication.

⁹ Oliver Wyman report - silver lining in China Banking

TACKLE NPLS HEAD-ON

Asian banks have been dealing with NPLs for many years. In some markets this happens quietly and with modest regulatory pressure; in others there is more top-down steering. An example of the latter approach is India, where the Reserve Bank of India's (RBI) Asset Quality Review (AQR) has forced banks to recognise the bad assets on their balance sheets.

Whether or not Asian banks are forced to act, they should upgrade their NPL management capability frameworks around three objectives: more thorough analysis to anticipate NPL risks; an effective early-alert process; and the availability of a spectrum of response tools, including collections, amendments to terms, prolongations, and restructuring measures.

Portfolio transactions and securitisation are also an effective way to diversify risks across a wider investor base, as long as they are transparent, properly regulated, and fairly priced. We would expect international distressed-debt specialists to show interest in such offerings.

ALIGN CONTROL INFRASTRUCTURES

Regulation and control requirements have substantially increased across Asia. Despite major investments in control infrastructures in risk management, compliance, and audit, many banks suffer from a lack of alignment: unclear scope of mandates, inconsistent processes, lack of skilled human resources, multiple overlapping tasks and reporting lines, and fragmented systems and data.

In response, Asian banks should invest to make their control infrastructures more effective and more efficient. Such an effort is a continuous challenge and typically should follow these principles:

- Defined scope and mandate for each control function
- Consistent methodologies and processes
- Coordination of people and infrastructure
- Consolidated management information system (MIS) and actionable reporting

Both costs and demands have been continuously rising for internal control functions in risk, compliance, and audit. Therefore, their effective alignment and lean setup can produce a quick and multifaceted positive impact.

BRING RISK MANAGEMENT INTO THE BUSINESS

Most banks in Asia have already implemented the Basel II and III risk frameworks and models. The challenge now is to embed a stronger understanding of risk in banks' frontline businesses. Risk should not be seen as a constraint on business, but as an enabler. This typically requires three main actions:

- Promote risk culture in the business frontline
- Provide the data, insight, and tools needed to understand risk and the relationship between risk and return
- Empower the "first line of defence" for a holistic economic assessment





It is not surprising that the awareness of risk is relatively low in Asian banks. Banks in North America and Europe have paid more than \$260 billion in litigation costs¹⁰ in recent years and have suffered a significant loss in their public reputations. Asian banks have been under less external pressure, but they should now proactively develop and professionalise risk management by embedding it in their businesses. Some countries, such as Singapore and Thailand, have already seen good progress in this area. Others still need to go much further. For example, in a 2015 Bankers Association of the Republic of China survey, 71 percent of senior bankers cited "the lack of comprehensive risk management capabilities amid a more complicated risk environment" as a major challenge and a top strategic priority.

STRENGTHEN TIES WITH REGULATORS AND THE PUBLIC

Regulation and the role of regulators will increase in most Asian banking markets and business segments. So will public attention. Asian banks should learn the lessons of their peers in North America and Europe and actively invest in a dialogue with regulators and the public in order to deepen public awareness and trust in banks. Specific themes could include conduct and risk culture, including misselling, proper governance, and control mechanisms; and the economic benefits of financial deepening.

¹⁰ Source: Financial Times, 2015

2. MAKING WHOLESALE NIMBLER AND MORE SOPHISTICATED

AGENDA	KEY CONSIDERATIONS
Be nimble in client selection and service 	<ul style="list-style-type: none"> • Adding segmentation criteria for more differentiation • Greater client understanding including value networks
Push RM effectiveness 	<ul style="list-style-type: none"> • Skill broadening • Structured client coverage with digital enablers
Optimise the corporate lending function 	<ul style="list-style-type: none"> • Data leverage • Risk-informed pricing • Process efficiency
Develop advanced financial solutions 	<ul style="list-style-type: none"> • Going beyond lending • Advanced financial solutions including derivatives and structured products

Corporate banking is the backbone of Asia's banking business, representing over 50 percent of total assets.¹¹ Corporates across Asia are undergoing fundamental changes. Three main trends are likely to affect the requirements of a state-of-the-art wholesale banking offering:

- **Evolving governance, especially for state-owned enterprises and family-led businesses.** These are becoming gradually more transparent and market-led, meaning that they require more holistic financial services
- **Increasing sophistication in financial needs.** Corporate lending is the core of Asian wholesale banking, but needs are evolving towards more complex financial products
- **Global connectivity.** Many Asian countries have been export champions for years. Despite concerns about a backlash against globalisation, we remain optimistic that global connectivity will continue to deepen. Demand from Asian businesses for inter-connected financial services will increase, as they move from an operating model led by exports towards a comprehensive global business model

These trends imply that Asian banks need to become nimbler in the way they address different wholesale banking needs and more sophisticated in the products and services they provide. We recommend that Asian banks pursue four main courses of action:

¹¹ Source: Thomson Reuters Datastream

BE NIMBLE IN CLIENT SELECTION AND SERVICE

As Asian corporates diversify their businesses, strategies, and financial structures, corporate banking must pay greater attention to individual clients' circumstances and tailor its services accordingly.

There are three main development areas that we observe across many of our Asian banking clients:

- **Comprehensive client ecosystem profiling.** This should include clients' broad connections with suppliers, business partners, and their own clients in order to understand more profoundly their financial services needs and the associated risks. The profiling requires greater access to clients, deep analysis of their data, and the ability to listen carefully and learn
- **Differentiated client selection going beyond the traditional focus on large corporates.** A more tailored approach should be taken, considering sector, ownership structure, strategy, profit model, and – of course – financial situation
- **Bundling within the bank of different business segments in order to provide a holistic offering.** This applies especially to wealth management, corporate lending, and investment banking. Entrepreneurs are a good example of a client segment which often combines needs in private wealth management with corporate lending, as well as complex investment banking and capital markets

This approach will lead to a much stronger return on investment per client.

PUSH RELATIONSHIP MANAGER EFFECTIVENESS AND EFFICIENCY

Relationship managers are a critical pillar of an effective wholesale banking model, yet they need to undergo a major transformation to become more effective and efficient. To boost managers' effectiveness, they must be trained in the skills needed to provide a client-centric, holistic service with a good understanding of risk. To become more efficient, they need digital tools and processes to free up time from administration and to support clients with the help of a suitable information and analytics base.

Effectiveness and efficiency can be transformed by supervising relationship managers based on their activity, quality, and long-term impact, rather than on their short-term transactions and revenue. Optimising activity inputs delivers strong outputs, while sharpening professional conduct and effectiveness.

OPTIMISE THE CORPORATE LENDING FUNCTION

Net interest margins, while still healthy in most parts of Asia, have come under pressure, forcing banks to respond. Most Asian banks could benefit from pulling on two strong levers:

- **Risk-based, differentiated pricing.** Banks should follow a comprehensive set of governance procedures for analysis, client management, and internal processes in order to achieve a more risk-informed, differentiated pricing of credit. In particular, improved sourcing and utilisation of data can lead to better-informed corporate lending decisions
- **Process-automation for efficiency.** Credit processes account for up to 40 percent of total operational costs in corporate banking, and are the most suitable area for efficiency gains through process automation.¹² Leading banks have created delegation grids based on risk rating, authority level, and type of transaction. Through these initiatives, many banks have shortened, standardised, and digitised their credit approval processes for greater efficiency

DEVELOP ADVANCED FINANCIAL SOLUTIONS

Asia's financial markets are at different stages of development. Hong Kong, Japan, Singapore, and a few others are mature financial services markets with deep expertise and experience in all areas. They are sizeable banking markets worth the equivalent of 200 to 300 percent of GDP.¹³ Hong Kong stands out at above 800 percent.






Other countries are still at earlier stages of financial deepening, and their markets are smaller relative to GDP. Most notably, Indonesia's banking market is less than 50 percent of GDP. As economies mature, it is critical to provide more sophisticated financial products. Indonesia still has no or only nascent derivative products and a limited spectrum of foreign exchange products.

Asia's increasingly complex economies mean that corporates and SMEs are going to have more sophisticated needs in financing, investing, and transactions. Regulators and governments need to provide the frameworks for financial deepening and innovation. Banks then need to expand beyond their traditional focus of lending to develop new expertise for a more sophisticated product offering. Banks from other countries that have such sophisticated offerings will be able to use them as entry opportunities.

