

Emerging Opportunities

Financial Services M&A in Asia 2011

PwC's sixth annual Asian Financial Services M&A survey and report explores the growing potential for deal activity in the region, including analysis of recent transactions and economic trends, and insights into emerging investment opportunities.

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Welcome

Welcome to the sixth edition of PwC's Financial Services M&A in Asia report. This report reflects the results of a survey of 375 senior executives in financial services across 13 Asian territories, conducted during May and June 2011.¹ This was further supplemented by individual client interviews, our own qualitative research and the analysis of M&A experts from PwC,² one of the leading advisors on financial services deals in the region. We would like to thank every one of our respondents and clients for their time and insights, without which this report would not exist.

1 Please refer to Methodology on page 42.

2 'PricewaterhouseCoopers' and 'PwC' refer to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL). Each member firm is a separate legal entity and does not act as an agent of PwCIL or any other member firm.

Asian financial firms are increasingly keen to use M&A to acquire customers.

Executive summary

The global financial services industry continues to undergo an unprecedented period of change, arising from the financial crisis and its aftermath. With the focus of global economic activity rapidly shifting eastwards, the prospects for growth in financial services markets are stronger in Asia than in any other region. At the same time, many Asian financial markets are continuing their path of deregulation, and competition in the region is increasing.

The result is that M&A is becoming an ever-more important strategic tool for financial institutions in Asia, whether local, regional or global in outlook. We therefore believe that the findings of this survey, the largest in the six years that this report has been produced, offer particularly valuable insights to those conducting or contemplating financial services deals in the region and observers of the Asian scene.

Understanding the market

The report is divided into five sections. 'Key findings' are highlighted at the front of each section, followed by more detailed analysis of the survey results. Each section is further supplemented by a box offering a focused look at a particular market or aspect of M&A in the region. The most important messages to emerge from each section are summarised here.

- **Introduction to Asian financial services M&A:** Asian financial services M&A declined in 2010, but held up well compared with other regions. Deal values for the first two quarters of 2011 have increased year-on-year. Survey respondents are increasingly confident in their own deal appetite and prospects for revenue growth. In the medium to longer term, growth in Asian financial services will continue to be driven by a range of supporting economic and demographic factors, including the rapid emergence of middle-income customers.
- **Strong strategic rationales drive domestic M&A:** Domestic M&A remains the predominant driver of Asian financial services transactions, and is being stimulated by a range of strategic factors. These include domestic competition, growing pressure on operational and capital efficiency, and ongoing divestments by strategic investors from outside the region. Asian financial firms are increasingly keen to use M&A to acquire customers, and to create financial conglomerates offering sophisticated product offerings to their corporate and high-net-worth clients. National regulators in some markets are also encouraging the emergence of stronger institutions.

Firms are most likely to invest cross-border where cultural links are strong.

- **Cross-border transactions gather momentum:** Institutions across Asia – and beyond – see M&A as a crucial tool in the search for exposure to higher growth, and cross-border deals are expected to accelerate. Companies from more mature markets such as Australia, Singapore, Japan and Korea are being joined by European and American groups in the hunt for targets. Coupled with the tantalising prospect of China joining the fray, this is supportive of increased cross-border activity across the entire financial services spectrum. Asian firms with regional ambitions are developing portfolios of strategic stakes, but joint ventures and distribution partnerships are also popular. Firms are most likely to invest cross-border where cultural links are strong.
- **Obstacles and enablers to deal-making:** Capital restrictions are emerging as the leading obstacle to financial services M&A in the region. The Basel III regime is a source of concern for many, and tighter capital regulation in many markets will have an effect on the size and shape of M&A transactions. Government intervention is a potential stumbling block, but can also act as a short-term stimulus. Difficulties over deal valuation are easing, but remain a significant obstacle in some markets. Human capital issues are identified as the leading post-deal challenge for management.
- **Looking ahead:** Despite renewed concerns over the global economic outlook, we believe that financial services M&A in Asia will accelerate through 2011 and into 2012, driven by a supportive long-term macro environment and a range of strategic factors. Some of the specific areas where we see potential for deal activity include: Indian asset management and non-bank finance; trust, life insurance and asset management in Greater China; Indonesian banking and insurance; Malaysian insurance; Australian asset management; and Vietnamese banking.

To summarise, we believe that M&A in Asian financial services is poised to accelerate. Domestic activity will continue to dominate, as companies focus on consolidating existing positions, but there will also be an increasing appetite for cross-border transactions. Despite regulatory and governmental activity, we predict stronger overall levels of M&A for late 2011 and 2012. In our view every financial institution in the region – even those not currently planning M&A – needs to be aware of this potential and its possible impact on their own strategic decision-making.

Preparing for success

We are very aware that Asia is not a homogenous region, and that generalisations can be misleading. At the same time, our analysis of the survey findings suggests that some key themes cut across the region's markets and all sectors of the financial industry.

We therefore conclude this Executive Summary by identifying four factors that we believe strategic decision-makers in Asian financial services would do well to consider. Every financial institution is different, but in our view these are highly relevant for every organisation contemplating M&A in the region.

1. **Scenario planning.** Assessing the potential evolution of specific markets and sectors within Asian financial services, recognising that economic and sector imperatives are always changing. Developing detailed executable plans under a range of scenarios including adverse situations, recognising that these often present attractive deal opportunities.
2. **Credibility.** Developing individual and organisational credibility with regulators, central banks and investors over time, so that the groundwork is laid before a specific deal comes onto the market.

3. Human capital. Ensuring that human capital and talent management considerations are part of the M&A process from the very start. Are you satisfied you understand who will run the business after you acquire it, and how?

4. Flexibility. Considering a full range of approaches to M&A, including joint ventures, partnerships and distribution agreements, as well as full acquisitions and the use of strategic investments.

The financial services industry in Asia is changing rapidly, and every organisation considering M&A activity in the region needs to ensure it is thinking ahead. The smartest players are developing a range of detailed execution plans that can be put into action at short notice, depending on the economic and industry-specific situation. We believe that all financial firms in Asia should aspire to this level of readiness and adaptability if they are to capitalise on the opportunities the region has to offer.



Key findings

- Asian financial services deals declined in 2010, but the geographic spread of deals increased
 - Asian transactions also held up more strongly than in some other regions
 - The Asian macro-economic environment continues to be highly encouraging. Despite renewed economic concerns in Europe and North America, this is providing support for business and deal confidence
 - Asian financial services markets are expected to expand rapidly in the medium to long term, supported by demand from the region's growing ranks of mass affluent customers, trade flows and investment
 - Most respondents to our survey report strong revenue growth and make surprisingly bullish projections for the year ahead
 - Our survey reveals a further year-on-year increase in appetite for material M&A transactions
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01: Introduction to Asian financial services M&A

At the start of 2010, a wide range of commentators including bankers, analysts and consultants were unanimous in predicting that a recovering global economy would lead to a strong pickup in M&A activity around the world. In fact, the picture proved to be much more complex.

Asian financial deals declined in 2010, but included some encouraging signs

Asian financial services M&A in 2010 and the first half of 2011 was driven by a range of strategic themes. Restructuring continued to be a driver of activity, with a number of groups from outside the region divesting businesses acquired during the pre-crisis years. At the same time, local and global acquirers remained focused on the growth potential of Asia's financial services markets.

Asian financial sector deal values captured in our dataset totalled US\$54.6bn in 2010 (see Figure 1). This was 14.3% less than the figure of US\$63.7bn from 2009,³ and much lower than the figures of around US\$100bn previously recorded in 2007 and 2008.

However, we note that total announced deal values for the first half of 2011 are significantly higher than those for the first half of 2010. We return to this in Section 5: Looking Ahead (see page 38).

Evidently 2010 did not deliver the strong upsurge in Asian financial services M&A that many had hoped for. Even so, we believe that the data is more encouraging than it first appears. Two factors suggest that the underlying picture of Asian financial services M&A may be more positive than the headline numbers imply.

First, Asian financial services deal values have held up much better than in other regions. Total financial services deal values reported in *Sharing Deal Insight*, PwC's regular review of European financial sector M&A, fell from €80bn in 2009 to €50bn in 2010, a decline of nearly 40%.⁴

³ To give a more accurate comparison, 2009's previously published figure of US\$70.3bn has been adjusted to reflect the fact that National Australia Bank's US\$6.6bn bid for AXA Asia Pacific did not complete. AXA Asia Pacific was the subject of a separate transaction in 2010, as discussed on page 25.

⁴ 'Sharing Deal Insight', PwC, February 2011.

Asian financial services M&A in 2010 and the first half of 2011 was driven by a range of strategic themes.

Figure 1: Summary of 2010 Asian financial services M&A transactions, by deal value (US\$m)

<i>Target country</i>	<i>No. of deals</i>	<i>Banking</i>	<i>Securities and capital markets</i>	<i>Mutual funds and asset management</i>	<i>Insurance</i>	<i>Other</i>	<i>Total (US\$m)</i>
China	78	10,823	1,960	2,666	672	613	16,733
Australia	104	258	46	1,654	8,300	185	10,442
Japan	104	1,239	491	67	5,363	1,047	8,207
South Korea	29	4,479	61	28	1,520	426	6,514
Hong Kong	39	1,410	207	327	3,143	366	5,453
India	88	829	254	553	19	399	2,054
Thailand	17	1,122	–	9	–	194	1,326
Malaysia	18	–	–	0	911	1	912
Indonesia	51	704	17	4	44	30	799
Taiwan	15	98	429	6	183	–	716
Singapore	16	–	4	228	313	2	547
Pakistan	8	279	–	–	–	–	279
Philippines	8	181	–	–	–	–	181
Kazakhstan	5	131	–	–	–	–	131
Bangladesh	3	55	–	–	17	32	104
New Zealand	17	–	–	31	2	48	81
Vietnam	23	11	45	3	11	–	69
Uzbekistan	3	17	–	–	–	–	17
Sri Lanka	13	2	3	2	2	–	9
Azerbaijan	2	2	–	–	–	–	2
Total	641	21,640	3,516	5,578	20,498	3,341	54,574

Source: Thomson Reuters, PwC analysis.⁵

⁵ Please refer to Methodology on page 42.

Second, the spread of Asian deals between target countries was more evenly distributed across the region than in 2009, when Japanese activity accounted for US\$30bn, or 46% of the adjusted total. In contrast, deals involving Chinese and Australian targets shared the lead in 2010, valued at US\$16.7bn and US\$10.4bn, respectively. Japan, South Korea and Hong Kong also recorded total deal values in excess of US\$5bn during 2010.

Export growth is predicted to remain robust, while moderating from 2010's very fast pace.

The Asian macro-economic environment is highly encouraging for business confidence

Trends in M&A activity reflect the confidence of management and investors, which in turn is strongly influenced by the wider economic environment. The economic situation in Asia is currently the most encouraging of any global region. Although Asia is not immune from the uncertainties arising from the sovereign debt crisis in Europe and the US, it is expected to continue leading the global economy. Export growth is predicted to remain robust, while moderating from 2010's very fast pace. Increasing trade within Asia and with other developing regions is expected to offset weaker demand from more advanced economies, and above-average GDP growth rates are forecast for most countries in the region (see Figure 2).

This is all the more impressive considering the huge diversity of Asian economies in terms of size, maturity and the balance between government control and market forces. Developing giants China and India are forecast to continue to generate robust growth, despite the winding down of stimulus measures by the Chinese central government. The developed economies of Hong Kong, Taiwan, Singapore and South Korea are expected to see their growth rates moderate from 2010 levels, but buoyant exports and private consumption are predicted to continue to support growth during 2011 and beyond. ASEAN (Association of South East Asian Nations) nations are also forecast to enjoy rapid expansion over the next few years, supported by infrastructure investment and growing consumer demand. Thanks to fiscal stimuli and a rebound in exports, even Japan enjoyed solid growth in 2010. Japanese GDP is expected to contract in 2011 as a result of the Tohoku earthquake, but is forecast to rebound in 2012.

Although most Asian economies remain major exporters, domestic private consumption is an increasingly important driver of growth across the region. This is especially true now that many traditional export markets in Europe and North America are facing fiscal rebalancing, increasing unemployment and slower growth. Nonetheless, most economists believe that buoyant domestic demand will keep many Asian economies on a healthy growth path for the foreseeable future.

Asian financial services markets are expected to expand rapidly in the medium to long term

The rapid expansion of Asia's educated and increasingly wealthy mass affluent customers is a crucial factor behind higher rates of domestic consumption. It is also one of the most important medium-term drivers of demand for financial services. Financial penetration rates increase as per capita national output grows, with middle-class customers consuming more – and more sophisticated – products as their income increases, especially in the wealth management arena. This is reflected in the fact that Asia is now expected to generate far higher growth in wealth management than Europe or the Americas.⁶ This not only increases the market opportunity for financial firms, but also their need for expertise and innovation. In both cases, M&A is a vital part of any institution's strategic tool kit.

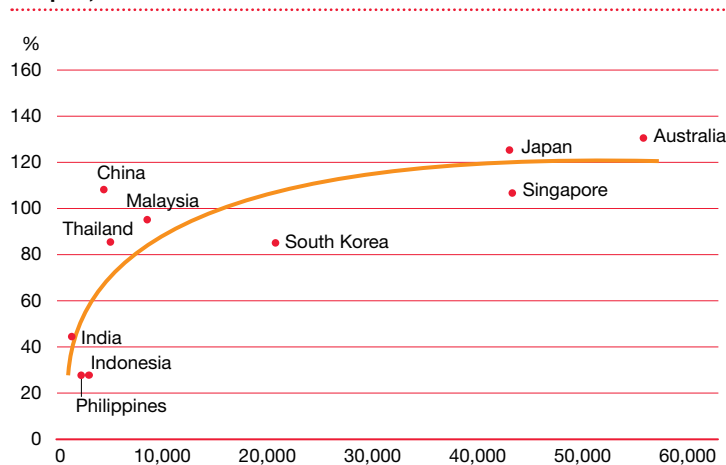
Levels of commercial bank lending relative to GDP are one indicator of financial penetration rates, and tend to increase rapidly as national output approaches the global average of around US\$9,000 (see Figure 3). This suggests not only that demand for financial services will continue to grow as Asian economies expand, but also that markets with comparatively high levels of commercial bank lending, such as China, could have scope for greater disintermediation. The IMF data also implies that India, Indonesia and the Philippines could experience financial sector growth in excess of GDP growth rates in the next few years.

Figure 2: Actual and projected real GDP growth rates, 2010-2012

	2010 Actual %	2011 Projected %	2012 Projected %
World	5.0	4.4	4.5
Advanced Asia			
Australia	2.7	3.0	3.5
Japan	4.0	-0.7	2.9
Newly industrialised Asia			
Hong Kong	6.8	5.4	4.2
Singapore	14.5	5.2	4.4
South Korea	6.1	4.5	4.2
Taiwan	10.8	5.4	5.2
Developing Asia			
China	10.3	9.6	9.5
India	10.4	8.2	7.8
ASEAN-5			
Indonesia	6.1	6.2	6.5
Malaysia	7.2	5.5	5.2
Philippines	7.3	5.5	5.5
Thailand	7.8	4.0	4.5
Vietnam	6.8	6.3	6.8

Source: Economist Intelligence Unit, August 2011.

Figure 3: Commercial bank lending as a % of GDP v. Real GDP per capita, 2010



Source: IMF World Economic Outlook and Financial Access Survey, April 2011.
Note: All data 2010 except for China, India and Malaysia (2009).

6 'Anticipating a new age in wealth management', PwC, June 2011.

Looking further forward, strong economic growth and increasing levels of financial maturity are expected to make Asia's largest financial sectors among the biggest in the world within the next 10 to 20 years (see Figure 4).

Our survey results bear out these positive growth forecasts

The results of our survey bear out these upbeat forecasts. An overwhelming majority of respondents (78%) say that their organisation's total revenues have increased over the past 12 months, with just 12% reporting a decline in turnover. It is notable that much of this improvement was achieved by doing more business with existing customers: Enhanced client focus (49%) and broader product offerings (48%) were cited as the leading drivers of growth. Improving distribution reach and opening new business lines, while also important, were cited by fewer respondents (37% and 31%, respectively), and only 22% of respondents attributed revenue growth to having entered new markets.

Survey respondents anticipate further revenue growth in 2011 and 2012, with 37% of respondents predicting their domestic business will expand by more than 10% during the year ahead and a further 39% forecasting growth of between 5% and 10% (see Figure 5). Unsurprisingly, the most positive responses came from fast-growing economies like China, India, Indonesia, Malaysia and Vietnam. Predictions for

international business were less upbeat, but still positive. This difference was most notable among Japanese and Australian organisations, many of which are comparatively exposed to slower growing markets in Europe and North America.

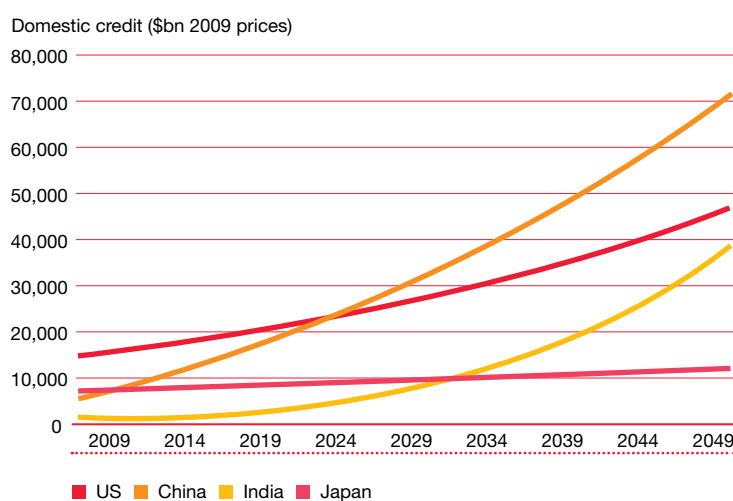
Respondents reveal a third year-on-year increase in deal appetite

Respondent's predictions for financial services M&A in Asia over the coming year are also strongly positive. More than a quarter of those surveyed (27%) consider it 'most likely' that their organisation will undertake a merger or acquisition during the coming year, and a further 31% say that a deal is already under consideration (see Figure 6). Another 22% of respondents are undecided, with just 20% of those surveyed taking a negative view of their organisation's M&A appetite.

This means that 58% of those surveyed expect their organisation to seriously consider or undertake a material merger or acquisition during the coming year. This is a further increase on last year's figure of 54% and the largest positive response recorded by the survey at any point over the past four years (see Figure 7), reflecting the encouraging economic environment. The industry's confidence is increasing, with firms growing more willing to use M&A as a rapid route to expansion. In the sections that follow, we review the motives for M&A in Asian financial services in greater depth.

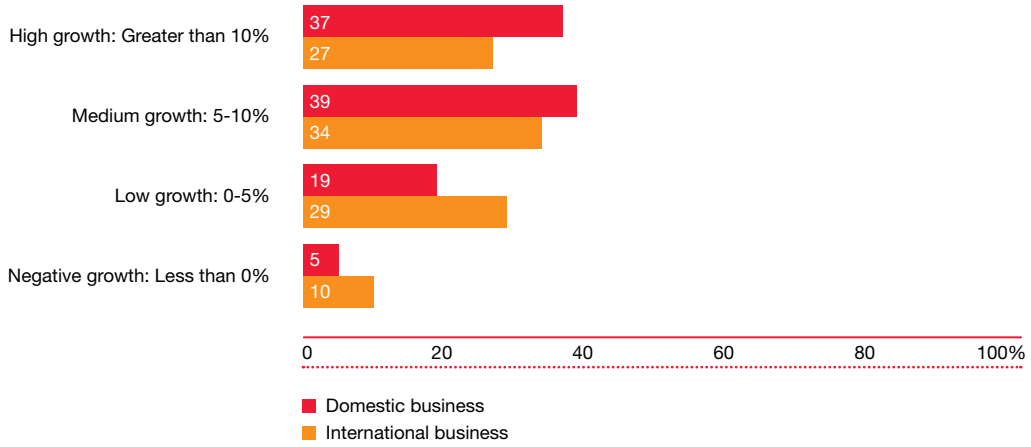
The industry's confidence is increasing, with firms growing more willing to use M&A as a rapid route to expansion.

Figure 4: Projected domestic banking assets, 2010-2050



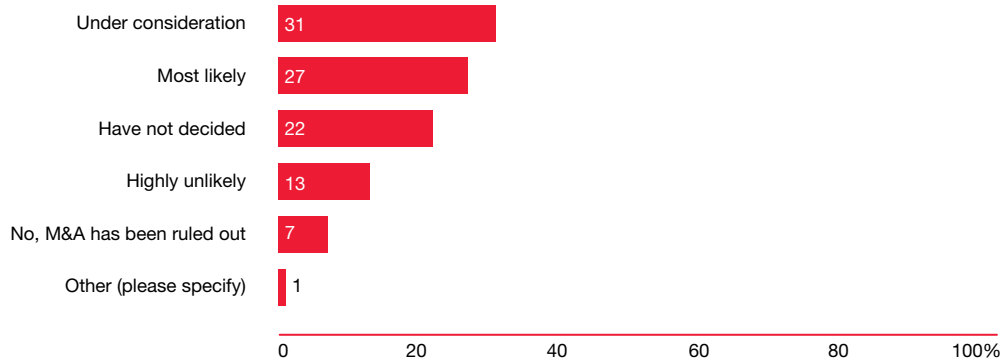
Source: Banking in 2050, PwC, May 2011.

Figure 5: Expected level of business growth, next 12 months



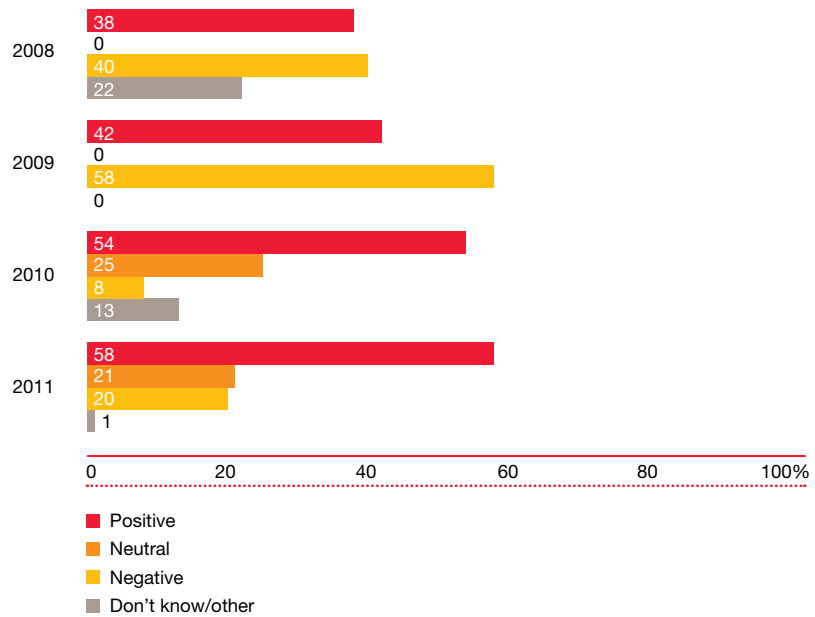
Source: PwC Financial Services M&A in Asia Survey 2011.⁵

Figure 6: Likelihood of considering or undertaking material M&A during the next 12 months



Source: PwC Financial Services M&A in Asia Survey 2011.

Figure 7: Sentiment regarding material M&A during the next 12 months, 2008-2011



Source: PwC Financial Services M&A in Asia Surveys, 2008-2011.

7 Please refer to survey methodology notes on page 42.

Key findings

- Growing competitive pressures are acting as a spur to domestic consolidation in many Asian financial services markets
- M&A is also seen as an effective way to accelerate customer acquisition, even in fast-growing markets
- Cost synergies mean that same-sector mergers remain the easiest to sell to shareholders and regulators
- Pressure to consolidate is particularly strong for small and medium-sized firms facing capital and profitability pressures
- Large Asian financial groups are increasingly targeting a financial conglomerate structure
- Firms are particularly keen to offer a full range of services to their corporate and high-net-worth customers
- Market-specific factors remain highly influential, especially regulatory attitudes and the role of other government bodies
- Deal activity is being supported by non-core disposals and the increasing interest of non-financial groups in financial services ownership

02: Strong strategic rationales drive domestic M&A

Domestic M&A continues to account for the majority of Asian financial services transactions and the bulk of total deal values. Domestic deals accounted for 13 of the 18 transactions valued at more than US\$500m during 2010. There are several common strategic themes at work, but deal activity in every Asian market also remains heavily influenced by local factors.

Domestic consolidation reflects growing competitive pressures, and a desire to boost customer acquisition

Respondents to our survey who are considering engaging in M&A during the coming year, clearly identify the desire to increase their market share as the strongest motive for deal-making (see Figure 8).

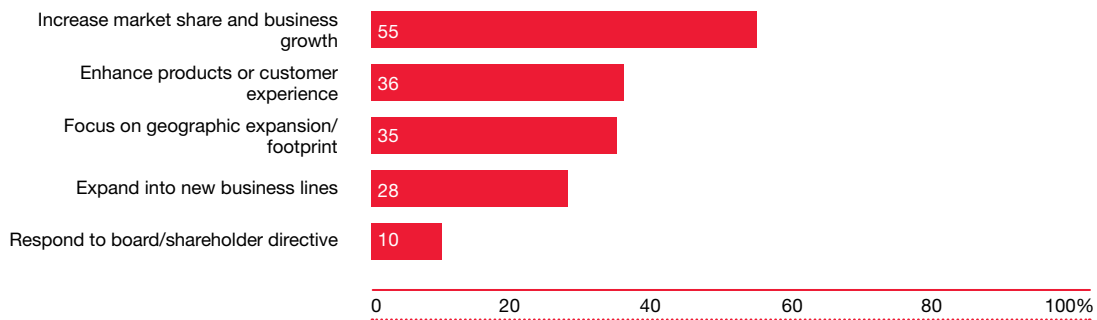
This is a logical strategic response to the competitive pressures that are an increasing hallmark of Asian financial services markets. According to respondents whose organisations saw their income decline over the past year, competition and customer churn were two of the three leading sources of

revenue pressure (see Figure 9). The increasing reach of private sector financial firms outside major cities and regional centres is a phenomenon being felt across several developing Asian economies, and M&A transactions are playing a major role in firms' growing domestic ambitions. Of course, in-market consolidation tends to increase competitive pressures, but larger firms are better placed to prosper in a more competitive market.

It is notable that some of the most bullish views on financial firms' appetite for M&A come from respondents in some of the fastest-growing economies in Asia, including China and Vietnam. In the case of Vietnam, the desire to merge also reflects a highly fragmented industry structure. This shows that M&A is being used as a means to accelerate customer acquisition in high-growth markets, as well as to offset the effects of margin pressure and declining fees. In our view, both themes will continue to support the rationale for domestic financial services consolidation in many Asian markets.

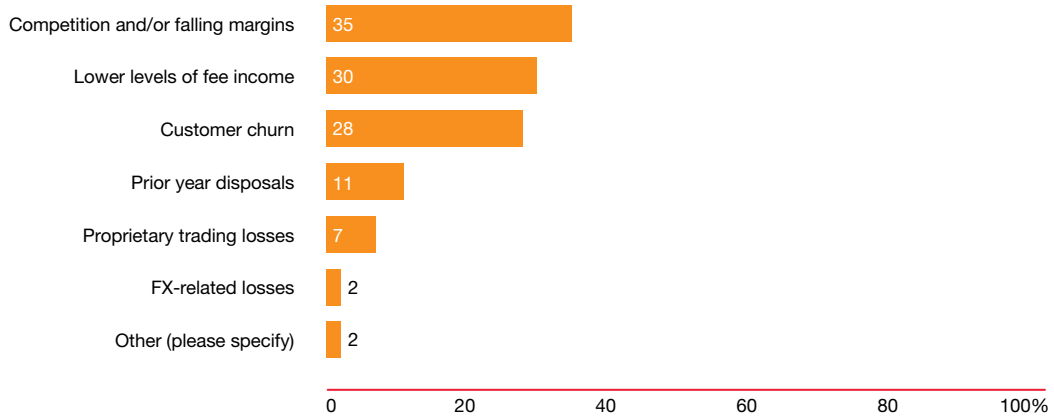
Respondents to our survey who are considering engaging in M&A during the coming year clearly identify the desire to increase their market share as the strongest motive for deal-making.

Figure 8: Primary motives for considering M&A during the next 12 months



Source: PwC Financial Services M&A in Asia Survey 2011.

Figure 9: Primary drivers of decreasing revenues during the last 12 months



Source: PwC Financial Services M&A in Asia Survey 2011.

The logic of in-market scale-building is often particularly strong in retail and commercial banking.

Same-sector deals maximise efficiency and have the strongest economic logic, particularly for small and medium-sized firms

When it comes to domestic transactions, consolidation within the same sector of financial services is generally the easiest sell to shareholders and – absent any antitrust concerns – national regulators. The logic of in-market scale-building is often particularly strong in retail and commercial banking. Several medium-sized banks in the region have found themselves under growing capital pressure in recent years, and rising costs and margin pressures have also encouraged banks to seek out cost synergies through the use of shared back-office functions. Some domestic transactions from 2010 included a further strategic investment by Mizuho Corporate Bank in Japanese rival Orient Corporation for US\$365m and Bendigo & Adelaide Bank's decision to purchase the 40% of Rural Bank it did not already own for US\$162m.⁸

However, in-market consolidation is far from being limited to the banking sector; 2010 saw numerous in-market mergers in asset management and brokerage across Asia. In many markets in the

region both sectors are characterised by a fragmented structure, intense competition and acute margin pressure. Consequently, deals are often numerous but relatively small. In China alone, our dataset captured 14 domestic brokerage deals and 9 domestic asset management transactions valued at less than US\$50m during 2010. There have also been some much larger brokerage deals, especially in Taiwan. One of 2010's largest deals was the US\$429m acquisition of Taiwan International Securities by Capital Securities Group, and in April 2011 Yuanta Financial Holding Company announced its acquisition of Polaris Securities for up to US\$1.65bn, a move that will create Taiwan's largest securities firm.

Given that many national regulators are reviewing or strengthening their capital and solvency requirements for banks and insurers in line with changing international standards such as 'Basel III', and that domestic competition in many markets is increasing, we expect the profitability pressures facing many small and medium-sized financial firms in Asia will only increase. If anything, this is likely to strengthen the cost-focused rationale for same-sector consolidation during the coming year.

⁸ Unless otherwise indicated, all deal data sourced from Thomson Reuters.

Financial conglomerates are forming, especially among corporate or high-net-worth-focused institutions

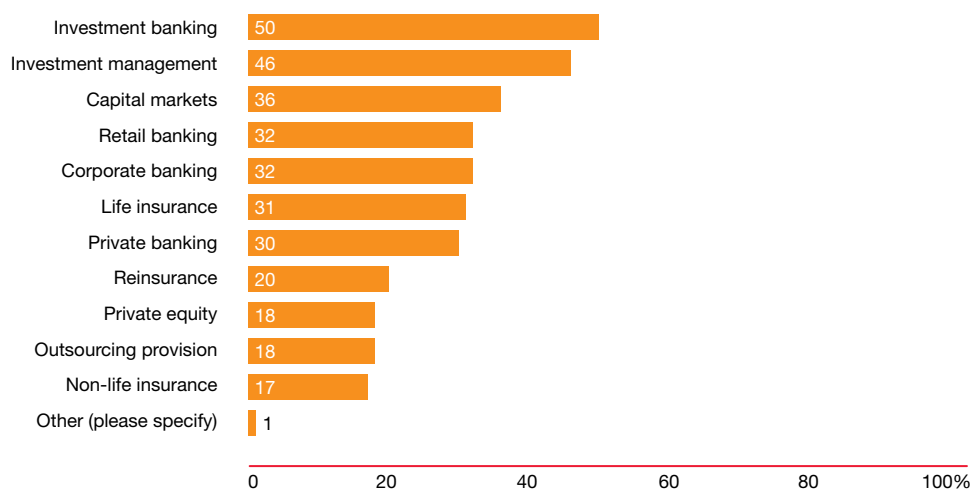
Gaining scale and market share is not the only driver for domestic financial services M&A in Asia. For 35% of those surveyed, improving product offering and customer experience is the primary motive, and a further 28% see the desire to expand into new business lines as a reason for deal-making. The desire to acquire new expertise and broaden product capabilities is increasing across Asia, often encouraged by falling regulatory barriers between different sectors of financial services.