¹² Source: Oliver Wyman "Delivering Excellence in Corporate Banking: How to Protect the Business Model and Improve Performance (2015)"

¹³ Source: Business Monitor International

3. TAILORING AND DIGITISING CONSUMER AND SME PROPOSITIONS

AGENDA		KEY CONSIDERATIONS
Respond to new consumer and SME needs		<ul style="list-style-type: none"> • More segment-specific differentiation • New offerings, e.g. consumer credit and cards
Serve SMEs in a tailored model		<ul style="list-style-type: none"> • Advanced risk understanding and pricing • Efficient service model using digital
Design suitable wealth and asset management		<ul style="list-style-type: none"> • Wider, low cost product and advice offering • Deeper understanding for institutional needs • Linking wealth and investment/corporate banking
Surprise customers with a new experience		<ul style="list-style-type: none"> • More empathy, more relevance • Pragmatic and efficient service • Full connectivity online/offline
Go digital and find the right link to Fintech		<ul style="list-style-type: none"> • Deepen data and information capability and technology • Front-to-back digital operating model • Mix of “beat/join/ignore” with respect to Fintech

Consumer and SME are growth segments throughout Asian banking. As an indicator, the ratio of household debt to GDP grew 56 percent between 2010 and 2016, outpacing the overall debt growth of 34 percent in the same period by almost two-thirds.¹⁴

Asian consumer and SME banking needs vary widely between some very mature markets and others that are still nascent. Yet there are two common themes: First, customers and SME clients in all Asian markets demand better-suited offerings, whether these be a first credit card, consumer loans, or new longevity provisions. Second, digital technology is transforming the ways customers can be served and business processes conducted.

Five courses of action should help make the most of the consumer and SME growth engines in Asian banking.

¹⁴ Source: Economist Intelligence Unit

RESPOND TO NEW CONSUMER AND SME NEEDS

No matter whether we look at the nascent Philippine and Indonesian markets, the rapidly maturing Chinese middle class, or the saturated and ageing Japanese and Korean consumer markets, the common theme is rapid change. Banks need to respond to changing needs with fast learning, rapid innovation, and flexible service.

The affluent, rapidly-maturing Chinese middle class is a prominent example of the profound changes in consumer characteristics requiring new propositions from banks:

- Chinese households' disposable income has grown 50 percent¹⁵ since 2011. They continue to be optimistic, with 58 percent of surveyed consumers¹⁶ expecting further increases in disposable income
- A new segment of the mass affluent¹⁷ has emerged, expanding from 10 million to 60 million households over the same period. Fifty-five percent of these are under 40 years old
- While China's 39 percent savings rate remains the world's highest,¹⁸ this affluent segment's marginal intent to save rather than consume indicates a future drop in the marginal savings rate to about 20 percent
- This new generation seeks more experience through entertainment and leisure – and is willing to fund this with consumer credit. Eighty percent of surveyed affluents find this acceptable, and consumer loans jumped from 3 percent of GDP in 2011 to 6 percent in 2016
- A lot of this business is now carried out digitally: Alipay and WeChat have the highest penetrations. Despite concerns over the conduct diligence of many peer-to-peer platforms, the concept is flourishing, and overall Fintech innovation is putting incumbents under pressure

We could describe in a similar manner the emerging middle class in Indonesia and other countries or the effect of an ageing society in Japan. The point is always the same: Consumers change rapidly and have new demands. Banks need to listen, tailor, and respond in an agile manner.

SERVE SMES THROUGH A TAILORED MODEL

SMEs drive economic growth and represent a significant financial services opportunity across the Asian market. Typically, more than 25 percent of retail financial services revenue is in the SME segment, and an SME customer is five times as valuable as an affluent banking customer. However, financial services providers still struggle to comprehensively address the needs of this segment. They fail to provide access to credit of the required nature, such as unsecured working capital finance or transaction management solutions that can improve the health of a business, such as cash forecasting.