China is a good example of a market where local firms are increasingly keen to create financial conglomerates. Following many years when Chinese banks were not permitted to own securities, trust and asset management companies, regulatory relaxation has seen several banks set up or acquire trust companies during the past two years,

with a view to developing a wider range of financial services. Nor is it just the banks that have been trying to diversify themselves. Ping An, China's second largest insurance group, paid US\$4.3bn in 2010 for a controlling shareholding in Shenzhen Development Bank, in a deal designed to increase the group's share of banking income and move Ping An closer to becoming a financial conglomerate.

The desire to offer a full range of services is especially strong among firms with corporate and high-net-worth clients who might otherwise turn to specialised or foreign rivals. Developing investment banking and advisory capabilities is particularly popular (see Figure 10), especially among retail and commercial banks. Investment management is also targeted for development by 46% of respondents. At a time when many banking and insurance groups are under pressure to improve their capital levels and solvency, the comparatively low capital requirements of both business lines may also be a significant factor.

Figure 10: Areas likely to attract firms using M&A to expand into new lines of business



Source: PwC Financial Services M&A in Asia Survey 2011.



Local dynamics remain critical – especially the role of government bodies

While we expect the strategic drivers for domestic consolidation and same-sector M&A to remain strong across Asia, it is crucial to remember that deal activity in each country and sector in the region is also affected by a range of specific factors.

To begin with, market maturity, structure and dynamics vary from country to country. A quick look at two contrasting markets illustrates this point. In a highly developed market such as Singapore, it is not unusual to find high levels of concentration in retail banking and insurance. As a result, the scope for material domestic transactions in these industries is limited. In contrast, the financial industry in a country such as Malaysia is less mature and far more fragmented, with Bank Negara Malaysia keen to encourage scale-building transactions that will increase market concentration.

The involvement of governments and their representatives in domestic financial services M&A varies widely across the region – a topic we examine further in Section 4 of this paper. Malaysia is far from being the only country in Asia where the central bank

is hoping to see the emergence of more institutions with the scale to compete internationally. Governments in South East Asia are particularly keen to promote consolidation, and the increasing number of countries with explicit financial services strategies means that this trend is only likely to accelerate. In another example, the Central Bank of the Philippines is encouraging consolidation among small rural banks, and the market has also seen mergers between commercial and universal banks, seeking to boost their capital positions and distribution networks. In contrast, Australian regulators have made it clear that they will not permit any further domestic market-share increase among the four largest nationwide banks.

Asian regulators and central banks also regularly help to arrange domestic transactions involving weakened institutions. While market forces continue to be the major driver of M&A in Indian banking, one such transaction took place in 2010. This was the acquisition of Bank of Rajasthan for US\$608m by ICICI Bank, India's largest private sector bank. ICICI had reportedly considered making a bid before the global financial crisis; more recently the Reserve Bank of India had appointed a new management team to Bank of Rajasthan.⁹

⁹ 'Bank of Rajasthan to merge with ICICI Bank', The Economic Times, 18.05.10.

Market size, divestments and non-financial buyers will also continue to stimulate domestic M&A deals

To conclude this section of the paper, we want to draw attention to several additional factors supporting volumes of domestic M&A in Asian financial services. One is the sheer geographic and human size of some Asian markets, which mean that domestic transactions can deliver significant diversification benefits. This is especially true where different regions of a single country are at different stages of economic development, and it is notable that survey respondents from China and India were among the most likely to identify their own countries as attractive destinations for investment.

Another factor is growing interest in financial services from non-financial conglomerates. In developed markets, this is most often seen when automotive or consumer product groups start lending to their customers, but in Asia it is more common for conglomerates to use financial services as a source of diversification. The increasing importance of technological innovation to retail financial services is also encouraging the development of novel relationships. China Mobile's US\$5.8bn acquisition of a minority stake in Shanghai Pudong Development Bank in 2010 illustrated this trend, with the telecoms operator describing the deal as part of a strategy to develop its offering of mobile payments and other forms of mobile finance.

An additional consideration is that domestic investment funds may be more likely to have financial services investments approved than foreign private equity firms. Two Korean private equity funds that made significant investments in local insurers during 2010 were Vogo Investment Fund, which acquired a controlling stake in Tong Yang Life Insurance for US\$796m, and the KDB Consus Value fund, which purchased 65% of Kumho Life Insurance for US\$569m.

Lastly, divestments – which we explore further in the next section – continue to provide Asian firms with local acquisition opportunities. Financial groups from outside Asia are no longer ready to sell their operations in the region at any price, but occasional disposals of subscale and non-core businesses continue to throw up valuable openings for local firms. One such example was the sale by American International Group (AIG) of a 97.6% stake in Taipei-based Nan Shan Life Insurance to investors led by Ruentex Group, for US\$2.16 billion, a transaction that closed in August 2011. MetLife decided to follow ING in pulling out of Taiwanese insurance, with local firm Chinatrust Financial Holding Company paying US\$180m for the business, although MetLife was also an acquirer in the region during the year (see page 24). We expect non-core divestments to continue to act as a driver of domestic acquisitions into 2012 and beyond.

The increasing importance of technological innovation to retail financial services is also encouraging the development of novel relationships.

Indian financial services markets have grown rapidly in recent years, and have huge further potential.

Indian financial services M&A: Poised for lift-off?

Indian financial services markets have grown rapidly in recent years, and have huge further potential. This reflects a variety of factors including annual savings rates of more than 30%, favourable demographic trends and growing demand from India's 250 million-strong middle class. Current levels of financial penetration are also lower than in many emerging markets.

Even so, despite a slight pickup in M&A since 2010, the Indian financial industry continues to experience comparatively low levels of deal activity. In this box we briefly examine the potential for a fresh wave of M&A in five key sectors of Indian financial services.

- The Indian **banking industry** is growing fast, but the 10% voting 'rights' cap and a foreign ownership limit of 5% have kept a lid on M&A. There is some latent potential for combinations of small domestic players, but for now the sector is awaiting guidelines for the issuance of new banking licences. These could open up Indian banking to local entrants, some of which may be open to foreign partnerships, within extant guidelines on foreign ownership of local banks and FDI norms.
- In contrast, the more lightly regulated **non-bank financial sector** – where full foreign ownership is

permitted – offers an easier way for acquirers to tap into growing credit demand. Non-bank financial companies (NBFCs) can conduct a wide range of lending in fast-growing areas such as mortgages, credit cards and rural lending, and there is strong potential for deal activity in this sector. Tighter provisioning rules and capital requirements from the Reserve Bank of India might act as a short-term impediment to transactions, but this could encourage NBFCs to seek a strategic partner in the medium term. A number of NBFCs might welcome a foreign partner that could introduce additional capital as well as technical expertise.

- India's **life and general insurance industries** have grown rapidly over the last five years, generating average premium growth of 27% and 15%, respectively. Further growth potential is enormous, with India's insurance penetration rate less than half that of China and a quarter of Brazil's. However, both markets are currently dominated by public sector companies, and most private firms already have existing foreign joint-venture partners. Deal prospects will depend on anticipated new M&A and IPO guidelines from the Insurance Regulatory and Development Authority, which could open up new opportunities for foreign players to contribute their product expertise via partnerships with local firms.

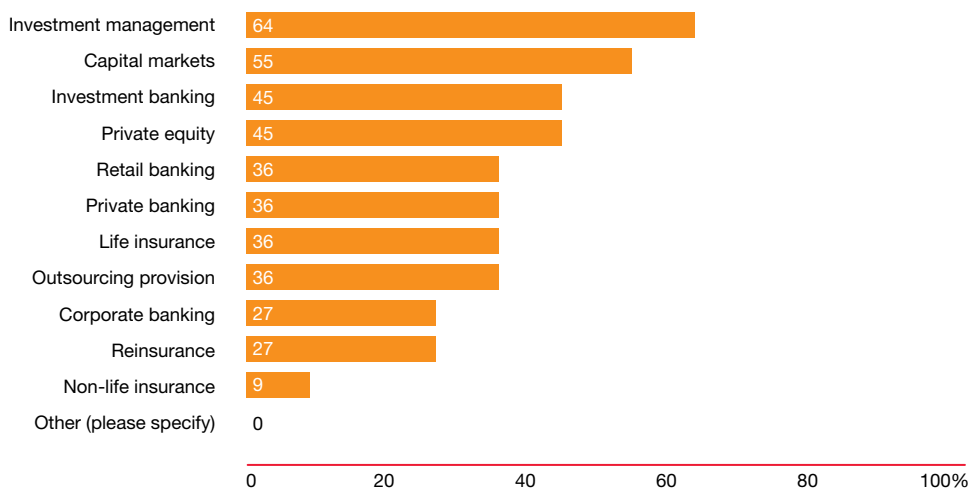
- India's **retail asset management sector** has seen explosive growth over the last decade, during which assets under management (AuM) increased by seven times. Recent regulatory changes have effected distribution, but the increasing wealth of India's middle classes should generate sustained growth in demand and increasing scope for more sophisticated wealth management. The asset management sector is fragmented, with good scope for consolidation and no limits on foreign ownership. There is also increasing interest in asset management among Indian financial firms looking to offer their customers a broader range of products, as illustrated by our survey (see Figure 11).

- Lastly, India's **securities brokerage sector** has potential for consolidation. The sector is fragmented, and levels of commissions have fallen since the global financial crisis. As a result competition is tight and many firms are facing sustained profitability pressure. The logical response would be a higher level of market concentration, but market volatility and poor profit visibility could make significant deal activity among brokers unlikely during 2011.

uncertainty over target valuations, which can be a barrier to getting deals done. Our Indian survey respondents agree, identifying valuation problems and government intervention as two leading obstacles to M&A activity. Nonetheless, we expect M&A activity in Indian financial services to pick up as regulatory barriers fall. This market might just be poised for lift-off.

Overall, there is strong potential for higher levels of M&A in Indian financial services, but this is partly offset by regulatory uncertainty. Regulatory changes and the wait for new banking and insurance guidelines are creating

Figure 11: If the primary motive for acquisition is to expand into new business lines, which of the following areas might attract your organisation? (Indian respondents)



Source: PwC Financial Services M&A in Asia Survey 2011.

Key findings

- Cross-border M&A in Asian financial services is poised for a new, more positive cycle of activity
 - High-growth markets – China above all – are generally viewed as the most attractive
 - More mature markets are also attractive as jumping-off points, and to buyers that can develop scale positions
 - Firms based in slower growing markets such as Japan and the US are becoming more active as cross-border bidders
 - Buyers from inside and outside Asia are using a range of cross-border approaches including full acquisitions, joint ventures and distribution partnerships
 - Firms with regional ambitions are developing portfolios of strategic stakes as a way to explore further expansion
 - Non-core and subscale businesses continue to be divested, often to non-Asian buyers
 - Asia is not homogenous, and intra-regional deals are most common where cultural links are strong. Even so, this is no guarantee of success
 - Wholesale banking and wealth management sectors are most likely to follow their customers abroad
-

03: Cross-border transactions gather momentum

Domestic M&A transactions may account for the majority of Asian financial services deal numbers and deal values, but political and cultural sensitivities mean that cross-border transactions often steal the headlines. They can also be more challenging – and more innovative. To understand why, we begin with some recent history.

The cycle of cross-border M&A in Asia shows clear signs of picking up again

Cross-border financial services deal activity in Asia has followed a strong cyclical pattern in recent years. After making a splash with high-profile acquisitions during the mid-2000s, many investors from Europe and North America made a rapid withdrawal in 2008 and early 2009. Bank of America, AIG, Royal Bank of Scotland, Citigroup and UBS were just a few of those who pulled back from Asia quickly, driven largely by group-level solvency concerns, regulatory requirements, or domestic politics.

Exits by players from outside Asia have since slowed. Instead, late 2009 and 2010 saw buyers from within Asia developing intra-regional acquisition strategies, encouraged by improving market stability and growing economic

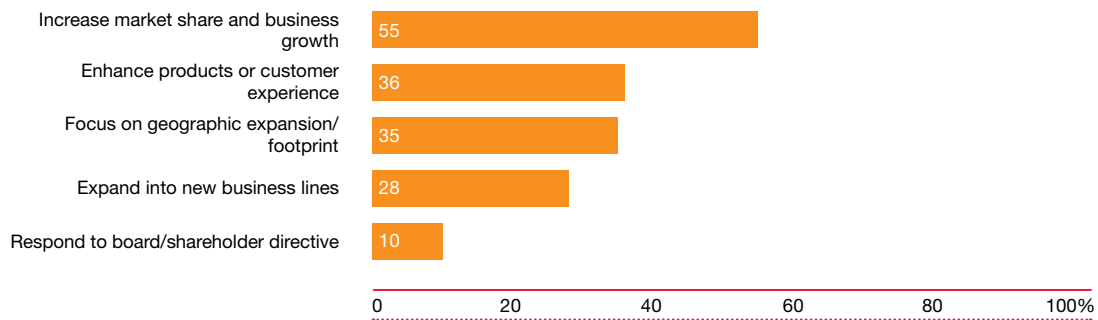
confidence. Our survey shows that geographic expansion is a very important motivation for Asian firms expecting to consider or undertake significant M&A during the year ahead (see Figure 12). Most recently, North American and European financial groups that weathered the crisis well – or that have rebuilt their capital bases – have rediscovered their appetite for exposure to the growth potential of Asian financial services markets.

High-growth potential is the leading motive, but mature markets can offer earnings growth too

It is, of course, the current and prospective growth rates of Asian financial services markets that make them so attractive to foreign buyers. Among respondents identifying geographic expansion as a major motive for M&A, it is no surprise that the huge and rapidly growing Chinese market was seen as by far the most attractive (by 37%, see Figure 13 overleaf). The attractive fundamentals of Chinese financial services are well known, but at a time when almost every international financial organisation is seeking to set out a credible Chinese strategy, the result also highlights the dangers of herd behaviour.

Cross-border financial services deal activity in Asia has followed a strong cyclical pattern in recent years.

Figure 12: Primary motives for considering M&A during the next 12 months



Source: PwC Financial Services M&A in Asia Survey 2011.

Respondents to the survey identify Singapore (23%) as the second most attractive market in the region. At first glance this seems surprising; Singapore continues to enjoy robust economic growth, but its small size offers limited potential for expansion. Like Hong Kong (21%) though, Singapore benefits from its status as a global financial hub and its high level of per capita income. Both markets are identified as attractive destinations by respondents from the capital markets and wealth management industries. Singapore's attraction may also be partly explained by its location in South East Asia, making it a mature, stable base from which to expand into larger, faster growing markets such as Malaysia – another popular destination (19%).

The survey also throws out some unexpected findings. First, despite its huge growth potential India is only identified as a potential destination by 16%. In the box on page 18 we examine

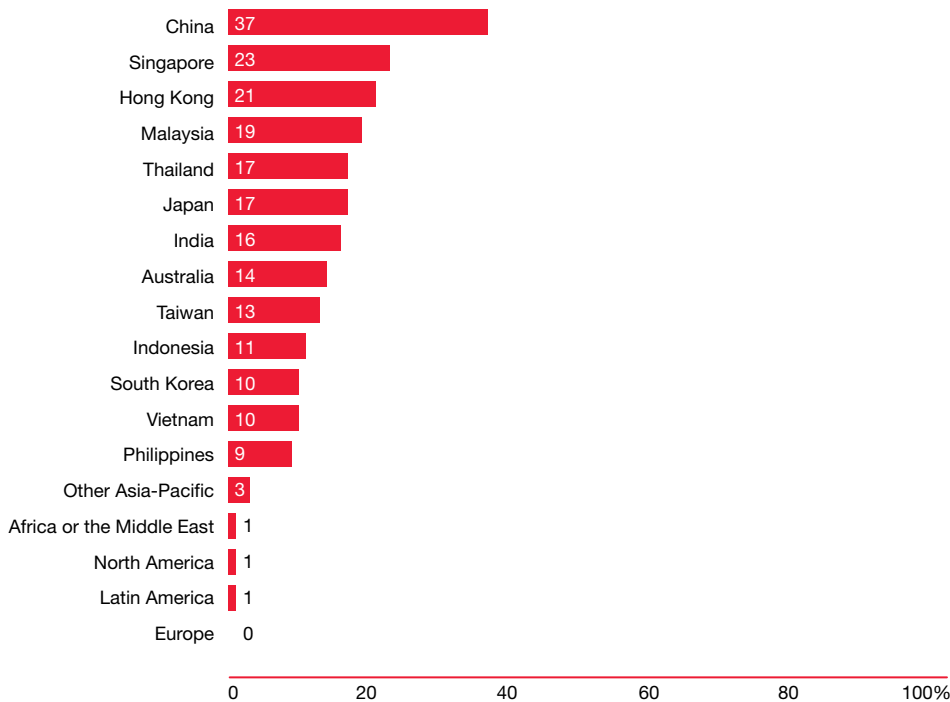
some of the reasons for this low rating, and India's potential for an upward revision. Secondly, Thailand remains relatively attractive to new entrants (17%), despite the political unrest that has been a recent feature of this market. This response may reflect hope that recent election results could herald a more stable period, increasing appetite for inward investment.

Buying into higher growth does not have to involve acquiring in a fast-expanding market. It is notable that Japan emerges from the survey as a mid-ranking destination (also 17%), even though its financial services market is the most mature and slowest growing in the region. This is a reminder that less dynamic markets can still be attractive to foreign players, provided bidders can achieve sufficient scale and profitability. This was illustrated by Prudential Financial's 2010 acquisition of AIG's two Japanese life insurance subsidiaries in a deal valued at

US\$4.8bn. Added to the bidder's existing Japanese businesses, the targets will make Prudential the biggest foreign player in Japan's life insurance market, helping it to compete more aggressively with leading domestic incumbents.

Furthermore, cross-border investors in Asian financial services targets continue to use a variety of approaches to increase their exposure to growth. Outright acquisition remains the most popular approach, especially for smaller targets, but limitations on foreign ownership continue to stimulate joint ventures and other forms of partnership. Foreign exchange risks and the lack of homogeneity between Asian markets also mean that many outward-looking firms in the region are looking to develop a portfolio of strategic stakes. This approach allows understanding and relationships to develop over time, while minimising risks and keeping strategic options open.

Figure 13: Most attractive areas for geographic expansion via M&A



Source: PwC Financial Services M&A in Asia Survey 2011.

Bidders from low-growth markets are launching inbound and intra-regional M&A

The search for stronger revenue and earnings growth is, of course, most important for firms exposed to slow-growing domestic markets. Further encouraged by the relative strength of the yen, Japanese insurance firms have become particularly active as intra-regional acquirers. In addition to Mitsui Sumitomo's transactions, Dai-Ichi Life Insurance also spent US\$1.2bn on Australian insurer Tower Group during 2010. The deal was intended to increase Dai-Ichi's exposure to foreign growth markets and provide a platform for further expansion across Asia-Pacific. We expect the largest Japanese insurers – and the more outward looking Australian banking groups such as ANZ and Commonwealth Bank of Australia – to continue to seek for regional opportunities to invest in growth.

Bidders from beyond Asia also continue to be attracted to the growth and profitability profiles of some of the region's financial services markets, and

2010 saw a range of approaches from European and North American acquirers. ACE's US\$210m purchase of Jerneh Insurance of Malaysia was an example of an outright acquisition, while UK insurer Prudential preferred to set up a bancassurance partnership with United Overseas Bank (UOB) of Singapore. This involved the acquisition of UOB Life for US\$307m and an agreement to distribute Prudential's products through UOB's branches in Singapore, Indonesia and Thailand. This was also a good illustration of the way that firms can use market entry to one Asian territory as a springboard to others.

Non-Asian firms also increased their Asian exposure via local subsidiaries. One example was Thanachart Bank's two-stage acquisition of Thai competitor Siam City Bank, with the first 48% being purchased from the Thai central bank for US\$1.1bn. Thanachart is a long-standing subsidiary of Canadian Bank of Nova Scotia. Announcing the deal, Nova Scotia officials stated their belief that their 30 years of experience with Thanachart had left them confident about negotiating the political risks of investing in Thailand.¹⁰

Non-Asian firms also increased their Asian exposure via local subsidiaries.

¹⁰ 'Scotia's Thanachart takes away Siam City Bank', Financial Post, 11.03.10.

Divestments by non-Asian players often lead to one foreign owner replacing another

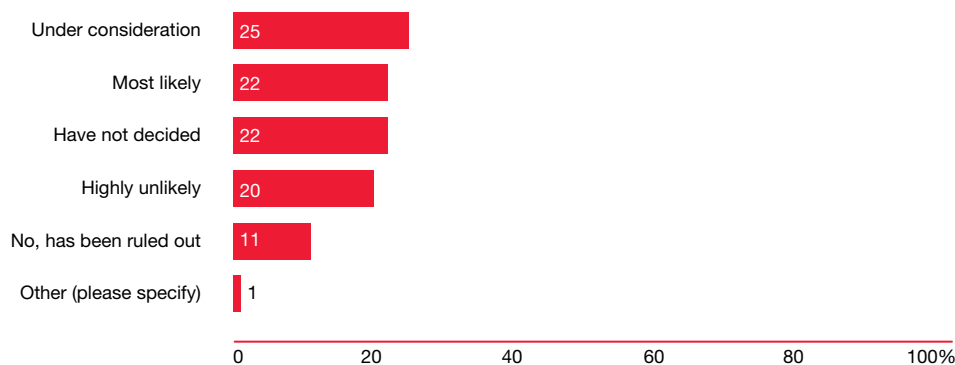
Our survey shows that financial firms in Asia are less likely to divest than to acquire, but disposals remain on the agenda. A total of 47% of respondents see divestments as being likely or under consideration, compared with 31% who view disposals as unlikely or as having been ruled out (see Figure 14).

Financial services groups based outside Asia also continue to pull back from the region, albeit less urgently than during the global financial crisis. The search for greater focus and the need to raise capital continue to be the two leading reasons for the disposal of non-core activities,

typically following a change in ownership or group-level strategy (see Figure 15). One organisation's need to sell is another's opportunity to buy, and as already mentioned there are just as many well-capitalised international financial groups looking to expand in Asia as there are weaker groups seeking an exit.

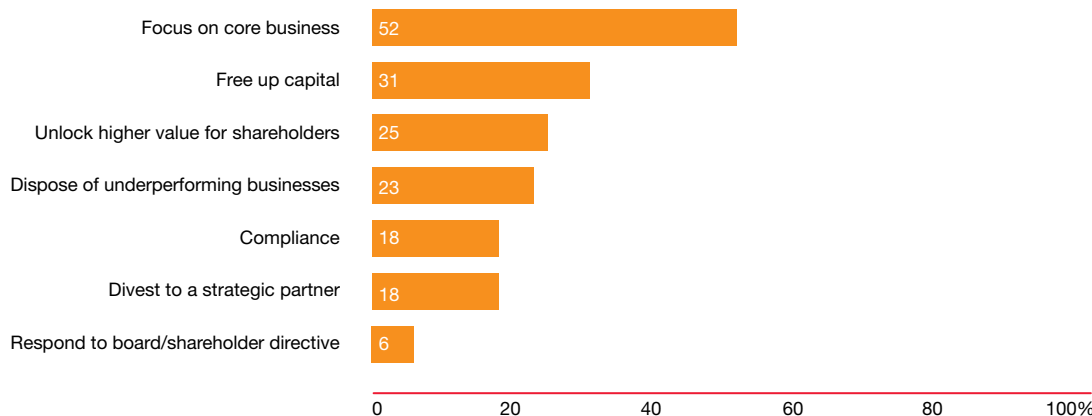
As a result, 2010 saw a number of Asian financial businesses change hands between North American or European owners. MetLife agreed to acquire AIG's non-US life insurance unit Alico for an estimated US\$15.5bn, a deal that gives MetLife instant exposure to several Asian markets including Japan.¹¹ Meanwhile Royal Bank of Scotland's refocusing

Figure 14: Likelihood of making a divestment during the next 12 months



Source: PwC Financial Services M&A in Asia Survey 2011.

Figure 15: Primary motives for possible divestments during the next 12 months



Source: PwC Financial Services M&A in Asia Survey 2011.

11 'MetLife to acquire Alico from AIG', MetLife press release, 08.03.2010.

strategy saw the group sell its banking operations in India and Kazakhstan to UK-headquartered rival HSBC for US\$221m and US\$52m, respectively. Global insurer ACE also acquired New York Life's businesses in Hong Kong and South Korea for US\$350m and US\$75m, adding two established businesses to its existing Asian portfolio.

One exceptional transaction during 2010 saw two joint bidders working together to achieve different goals. This was the acquisition of AXA Asia-Pacific, an Australian-listed asset manager partly owned by French insurance group AXA. AXA and Australian asset manager AMP made a joint proposal to AXA Asia-Pacific, with AMP acquiring AXA Asia-Pacific, retaining its Australian and New Zealand activities and divesting the remainder of AXA Asia-Pacific's Asian business to AXA. The transaction valued AXA Asia-Pacific at A\$13.3bn (US\$13.2bn).¹² For AXA, this is consistent with its strategy of refocusing on higher growth markets, which also saw the group sell its UK life and pensions' business during 2010. For AMP, the acquisition enables a significant challenge to the dominant wealth management businesses of Australia's four leading banks, creating a new 'fifth pillar' in the local asset management industry.

Cultural and geographic links are often crucial, but there are no guarantees of success

As well as exploring the appetite for cross-border M&A and the attractiveness of specific markets, our survey allows us to compare and contrast attitudes towards international transactions between different Asian countries and industry sectors.

The diversity of Asian markets in terms of languages, customer preferences, taxation, governance and business practices mean that cross-border deals are most likely to occur where cultural, legal, or geographic links are strong. So while the survey identified mainland China as the most attractive market in the region, respondents from Hong Kong, Taiwan and close neighbour South Korea were more enthusiastic than most. In the same way, those surveyed in mainland China were most likely to identify Hong Kong as a market for investment.

The importance of cultural links is illustrated by Malaysian group CIMB's acquisition of a further strategic stake in Indonesian Bank CIMB Niaga, for a consideration of US\$529m. Niaga is Indonesia's fifth-largest private bank, and the deal gives CIMB greater exposure to Indonesia's expanding financial services markets, in line with its ASEAN-focused growth strategy.

Even so, organisations contemplating cross-border M&A need to remember that Asia is far from being a trading bloc. Trade relationships such as that between Taiwan and mainland China, improved by the signing of the Economic Cooperation Framework Agreement in June 2010, remain the exception rather than the rule. Taiwanese financial firms are keen to expand on the mainland, and several joint ventures have already been set up in commercial banking, insurance and asset management. Even here though, there are obstacles to cross-border M&A. For instance, there is still no agreement on how to resolve cross-Straits arbitration disputes, and while there are few restrictions on foreign ownership of Taiwan's financial sector, Taiwanese buyers are bound by the same foreign ownership rules as any international investors in mainland China.

The diversity of Asian markets in terms of languages, customer preferences, taxation, governance and business practices mean that cross-border deals are most likely to occur where cultural, legal, or geographic links are strong.

12 'AXA to close AXA APH transaction on April 1, 2011', AXA press release, 23.03.11.

Wholesale sectors are more likely than most to follow their customers across borders

The survey also confirms that wholesale-focused financial organisations in Asia are more likely to engage in cross-border M&A than their retail counterparts. The desire to follow corporate customers overseas is a strong part of many international strategies, and respondents from the corporate banking and capital markets sectors are most likely to consider using M&A to expand geographically. The same sectors were also keenest to expand in China's fast-growing capital markets or in the regional financial hubs of Hong Kong and Singapore.

Investment management and private banking were the other sub-sectors of financial services most likely to consider using M&A to enter new markets. Like

the wholesale banks, wealth management firms are seeking to serve their upwardly mobile high-net-worth clients, wherever in the region they are. Unsurprisingly, wealth management respondents were particularly attracted to affluent Hong Kong and Singapore. Nikko Asset Management's acquisition of DBS Asset Management from Singaporean bank DBS for US\$105m, announced at the end of 2010, was an example of this type of regionally focused expansion. It was also notable that the seller retained a minority stake in Nikko Asset Management. Banks selling off asset management product businesses are not the only financial groups looking to retain some exposure to divested businesses. Firms in the region's more mature markets are increasingly willing to exit subscale businesses if they can keep some 'skin in the game'.



Asset management in Greater China has clear potential for a fresh wave of M&A activity

Asset management offers some of the most attractive markets in China in terms of its growth potential, both in the retail and in the institutional arenas. Growth in assets under management is strong, there is clear potential for expansion in wealth management, and there is increasing demand for more sophisticated products and services from Chinese institutional investors.

There have been many domestic mergers between small and medium-sized Chinese asset managers during the past two years, and we expect this to continue as firms within China seek greater scale and wider access to distribution. However, we also see growing potential for cross-border asset management M&A within Greater China, as companies seek to develop their international growth avenues. In particular, mainland firms will continue to acquire in Hong Kong, both in search of expertise and as a route to regional expansion.

The fundamentals of the Chinese asset management sector may look attractive to foreign firms, but there are significant distribution barriers to overcome. Retail fund distribution is dominated by the four leading domestic banks, and local asset managers benefit from existing relationships and the strength of well-established brands.

Foreign asset managers looking to operate in China must form joint ventures with local firms, with foreign ownership capped at 49%. More than 30 of these partnerships have been set up, but securing distribution with the biggest banks is a challenge and can be expensive, especially for smaller players. Forming a brand new joint venture will involve a long wait for approval, and while new entrants can wait for existing investors to withdraw, this is likely to be expensive.

As a result, foreign entrants are increasingly looking to use trust companies as vehicles for off-balance sheet investment management, as well as other financial services. The advantages of Chinese trusts include their ability to engage in a wide range of investments and financial activities, and to offer products across different Chinese provinces.

By limiting cooperation between trusts and local banks on wealth management, regulators have also encouraged existing trusts to seek new strategic partners in recent years. Foreign players that have invested in Chinese trusts since 2007 include Barclays, NAB, Ashmore Investment Management, Morgan Stanley, Sumitomo and JP Morgan. We see clear further potential for foreign entrants to use trusts as a route to enter the Chinese asset management market.

At the same time, we believe Chinese asset managers are themselves

becoming increasingly prepared to expand overseas. This is consistent with a wider pattern of Chinese financial services firms looking to invest outside China, as they follow their corporate customers from other industries. For asset managers, there are two major motives: Developing their expertise and a stronger range of products for domestic customers; and tapping the huge international demand for exposure to Chinese economic growth.

Chinese asset managers are already setting up offices in Hong Kong, and we expect to see increasing inbound deal activity there – and in Taiwan. Acquisitions in Greater China could represent an attractive step towards regional expansion for Mainland firms, giving them the chance to develop their expertise before entering less familiar markets. Looking further afield, the impact of renewed market volatility in Europe and the US could offer Chinese firms the chance to act opportunistically to develop their footprint in developed markets.

All in all, we feel that the huge growth potential of asset management in China, coupled with increasing demand for inbound and outbound cross-border investment, means that this is likely to be an active area for M&A over the next few years.