15 Source: National Bureau Statistics of China

16 Source: Oliver Wyman survey, Oct 2016

17 Sources: Economist Intelligence Unit, Oliver Wyman analysis: defined as net financial wealth of US\$0.1-1 million on household level

18 Sources: Economist Intelligence Unit, Oliver Wyman survey, Oct 2016

Financial services providers need to follow a tailored approach to get the SME segment right. That means starting from a dedicated organisational model, building segment-specific capabilities, and delivering tailored solutions through partnerships in other parts of the ecosystem. We have laid out a set of five proven initiatives for the SME segment:

- Develop segment-specific functional capabilities championed by a dedicated SME organisational unit; focus on efficient credit processes, the use of new data in risk analytics, and understanding the needs of the SME customer
- Establish an operating model that combines the best of the wholesale and retail approaches: enabling access via retail footprint and driving efficiency with standardised processes, while following the best practices of relationship management from wholesale
- Re-imagine SME credit “end-to-end” with a heavy infusion of advanced analytics, automation, and digitisation. Enable simple, fast credit delivery, while managing the associated risks and costs
- Develop tailored value propositions that go beyond typical banking products to address SMEs’ underlying needs, such as cash flow management. This will require a deep understanding of SME sub-segments, combining dimensions such as sector, value chain, and size
- Pursue a mass acquisition strategy in the segment via ecosystem partnerships. In the fast-digitising Asian economy, SMEs are organising themselves around new platforms such as e-commerce and aggregator applications. These can be tapped for targeted solutions to gain access to a vast number of SMEs

Getting this right can lead to significant commercial success. Leading SME banks in the region operate a segment ROE of over 25 percent, while being self-funded and receiving diverse sources of income from the segment. They also do better in managing periods of economic stress, when tier-2 SME banks often suffer rapid losses.

DESIGN SUITABLE WEALTH AND ASSET MANAGEMENT SYSTEMS

Despite the rapid accumulation of retail wealth in Asia, wealth management remains underdeveloped. The penetration of managed asset management products is significantly lower than in Western countries, and many customers hold too much of their wealth in cash relative to their long-term liabilities. At the other end of the spectrum, wealth that is invested in public securities is often badly self-managed, with the investors chasing speculative returns.

Access to wealth management offerings and their appeal are still generally nascent. Wealth management business models are overly reliant on high retrocessions, which require investors to pay high all-in fees. In an environment where only modest investment returns are expected, this will have a materially detrimental impact on investors’ wealth management experience.

Digitally-based wealth advisory models present an opportunity to radically change the way wealth advice is delivered and to lower costs. There is an important human role in providing emotional support to investors, particularly during periods of market volatility, but we believe that the productivity of Asian wealth relationship managers could at least double from today’s norms.

At the top end of the market, many Asian universal banks have an opportunity to serve the wealth needs of their entrepreneur commercial clients better than at present. Here again, the adoption of digital tools and communication channels can be key differentiators.

To make the most of this shift, asset managers should provide lower-cost products designed to fit diversified, Asia-centric portfolios. Till now, Western asset managers have mainly sold Western-designed products into Asian markets. But, as Asian capital markets mature, we see a real opportunity for Asian asset managers to develop their mostly domestic-focussed business models and become sizeable international players.

SURPRISE CUSTOMERS WITH A NEW EXPERIENCE

Financial services in general, and banks in particular, face mixed customer feedback and a low public reputation – both globally and in many Asian markets. Based on a recent Oliver Wyman survey of customer experiences, it is not so much the flashy surface that marks the customer experience. Rather, the stand-out differentiator is simply problem resolution and an efficient offline-online process for customer service and transactions. Of course, banks face a balancing act to design a positive customer experience that is easy-to-use, fast, and responsive, but that also complies with increasing risk and compliance requirements for prudence, documentation, and control.

Surprising customers with a new experience should therefore start with core banking touchpoints:

- Removing hassles, for example through pre-populated forms, digital template storage, voice recognition for phone services, and shorter waiting times
- Accelerating problem solving by empowering staff, providing faster access to specialists, and through clearer communication
- Showing more empathy and pro-active, value-added features, such as enhanced loyalty services, better information and learning, and personal gestures

Digital technology and the effective use of data are critical to creating a more enjoyable experience.