Key findings

- Our survey identifies a range of obstacles to financial services M&A in Asia
- Capital restrictions are seen as the leading obstacle, with Basel III a source of particular concern
- Tighter capital regulation is likely to have conflicting effects on the volumes and types of M&A
- Public sector intervention in the deals process is another worry, but deregulation can also act as a stimulus to deal-making
- Poor information on deal targets and pricing gaps remain significant obstacles, particularly in the region's less sophisticated markets
- Difficulties over deal valuations are easing, but remain a greater concern in some markets than others
- Human capital issues are clearly seen as the major post-deal management challenge

04: Obstacles and enablers to deal-making

In the previous two sections we explored some of the motives driving financial services M&A activity in Asia, whether domestic or cross-border. Here we consider some of the factors that can act as obstacles – or enablers – to getting transactions done and making them a success.

Respondents identify a wide range of potential obstacles to financial services M&A in Asia

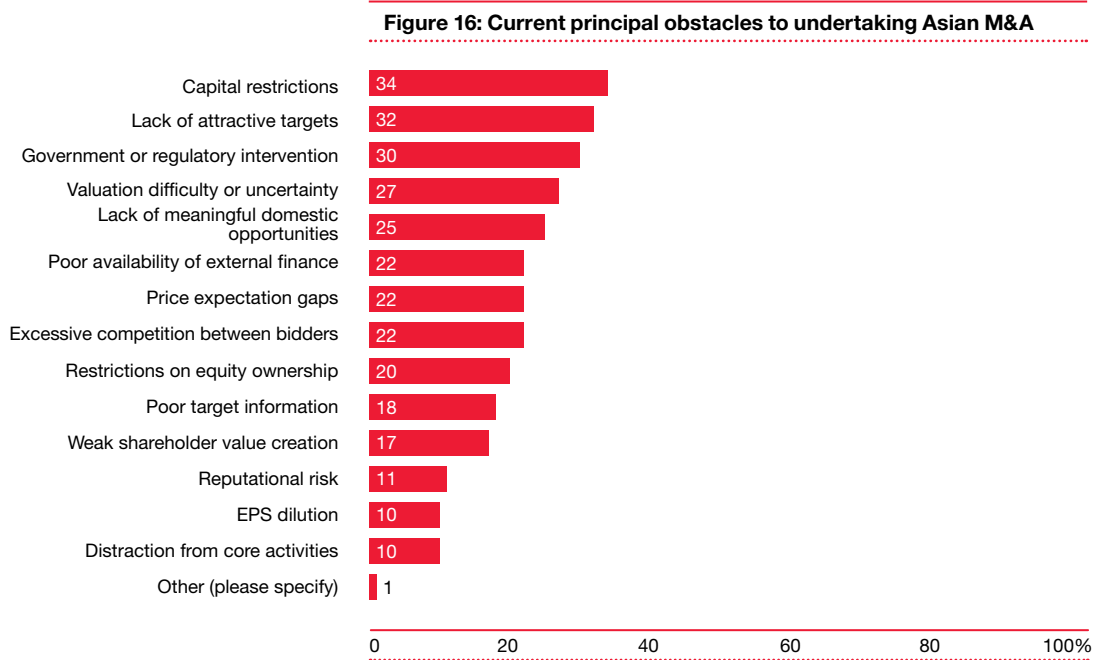
Respondents to our survey have clear views about the main obstacles to undertaking financial services M&A in Asia. More than two years after financial markets began to rebound from the worst of the global financial crisis, capital restrictions are identified as the largest single obstacle to M&A in the industry, cited by 34% of respondents (see Figure 16). This was followed by a lack of attractive targets (32%), government or regulatory intervention (30%), and valuation problems (27%).

It is no surprise that capital restrictions are seen as the greatest limitation on deal activity. Medium-sized Asian financial services companies – especially those in less developed markets – often find it particularly hard to obtain access to external funding. Even in the region's more developed markets, volatility continues to limit financial institutions' ability to obtain a listing or issue securities.

Basel III is a particular source of uncertainty, and is expected to have an impact on M&A in the region

The focus on capital is receiving a further boost from global efforts to reduce leverage and contagion risks in the financial system. This has resulted in a raft of regulatory initiatives, and it is notable that respondents' concerns over capital restrictions are higher now than when the question was last asked in 2009. In this context it is understandable that most of those surveyed take a robust view of Basel Committee proposals to increase the quantum and quality of banks' equity capital. More than half of respondents asked about the potential effects of Basel III on financial services M&A in Asia, predict a greater focus on the capital efficiency of transactions (see Figure 17 overleaf). Another striking finding was that 37% of those surveyed expect to see Basel III have a direct effect on bidder behaviour, by increasing demand for smaller deals at the expense of larger ones. Significant numbers of respondents also predict Basel III will stimulate greater focus on targets' liquidity profiles (35%) and increasing interest in the quality of targets' risk management controls (28%).

Respondents to our survey have clear views about the main obstacles to undertaking financial services M&A in Asia.

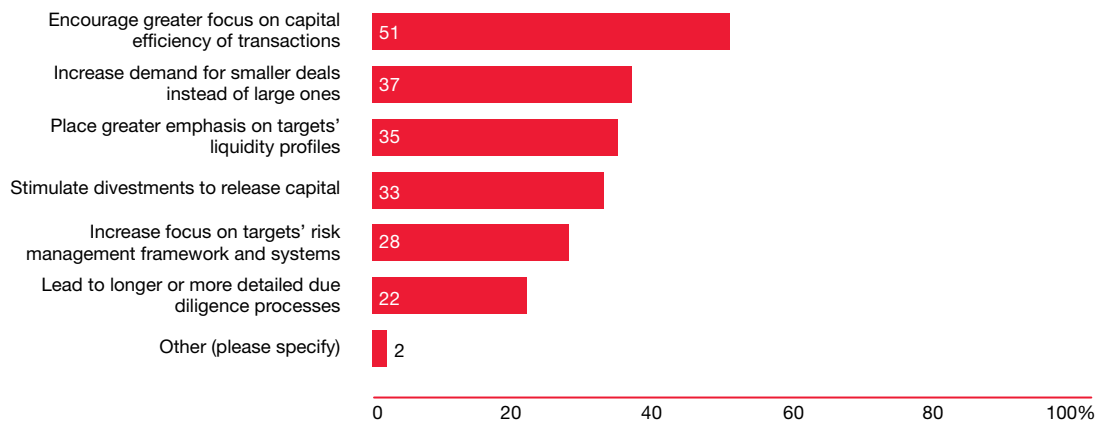


Source: PwC Financial Services M&A in Asia Survey 2011.

Retail and commercial banks are more preoccupied than most about the potential effects of Basel III, but national variations in solvency levels – and implementation of the new rules – mean that the impact of the new regime will vary widely across the region. For example, the Monetary Authority of Singapore is planning to add ‘gold plating’ to the minimum capital requirements set out by the Basel Committee, but the extremely strong capital ratios of most Singaporean banks mean that, in most cases, the impact of these additional requirements is expected to be minimal. The sheer complexity of new trading book capital requirements also means that the impact of Basel III is likely to vary from firm to firm.

These variations suggest that Basel III could have conflicting effects on financial services M&A in Asia. On one hand, many respondents clearly expect the new rules to restrict individual institutions’ ability to use capital on acquisitions, implying that smaller, lower risk deals will receive a boost at the expense of larger strategic transactions. On the other hand, the new rules could stimulate some short-term divestments intended to raise the seller’s capital ratios. In the long run, the regime could also increase the benefits of scale and provide a further spur to consolidation, despite the additional capital requirements that are being considered for systemically important financial institutions.

Figure 17: Expected effects of Basel III on M&A in Asia



Source: PwC Financial Services M&A in Asia Survey 2011.

Public sector intervention – direct and indirect – is a significant obstacle to deal activity...

Moving beyond Basel III, the increasing involvement of governments and their agents – the regulators and the central banks – in the global financial industry is seen as representing a significant obstacle to financial services M&A in Asia. This is a highly complex topic; public sector intervention varies between countries and sectors, and can effect deal processes in many ways.

The highest profile public sector interventions in financial services M&A occur when specific deals are blocked. This may reflect competition concerns, as when National Australia Bank's US\$5.5bn bid for AXA Asia Pacific was blocked, or political considerations such as Canberra's recent decision to reject SGX's US\$8.8bn bid for the Australian Securities Exchange on national interest grounds. Decisions of this type can often have unintended knock-on effects on the M&A environment. This is illustrated by the difficulties that continue to arise from private equity firm Lone Star's abandoned attempt to sell its controlling stake in Korea Exchange Bank to Kookmin Bank in 2006.

In November 2010, Korean group Hana Financial announced a US\$4.1bn bid for KEB, but at the time of writing the deal is still waiting regulatory approval.¹³ The uncertainty surrounding the future of KEB has been seen as damaging external perceptions of South Korea as a destination for foreign investors.

As already discussed, regulators also have a direct impact on M&A when they impose limits on foreign ownership of financial services companies. This may protect local groups from predatory takeovers, but it can also increase the medium-term logic for M&A by restricting the inflow of new entrants and expertise, and by creating blockages to industry consolidation.

A less tangible, but perhaps more pervasive effect of public sector intervention in financial services M&A is to create an atmosphere of uncertainty. This can arise from a range of factors such as the issuance of licences, inconsistent supervision, the speed of regulatory approvals, or perceptions of local bias or political risk. Turf wars between regulatory agencies – as recently seen in South Korea – can also heighten the sense of uncertainty.¹⁴

The highest profile public sector interventions in financial services M&A occur when specific deals are blocked.

¹³ 'South Korea: time to end KEB saga', Financial Times, 05.07.11.

¹⁴ 'Clash of regulators', Korean Times, 20.04.11.

....But deregulation and other public sector activity can stimulate M&A too

Despite respondents' concerns over the effects of public sector intervention on M&A, it is worth remembering that deregulation and other supervisory actions can sometimes have the effect of stimulating M&A activity.

To begin with, government agencies often push weakened institutions into the arms of a stronger merger partner. This was illustrated by two recent deals we have already discussed, namely ICICI's acquisition of Bank of Rajasthan and Thanachart Bank's purchase of Siam City Bank. Concerns over anti-competitive behaviour can also lead to compulsory divestments, as seen in 2010 when CITIC Securities sold a 45% stake in China Securities to an investment arm of the Beijing Government for US\$1.1bn, following a ruling by the China Securities Regulatory Commission.

Another stimulus to deal activity can come from deregulation or financial services master plans, as seen in several South East Asian countries over the past year and a half. These typically set out a strategy to boost competition, increase efficiency and improve the affordability of core financial products for a wide customer base. Practical steps can include encouraging institutions to merge, issuing new licences and relaxing foreign ownership rules.

Lastly, public sector bodies often stimulate M&A indirectly – and unintentionally – via regulatory arbitrage. As discussed in Section 2, businesses such as wealth management, which carry low capital requirements, are often the most attractive to financial firms seeking diversification. Similar effects often apply at the national level. India – and to an extent, China – are both examples of countries where tight regulation of deposit-taking banks has led to rapid development of non-bank lending and consumer finance.

Valuation problems, pricing gaps and poor information also remain significant obstacles to M&A

Several other significant obstacles to deal-making are interconnected. There is a particularly obvious link between respondents' concerns about bidder competition and price expectation gaps, both of which were identified by 22% of respondents. Although pricing gaps have closed somewhat since the height of the financial crisis, they remain a significant issue in the region's less mature and more volatile markets, where financial services M&A has a relatively short track record. Another connected obstacle is the difficulty of obtaining reliable valuations. This is a particular problem in Asia's emerging economies, where growth rates can be unpredictable and capital markets are often relatively volatile.

However compelling the logic of M&A may be, practical problems can often emerge during the due diligence phase.

Valuation problems were a very real barrier to M&A in the region during the financial crisis, but the survey provides some reasons to hope that the situation is improving. The number of respondents identifying valuation as a problem remains significant (27%), and obtaining reliable financial information about deal targets remains challenging. However, valuation concerns have fallen a long way from the figure of 49% recorded during the financial crisis. There were also wide national variations on this point, with Indian respondents particularly concerned about the problems created by uncertain valuations.

It is no surprise that 32% of respondents to our survey rank a lack of attractive targets as the second greatest obstacle to M&A in the sector; the attractive fundamentals of many Asian financial services markets mean that few firms are looking to sell. A lack of domestic opportunities also scores highly (25%). Local industry structures can also have a limiting effect on deal-making. It is interesting to note that respondents with the greatest concerns over a lack of attractive targets were those in: China – where many local firms already have foreign partners; India – where private owners are often reluctant to sell; and Singapore – where markets are highly concentrated. Separately, the survey had identified each of these markets as attractive destinations for investment – illustrating that mismatches in demand and supply can be a barrier to M&A activity.

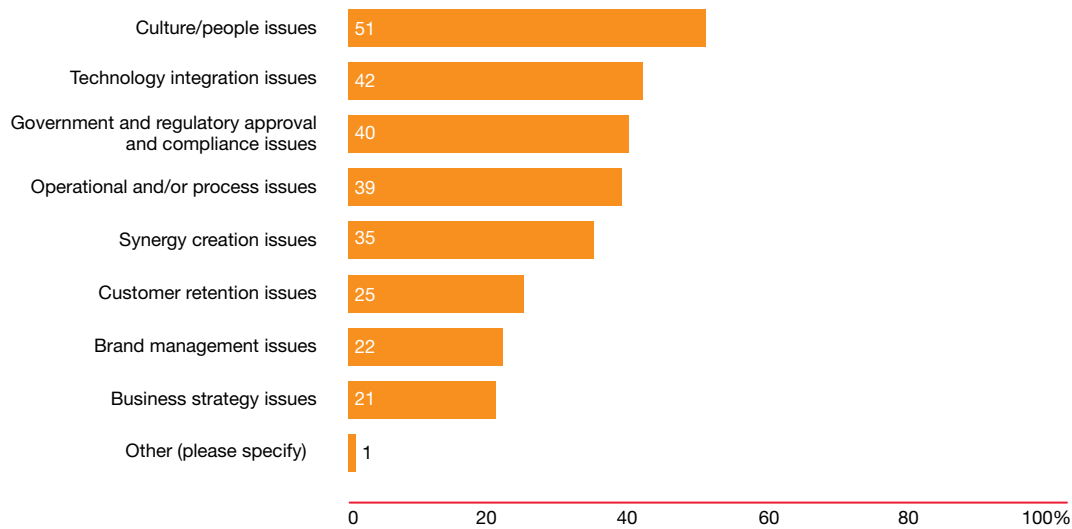
Asian financial leaders face a range of post-deal challenges, particularly in terms of human capital

Obstacles to successful M&A strategies do not end when the deal is signed. Post-deal barriers are a particular concern in financial services where IT systems are highly complex, reputations are easily damaged and regulators are watching closely. Respondents to our survey agree that these factors are all potential post-deal challenges, but – despite increasing concern about regulatory intervention – 51% identify culture and people issues as the greatest challenge for management (see Figure 18).

across borders or language barriers. The challenge is particularly acute in financial services, where the collective expertise of management and staff is often a firm’s most sustainable source of competitive advantage. Retaining talent is a key management challenge for financial services leaders at the best of times, let alone during the uncertainty that often flows from an acquisition, so a considered approach to human capital management is vital at every stage of the deal process. Decisions to sell subscale businesses are just as often based on their inability to retain talent as they are on the difficulties of developing sufficient economies of scale.

Cultural and people challenges can be difficult to manage in any industry, especially when M&A is taking place

Figure 18: Management challenges during and after a merger or acquisition



Source: PwC Financial Services M&A in Asia Survey 2011.

Asian regulators' attitudes towards private equity are ambivalent. Will this begin to change?

The potential for attractive returns continues to attract private equity investors to Asian financial services, and is demonstrated by many firms' long-standing commitment to the region. TPG Capital, Carlyle and CVC are just some of the managers that have been active in Asian financial services in recent years.

Our survey shows that, as elsewhere in the world, private equity firms often prefer to invest in financial infrastructure and other service providers than mainstream financial services companies (see Figure 19). Low capital requirements and ease of exit also mean that investment managers remain a favoured target. Private equity firms have also arguably been more willing to invest in banks in Asia than elsewhere, as seen in CVC's recent minority investment in RCBC Bank of the Philippines.