GO DIGITAL AND FIND THE RIGHT LINKS WITH FINTECH

The impact of Fintech as a disruptive innovation has been substantial, most profoundly in China. Yet, its overall scale is still limited to a low single-digit percentage of overall financial services. It is focused on areas of unmet demand and inefficient cost structure or capital usage, and on the leverage of information and networks.

For incumbent Asian banks, there are two dominant priorities related to digital innovation.

- First and most important, consumer and SME banking has to be largely digitised. This includes not only the front end of customer service, but also all back-office processing and support functions
- Second and sometimes overlooked, banks need to decide on the right response mix to Fintech. Rather than simple competition or copy-and-paste, they may do better to partner with Fintech enterprises – or just ignore them if they are stuck on the periphery of the banking business

4. CAPTURING SELECTIVE INTERNATIONAL OPPORTUNITIES

AGENDA	KEY CONSIDERATIONS
Serve intra-Asian business and trade 	<ul style="list-style-type: none"> • Cross-border trade coverage and finance • International networking
Go selectively international 	<ul style="list-style-type: none"> • Careful market/product picking • Capturing ground where others retrench
Work with multiple currencies 	<ul style="list-style-type: none"> • Continued role of RMB • Managing FX including specific risk aspects
Engage in regional and global banking community 	<ul style="list-style-type: none"> • Banking associations and networks • Direct peer partnerships

Despite current doubts over the benefits of international connectivity and some retrenchment by international banks in the region, we advise most banks to stay committed to a selective international strategy. However, this does not mean a simple international market expansion. It is, rather, about connecting with international banking partners to provide better service at home, including business with multiple currencies; carefully and creatively building selected international businesses; and being an active part of the banking community.

These objectives can be approached through four main development areas:

SERVE INTRA-ASIAN BUSINESS AND TRADE

Trade with North America is running into political troubles. Europe's growth remains low. As a result, intra-Asian trade is becoming the major growth engine for Asia. Greater China trade accounts for about 50 percent of all trade in Asia. This is followed by the mature economies of Japan and Korea, and then the dynamic South East Asian region. The exports of many countries have been growing at more than 10 percent a year, with Vietnam hitting 17 percent.¹⁹

Ongoing initiatives such as "One Belt, One Road" will likely further stimulate regional trade, and new intra-Asian trade agreements are being discussed. This growth will create demand for specific trade- and transaction-related financial services, including trade finance, transaction banking, and foreign exchange. These areas represent a major growth theme, as Asian countries face a gap in trade finance estimated at \$1 trillion,²⁰ equivalent to approximately 30 percent of the region's overall trade.

To supply this, banks need to develop suitable capabilities, associated risk-management practices, and a professional international network of correspondent banks and expertise.

¹⁹ Sources: OECD, Economist Intelligence Unit

²⁰ According to a 2015 study by the Asian Development Bank
<https://www.adb.org/sites/default/files/publication/175855/2015-trade-finance-gaps-growth-jobs.pdf>

GO SELECTIVELY INTERNATIONAL

Asian banks' international expansions have typically followed one of three models:

- **Follow the expansion of large corporations abroad.** Examples are Japanese megabanks in the 1980s and 1990s and Chinese large banks since 2000
- **Overcome limited opportunities in home markets by going abroad.** This is one interpretation of the recent expansions by Korean and Japanese banks
- **Go for a pan-Asian business portfolio model.** Many South East Asian banks have expanded in Asia, in some cases where Western (and Australian) banks have retrenched

There are many examples of troublesome international expansions, both by Western global banks and Asian banks. Stock markets are therefore often sceptical of such moves. But they can have an inherent logic that produces a wider economic benefit by connecting markets and replicating winning capabilities of individual banks in different markets.

WORK WITH MULTIPLE CURRENCIES

The mix of political retrenchment and rising value will make other currencies increasingly attractive for use in trade in the Asia-Pacific region. That means that high foreign exchange volatilities will make currency risk a major consideration. Rather than a simple shift from one main trade currency to another, we expect a wider range of currencies to be used – which implies that banks should be ready to provide transaction banking in multiple currencies.

The role of the renminbi is especially interesting. The share of China's foreign trade settled in renminbi is expected to reach 50 percent by 2020, up from 30 percent today.²¹ Also, we expect other factors to stimulate the role of the renminbi as an investment currency: the Stock Connect programs, the mutual recognition of public offered funds (MRF), and the continued importance of the panda and dim sum bond markets.

For Asian banks, there are three implications:





- Improve their capabilities and networks to provide transaction banking in multiple currencies
- Enhance their foreign exchange risk management expertise
- Consider whether and how to capture opportunities from the growing role of the renminbi as a trade and investment currency

ENGAGE IN THE REGIONAL AND GLOBAL BANKING COMMUNITY

Asia-Pacific is becoming the biggest regional banking market. Asian banks are already among the largest and most-valued institutions both on a regional scale and globally. This importance should lead to a stronger engagement by Asian banks in the global banking community. The spectrum of activities includes industry communities such as the Institute of International Finance (IIF) and the Asia Banking Association, links to global bodies such as the Group of Thirty, and a stronger voice in regulatory bodies at a national, regional, and global level.

²¹ Sources: CEIC Data Company Limited, Standard Chartered Research

5. BOOSTING OPERATIONAL EFFICIENCY WITH DATA AND TECHNOLOGY

AGENDA	KEY CONSIDERATIONS
Bring back office to the front	 <ul style="list-style-type: none"> • Front-to-back connectivity • Back office as part of customer experience • Alignment of capabilities, KPIs and incentives
Think modular	 <ul style="list-style-type: none"> • Orchestrating the value chain along strategic control points • Profit pool capture
Instil cost discipline	 <ul style="list-style-type: none"> • Cost variabilisation • Utility outsourcing and platforming
Monetise data	 <ul style="list-style-type: none"> • Integrated data analytics operating model • Focus on target business outcomes and use cases • Pragmatic and lean approach

Unlike their North American and European peers, Asian banks have consistently enjoyed good revenue growth with high, stable NIMs. Consequently, cost discipline and operational efficiency have been a relatively minor concern until recently. However, faced with a more volatile business environment, Asian banks will need to squeeze out profits by increasing operational efficiency and leveraging emerging technologies such as digitisation and data analytics along the value chain. Below are three tactics they should consider.

BRING THE BACK OFFICE TO THE FRONT

World-class operations teams do not just drive cost reduction and service quality; they also play a critical role in delivering client experience – a source of differentiation that is driving immense change in banks. Insights and successes from other industries suggest a pathway for banks to elevate the role of operations functions and generate value:

- Connect the front and back offices by creating end-to-end processes that start with the client and cross organisational boundaries
- Make back office processes and services a core aspect of the client experience through their ability to facilitate speed, tailoring, and quality of service
- Align talent, capabilities, governance infrastructure and incentives through a “front-to-back” view

THINK MODULAR

When redesigning the banking value chain, it is critical to think in a more modular way, so that supply and demand in financial services become more fragmented.²² What does this mean?

- **Modular demand:** New technology is making it easier for customers to buy from multiple product providers
- **Modular supply:** Financial services firms are using more third-party suppliers, such as providers of specialist services and risk capital

Until now, Asian banks have mostly supplied the products from one end to the other of the value chain. But we believe there will be a trend towards modular financial services. This is already evident from new entrants with highly-focused business models such as CompareAsiaGroup, which compares consumer loan products in Hong Kong and several other East Asian markets, or with more holistic financial services product offering like Lufax in China.

Many Asian banks still run their businesses on legacy infrastructure with duplicated, inflexible systems. This will be unsustainable in a modular industry. So, banks need to overhaul their back-office processes and systems. With the exception of China, modular financial services are not yet as far developed in Asia as elsewhere. In making these changes, Asian banks should capitalise on their stronger starting positions, outlined earlier in this report.

When deciding which parts of the value chain to focus on, banks should ask themselves the following questions:

1. Which parts of our business have products that are relatively simple and could be commoditised relatively easily?
2. Which parts of the value chain are protected by regulation, and which are vulnerable to it?
3. Which activities are non-core, and hence more likely to be modularised?
4. Could consumers still be guaranteed a seamless experience with services combined from several suppliers?
5. Is the modularisation of specific value chains sustainable? Could it be made sustainable? For example, the global financial crisis showed that broker-led mortgage origination and securitisation was not sustainable in its then-prevailing form

Asian banks should find opportunities to orchestrate the value chain, rather than clinging to their current model of vertical integration.