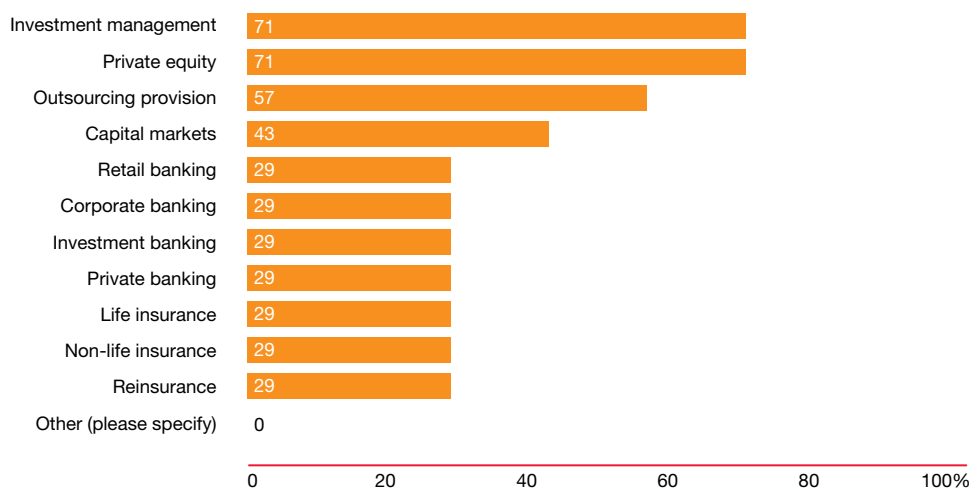
Nonetheless, it is undeniable that private equity firms continue to be viewed with mistrust in some Asian markets, stemming from profits made after the 1998 crisis. Korea offers the most high-profile example of suspicion towards private equity, exemplified by Lone Star's difficulties in offloading its investment in Korea Exchange Bank. Malaysia is another country where government bodies are highly sceptical of private equity investors' motives. As a result, regulators in several markets continue to make it difficult for private equity firms to acquire – and sell – stakes in financial services businesses.

Even so, it is worth remembering that other Asian countries are open to private equity. For example, investors are more likely to be welcomed in markets such as the Philippines, where the sector is beginning to establish itself and financial services consolidation is an explicit policy goal. Financial hubs Hong Kong and Singapore also continue to use tax incentives to enhance their attractiveness as a domicile for private equity funds.

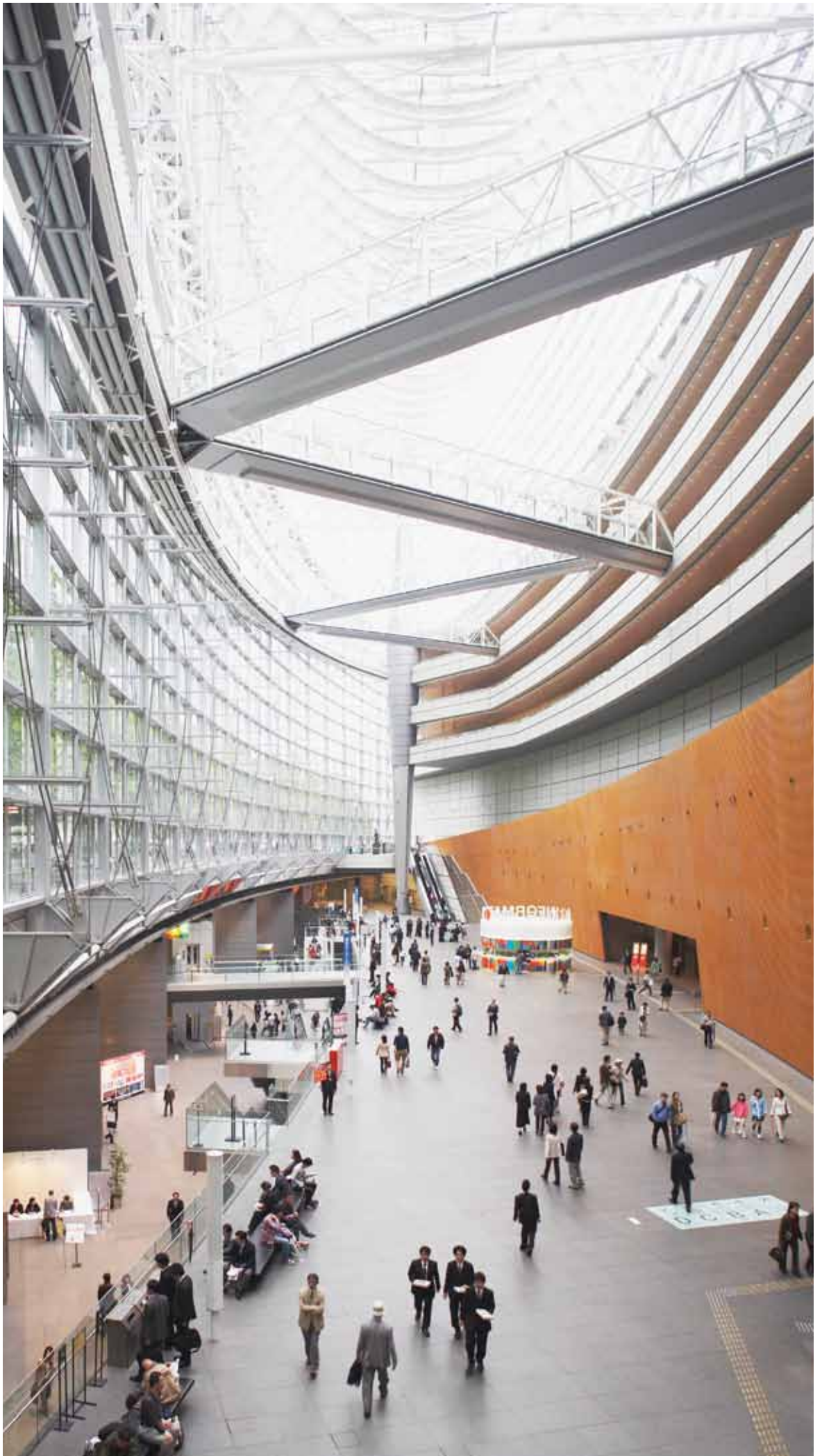
There is also grudging recognition in some Asian markets that private equity firms can often provide capital at times when institutional investors are reluctant to step forward. Private equity investors that are able to contribute the kind of expertise that strategic buyers typically bring to transactions are most likely to be favoured by regulators keen to develop local talent bases and improve management quality. As a result, some private equity firms are developing financial holding companies to consolidate their financial management expertise while also offering a potential exit vehicle.

All in all, there is no doubt that private equity firms continue to face considerable mistrust in a number of Asia's key financial services markets. However, with the aftermath of the global financial crisis presenting fresh opportunities for private equity investment, the sector could have an opportunity to change its public perceptions and achieve penetration levels comparable with those of Europe or North America.

Figure 19: If the primary motive for acquisition is to expand into new business lines, which of the following areas might attract your organisation? (Private equity respondents)



Source: PwC Financial Services M&A in Asia Survey 2011.



Australia also has one of the most mature financial services industries in the region.

Despite its maturity, Australia's financial industry looks set to continue generating M&A activity

Australia is one of the most mature economies in Asia, but thanks to the ongoing resources boom, low interest rates and low unemployment it continues to enjoy robust growth and remains an attractive market for investment. Australia also has one of the most mature financial services industries in the region. Market concentration is high, particularly in the retail arena where the four largest banks not only dominate personal banking but also – together with asset manager and life assurer AMP – the sale of mass-market investment products.

Antitrust considerations prevent the leading banks from making material domestic acquisitions, and it is hard to see foreign entrants competing in the retail banking space. Beyond banking though, consolidation continues, illustrated by AMP's acquisition of AXA Asia-Pacific's local operations. The insurance market is also relatively fragmented, but the timing of any activity will depend on the visibility of losses arising from the disastrous floods of 2011 and other recent natural disasters.

We therefore expect cross-border deals to become an increasing feature of the Australian M&A scene during the coming year. We anticipate further outbound transactions by the large banks, most notably the Asian-focused ANZ, but also, potentially, CBA and NAB. One reason for Asian expansion might be to improve the big banks' liquidity profiles. Our survey suggests that the banks' desire for diversification

and faster growth avenues could also be supported by the strong Australian dollar (see Figure 20).

Our survey also shows that inbound M&A is expected to become an increasing feature of the Australian financial industry over the coming year (see Figure 21), and we believe asset management will see some of the strongest levels of M&A activity.

A number of factors argue for a mini-boom in asset management M&A. One is the size and growth of the Australian retail market. Thanks to superannuation, this is mandated to grow at 9% per year – or more, if planned legislative changes are enacted. This is a highly attractive growth profile compared with fast-growing but smaller Asian markets and larger, more mature markets elsewhere in the world.

The second factor is a wave of regulatory change, especially Future of Financial Advice (FOFA) proposals aimed at improving investor protection. This approach spares Australian asset managers from new compliance requirements aimed at advisors and distributors, but will still have a significant effect on the economics of the whole retail investment value chain. Finally, the Australian federal government is looking to help Australian asset managers to leverage their skills and experience across wider Asian markets. A number of tax changes are intended to improve the regional competitiveness of Australian funds, and there are nascent plans to create an Asian funds passport scheme comparable with the European UCITS (Undertakings for Collective Investment

in Transferable Securities) regime. This could improve investor choice, efficiency and the mobility of capital around the region.¹⁷

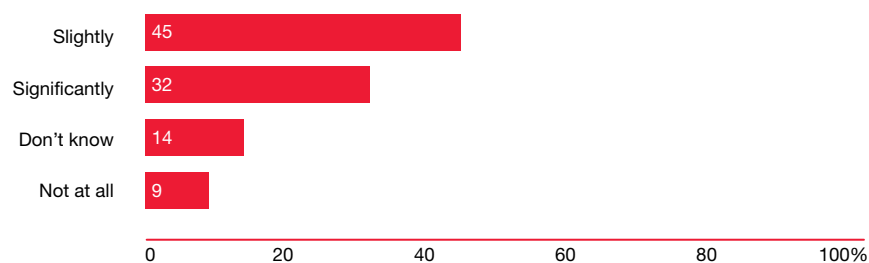
Australian asset managers are already attracting growing interest from offshore investors. We anticipate particular interest in boutique targets, but the dominance of retail and mass-affluent distribution by the big

banks and the large advisor networks mean that entry strategies need to be carefully targeted. Disposals by Australian groups could also play a role – as seen in Suncorp’s sale of Tyndall to Nikko Asset Management.

Nonetheless, foreign acquirers may face significant cultural challenges. Maintaining performance will be crucial to good consultant

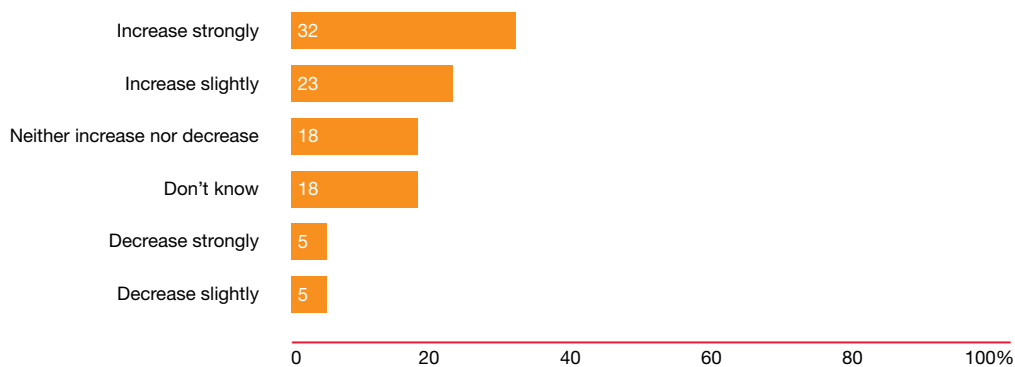
recommendations and positive fund inflows. This in turn will call for a willingness to embrace the culture and remuneration style of the target, which may owe more to New York or London than to much of the rest of Asia. Success could therefore require a hands-off, high-trust approach that may not come easily to organisations used to keeping their subsidiaries under close control.

Figure 20: Does the strength of the Australian dollar have an impact on cross-border deal activity?



Source: PwC Financial Services M&A in Asia Survey 2011.

Figure 21: How do you expect the trend for foreign entrants to enter the Australian market via acquisitions to develop over the next 12-18 months?



Source: PwC Financial Services M&A in Asia Survey 2011.

¹⁷ 'Asia Region Funds Passport', PwC, November 2010.

05: Looking ahead

We conclude the report by reviewing the economic and strategic drivers of M&A growth in Asian financial services, and making some specific comments on areas where we see strong potential opportunities for deal-making during late 2011 and 2012.

The overall outlook for Asian financial services M&A is highly encouraging

At the start of this report we set our belief that the highly positive macro-economic environment in most Asian countries will continue to stimulate growth in financial services. Despite renewed concern about the global economic outlook, which has the potential, not only to create uncertainty, but also to increase the cost of external capital for financial institutions, we remain positive about the fundamental drivers of expansion. Key considerations include positive demographic trends, increasing levels of domestic consumption and rapid expansion in the numbers of

mass-affluent customers. The last point is illustrated by the increasing Eastwards shift of the global wealth management industry's centre of gravity.¹⁵

We also stated our view that Asian financial services M&A activity will accelerate through 2011 and into 2012. Respondents to our survey seem to agree, with the large majority predicting overall increases in deal activity in their own markets during the year ahead (see Figure 22). In the short term, uncertainty arising from the sovereign debt markets of Europe and the US could even create additional opportunities for M&A.

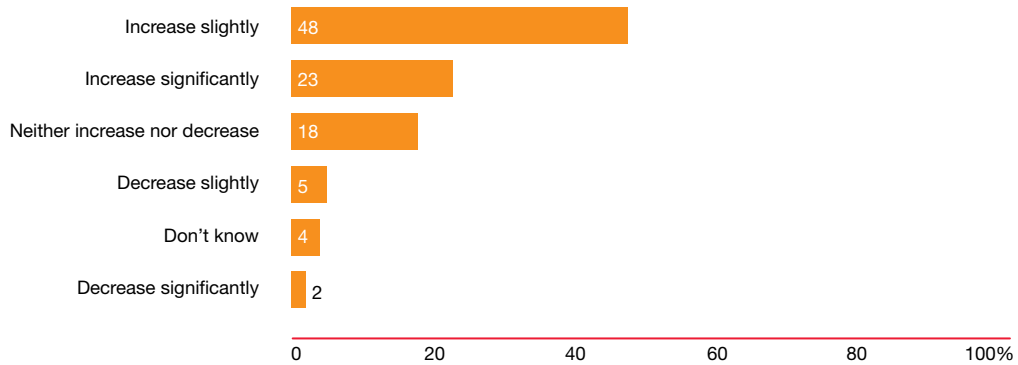
Furthermore, our quarter-on-quarter analysis of Asian financial services M&A activity shows that the number and total deal value of transactions announced during the first two quarters of 2011 was significantly higher than that of the first two quarters of 2010 (see Figure 23).

¹⁵ 'Anticipating a new age in wealth management', PwC, June 2011.

¹⁶ Please refer to Methodology on page 42.

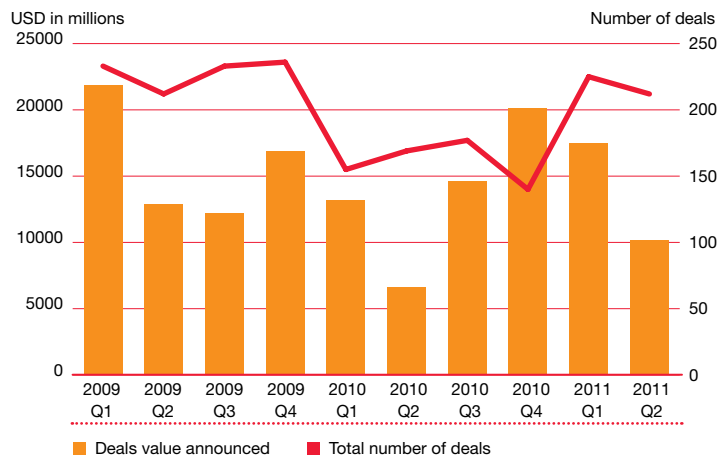
Key considerations include positive demographic trends, increasing levels of domestic consumption and rapid expansion in the numbers of mass-affluent customers.

Figure 22: Do you expect M&A activity to increase in your market during the next 12 months?



Source: PwC Financial Services M&A in Asia Survey 2011.

Figure 23: Quarterly summary of Asian financial services M&A transactions Q1 2009-Q2 2011, by deal value (US\$m)



Source: Thomson Reuters, PwC analysis.¹⁶

A range of strategic priorities point to increasing appetite for deal-making

In the middle sections of this report we set out the key strategic goals that we expect to drive growth further in Asian financial services M&A activity. Naturally, these vary between countries, sectors and organisations, but in summary we believe the most important ones are:

- To counteract the growing competitive and profitability pressures being felt within many Asian financial services markets.
- To accelerate customer acquisition – whether at home or in foreign markets.
- To develop financial conglomerates that offer a broader range of services, particularly to corporate and high-net-worth customers.
- To divest non-core activities and improve strategic focus. This applies both to Asian groups and those from other regions.
- To enter or expand in high-growth markets, whether in different provinces or different countries.
- To develop pan-Asian networks that improve diversification and offer more levers for future growth.
- To comply with regulatory requirements including: Improving solvency, increasing competition, creating stronger national players and enhancing management capabilities.



We see a number of areas of opportunity for the year ahead

Analysing the strategic rationale for further growth in Asian financial services M&A is not the same as making specific predictions. Where can we expect to see bursts of activity during the year ahead? We are wary of making over-specific forecasts, but in concluding this report we want to point out some possible areas of opportunity for potential acquirers.

To begin with, we reiterate some of the predictions made in the boxes on India, Greater China and Australia.

- We believe that the Indian financial services market offers strong potential for an up-tick in M&A activity. The asset management and non-bank financial sectors offer clear scope for further consolidation, and both are open to foreign bidders seeking exposure to Indian growth prospects.
- Despite the maturity of Australian financial services, we expect the country to continue to generate significant M&A. This includes both outbound deals by the largest Australian financial groups and increasing inbound investment in Australia's fast-growing asset management sector.
- We expect the growth potential of asset management in China, coupled with increasing demand for cross-border investment, to stimulate significant asset management M&A within Greater China during the next few years.

We also see latent potential for the largest Japanese and Chinese banks to accelerate their overseas acquisitions, once the Japanese have adjusted to the impact of the 2011 tsunami and the Chinese to the rapid balance-sheet expansion of recent years.

In addition, we highlight our view that, while private equity firms are still viewed with suspicion by regulators in a number of regional markets, the post-crisis phase of economic and financial recovery in

Asia could offer attractive opportunities for private equity investors able to contribute, not only capital, but also expertise to a financial services target. However, developing positive relationships with local investors, regulators and other stakeholders will be crucial to success.

Lastly, we identify some other potential areas of opportunity for financial services transactions. These include:

- Life insurance in Mainland China, where there may be investment opportunities for investors who can provide product developments skills or offer routes to offshore markets.
- City commercial banks in Mainland China, where some opportunities remain for foreign investors or domestic mergers.
- Mid-sized Indonesian banks and insurers, which offer attractive growth opportunities for investors able to strengthen capital ratios at a time of increasing supervisory requirements.
- Insurance in Malaysia, where foreign ownership limits have recently been relaxed to 70%, and the central banks are keen to see higher levels of capital and industry consolidation.
- Asset management and brokerage in Taiwan, where recent transactions could prompt a further round of consolidation.
- Banking in Vietnam, where tougher capital requirements and inflationary pressures could lead to further consolidation in a highly fragmented sector.

Of course, all of the predictions in this section are subject to the whims of economics, politics and other factors. We would be delighted to hear your views, and if you would like to discuss any of the issues raised in the report, please get in touch with a member of the editorial board or your usual PwC contact.

Analysing the strategic rationale for further growth in Asian financial services M&A is not the same as making specific predictions.

Appendix and survey results

Methodology

Survey data:

The PwC Financial Services M&A in Asia Survey 2011 was conducted during May and June 2011. A total of 375 senior executives in financial services were surveyed across 13 Asian territories, using a combination of individual client interviews, our own qualitative research and the input of PwC M&A experts in the region.

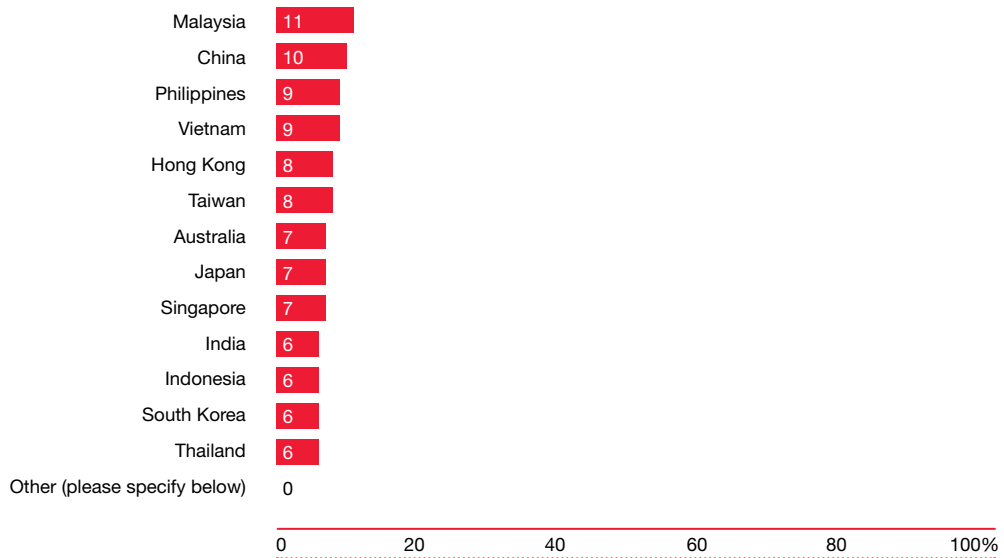
Our thanks are due to all those who participated, for sharing their insights with us.

Please note that not all totals add up to 100%. This reflects the fact that some questions permitted multiple answers and that some follow-up questions were limited to specific respondents, depending on their initial answers.

Deal data:

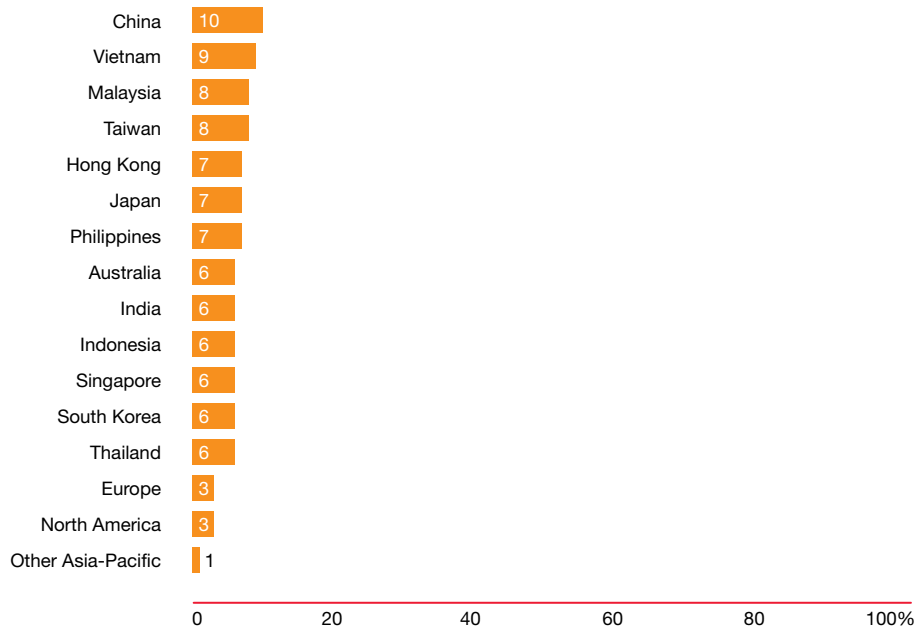
Deal data shown in Figure 1 reflects financial services deals reported by Thomson Reuters, announced during 2010 and expected to complete. Transactions without a publicly disclosed deal value are included in 'Number of deals' but do not contribute to total deal values. Selected deals announced during the first half of 2011 are also discussed in this report, but do not form part of the 2010 dataset.

Q1 In which country are you currently based?



Source: PwC Financial Services M&A in Asia Survey 2011.

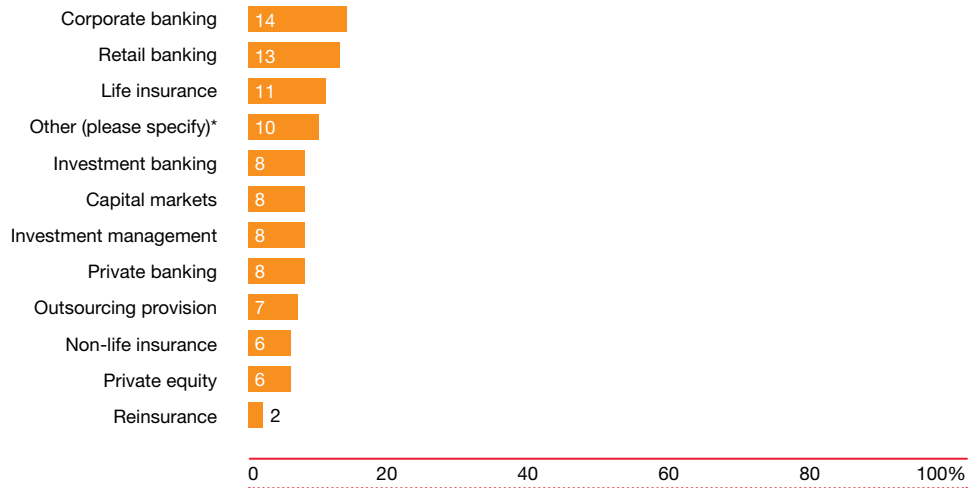
Q2 In which country or region is your company headquartered?



Source: PwC Financial Services M&A in Asia Survey 2011.

Source: PwC Financial Services M&A in Asia Survey 2011.

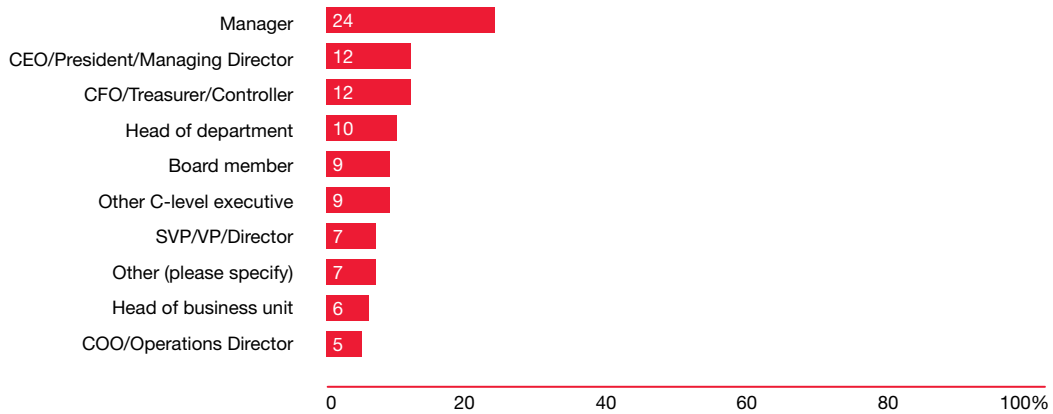
Q3 Which sector of financial services is your company's primary area of focus?



Source: PwC Financial Services M&A in Asia Survey 2011.

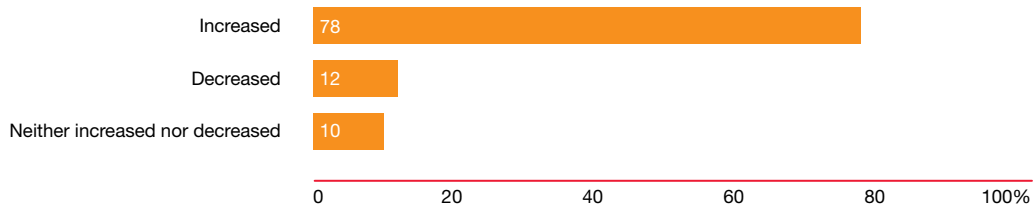
*Responses that specify 'Other' primary sectors of focus include credit cards, consumer finance, auto finance, Islamic finance, Takaful and universal financial institutions.

Q4 Which of the following best describes your title?



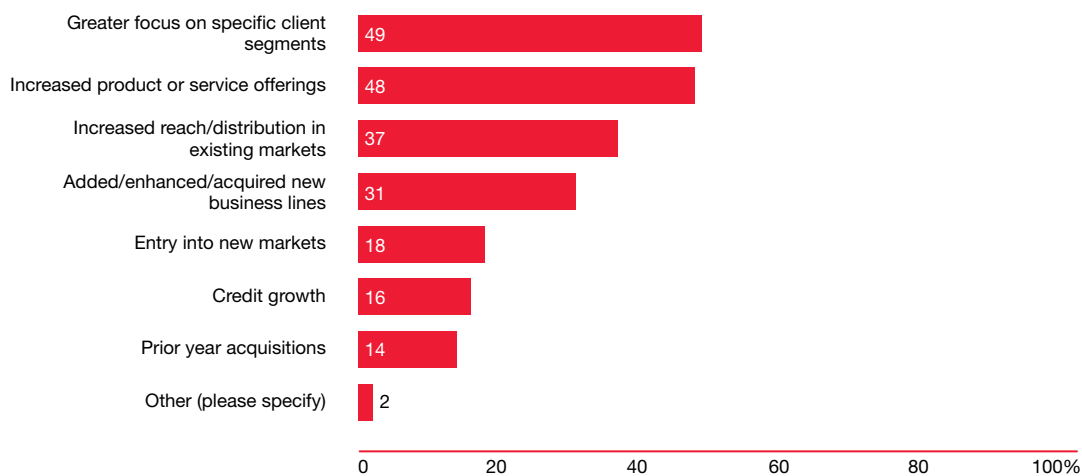
Source: PwC Financial Services M&A in Asia Survey 2011.

Q5 Over the past 12 months, have your organisation's total revenues increased, decreased or neither?



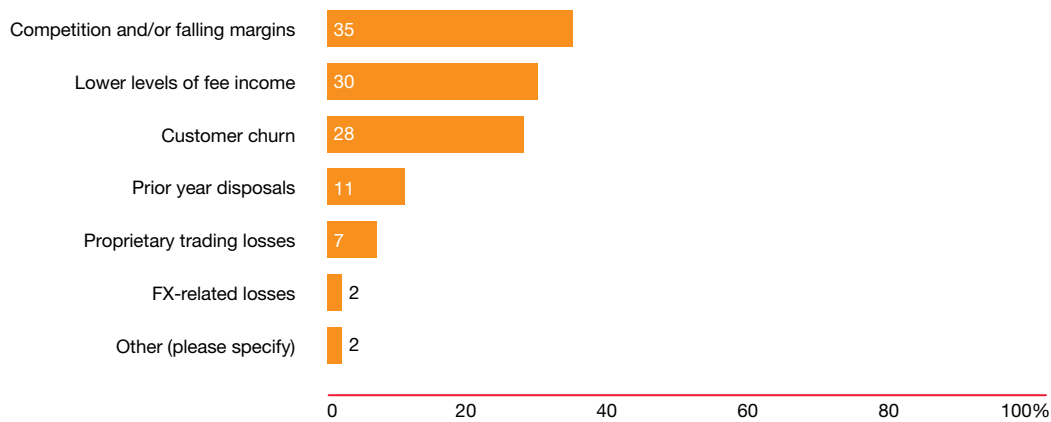
Source: PwC Financial Services M&A in Asia Survey 2011.