²² See Oliver Wyman: "Modular Financial Services" (2016) for more details

INSTIL COST DISCIPLINE

Asian banks have been growing strongly recently, so some have not been under pressure to cut costs. To prepare for future growth, they should consider the following steps to make their businesses scalable:

1. Apply a zero-based cost approach, and choose which areas to operate in at the leanest-possible level and where to put more emphasis on service. These choices could minimise non-critical costs
2. Re-assess the cost base and apply appropriate levers to increase the share of costs that are variable. This could include outsourcing and leveraging services shared with global banks. The resulting decline in fixed costs would make it easier to cope with any unforeseen fall in revenues
3. Introduce effective steering to encourage entrepreneurial behaviour, while maintaining stringent cost control. For example, smart cost controls could be embedded in management information systems

MONETISING DATA

More data has been created in the past two years than mankind has created in its entire history. At the same time, technology has reached a tipping point: The infrastructure and skills required to host data have become accessible and economical.

The Oliver Wyman Data Analytics Capabilities Study, conducted in mid-2016, found that organisations that have achieved significant performance uplift by deploying data analytics share four common characteristics.

First, many leading organisations (44 percent of those surveyed) have transitioned towards an integrated data-analytics operating model, with a two-tier cross-enterprise arrangement. At the centre, a data analytics centre of excellence (CoE) enables enterprise-wide analytics excellence and acts as a data broker to source and curate internal and external data. Local analytics teams sit close to business functions and perform analyses using sophisticated, best-in-class tools, which are then typically tweaked or refactored by CoE data scientists.

Second, the organisations that have achieved the most notable uplifts have invested more extensively in data analytics, moving to the next frontier of applications. Of the organisations surveyed, 68 percent are using data analytics beyond marketing, sales, and customer targeting, for optimising operational processes, resource or inventory management, and risk mitigation.

Third, at a number of leading organisations the balance of IT resources and investments has shifted dramatically from more traditional transaction processing, data services, and infrastructure provisioning towards shared, democratised analytics capabilities. As one study participant remarked, “our aim is to have high-end analytical capabilities used as commonly in the future as Excel has been in the past”.

Fourth, the new capabilities are not applied in a generic way, but targeted at specific, nimble business applications where they can realise immediate outcomes and have a tangible impact. This often lowers the budget needed, but requires greater agility and an entrepreneurial approach to accelerated application.

SUMMARY – CAPITALISING ON THE OPPORTUNITY

In this perspectives paper we have highlighted five engines of future momentum that Asian banks should focus on in 2017. These engines feature a total of 22 specific actions. Of course, not all engines and actions are equally relevant for all banks, and every institution's specific agenda is unique. Yet, across the region we sense that this Asia Banking Agenda will be decisive in maintaining strong growth and value creation.

How much will the Asia Banking Agenda contribute?

KEEPING GROWTH IN THE 5 TO 7 PERCENT RANGE

The CAGR of Asian banking assets has averaged 8 percent over the past five years, though it has slowed to between 5 and 7 percent in the past two or three years. A baseline scenario is for further declines in growth as standard deposit and lending businesses plateau. Our market forecast models suggest that application of the Asia Banking Agenda can maintain growth in the 5 to 7 percent range. The core levers will be financial deepening and digital in the retail and SME segments and innovation in wholesale banking.

MAINTAINING ROE ABOVE 10 PERCENT

Starting from today's 11 percent average ROE for the top 70 banks in Asia, our baseline scenario would suggest a decline in ROE driven by lower NIMs, more complex funding, and slower growth. But banks can maintain high ROE by strengthening their top-line performances and improving capital efficiency through risk management, nimble underwriting, and a heightened focus on operational efficiency.

In summary, the Asia Banking Agenda will help sustain the momentum of the top line and high value creation. This in turn will foster continued macroeconomic growth and prosperity across Asia.

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