Q5a What were the primary drivers of your organisation's increase in total revenues?



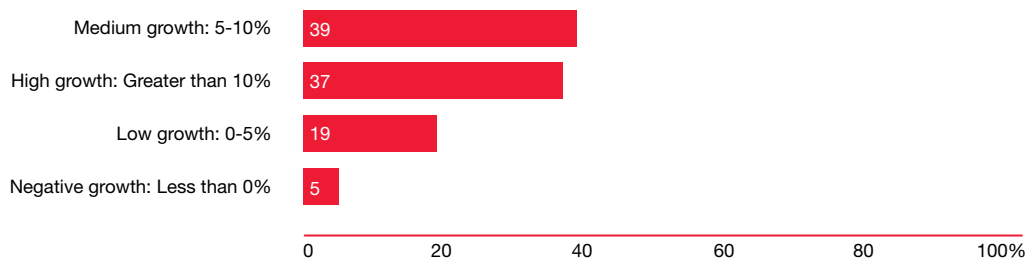
Source: PwC Financial Services M&A in Asia Survey 2011.

Q5b What were the primary drivers of your organisation's decrease in total revenues?



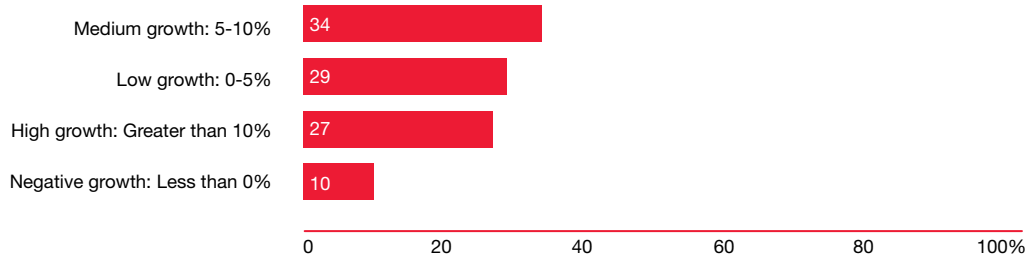
Source: PwC Financial Services M&A in Asia Survey 2011.

Q6 What level of domestic business growth do you expect to see from your organisation in the next 12 months?



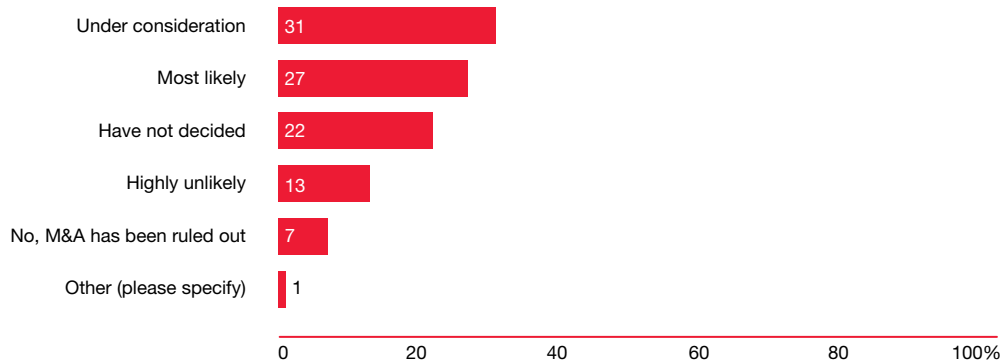
Source: PwC Financial Services M&A in Asia Survey 2011.

Q6a What level of international business growth do you expect to see from your organisation in the next 12 months?



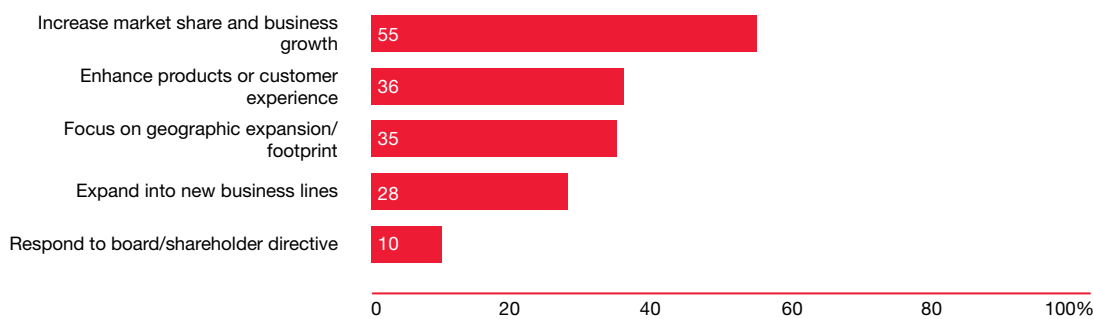
Source: PwC Financial Services M&A in Asia Survey 2011.

Q7 Is your organisation likely to seriously consider or undertake a material merger or acquisition during the next 12 months?



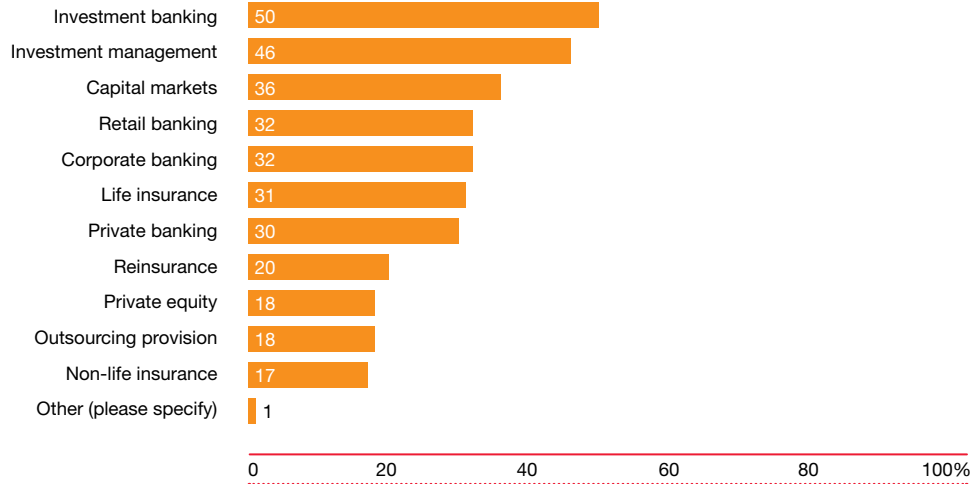
Source: PwC Financial Services M&A in Asia Survey 2011.

Q7a If your organisation does consider a merger or acquisition during the next 12 months, what would be the primary motives?



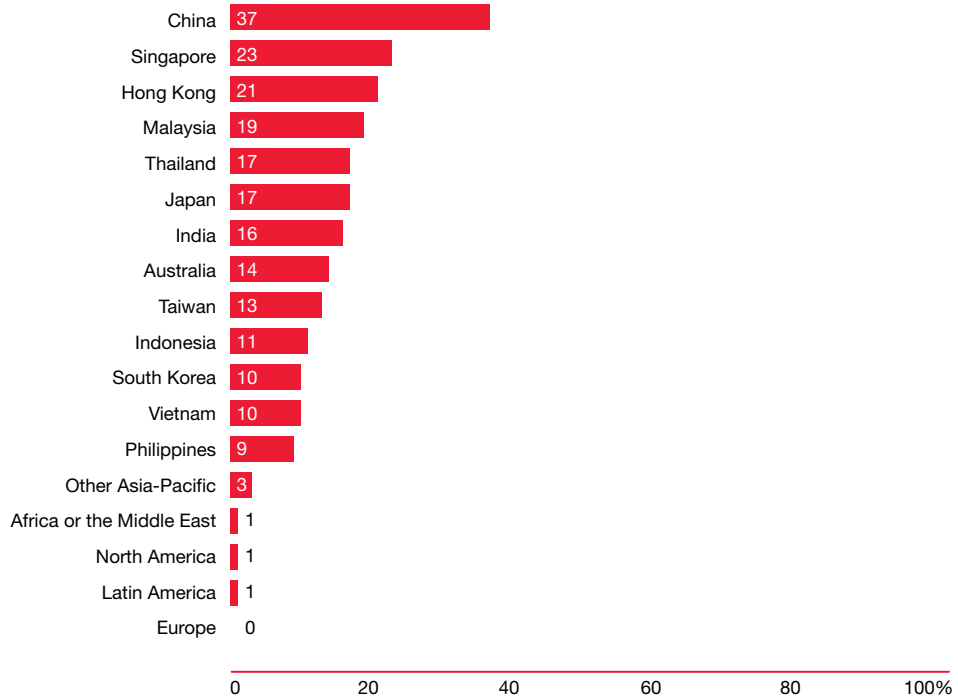
Source: PwC Financial Services M&A in Asia Survey 2011.

Q7b If the primary motive for acquisition is to expand into new business lines, which of the following areas might attract your organisation?



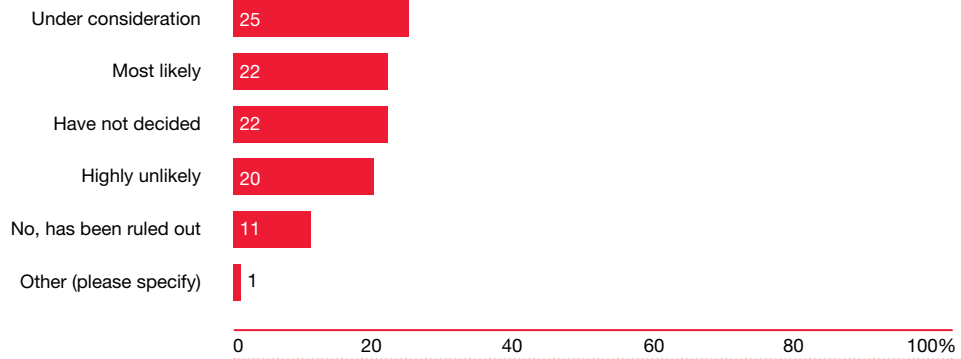
Source: PwC Financial Services M&A in Asia Survey 2011.

Q7c If the primary motive for acquisition is to expand geographically, which of the following places might attract your organisation?



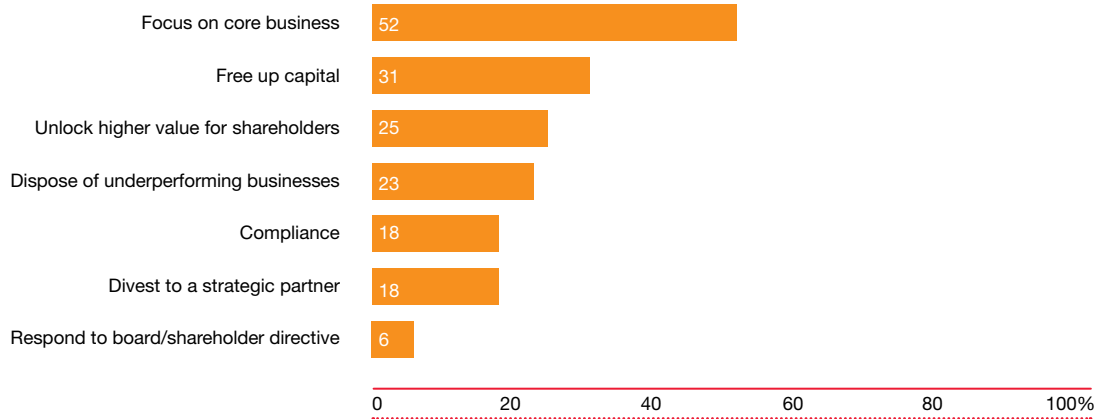
Source: PwC Financial Services M&A in Asia Survey 2011.

Q8 Is your organisation likely to make a divestment during the next 12 months?



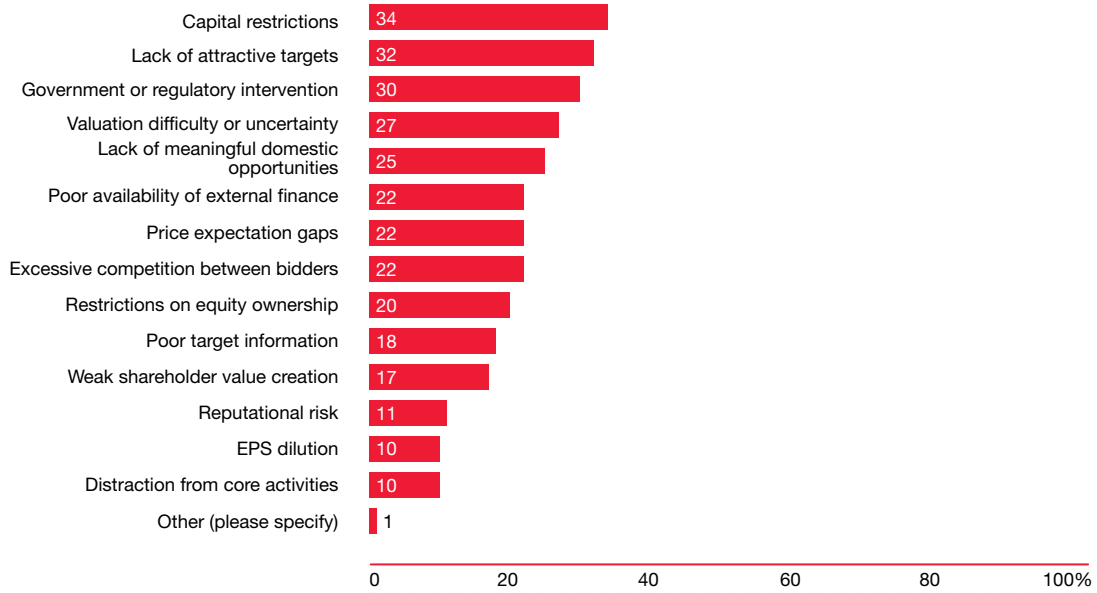
Source: PwC Financial Services M&A in Asia Survey 2011.

Q8a If your organisation does consider a divestment during the next 12 months, what would be the primary motive?



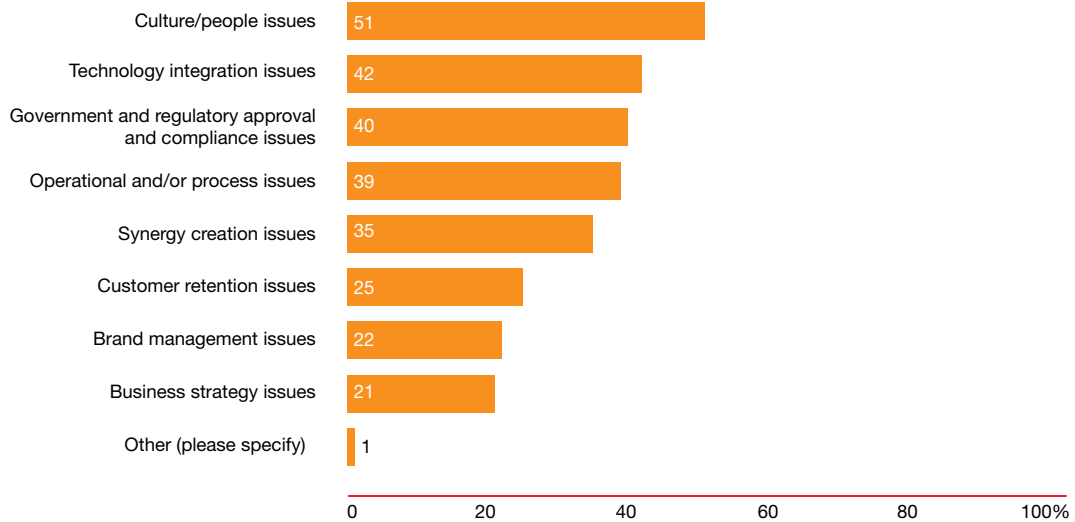
Source: PwC Financial Services M&A in Asia Survey 2011.

Q9 What do you currently see as the principal obstacles to undertaking mergers and acquisitions in Asia?



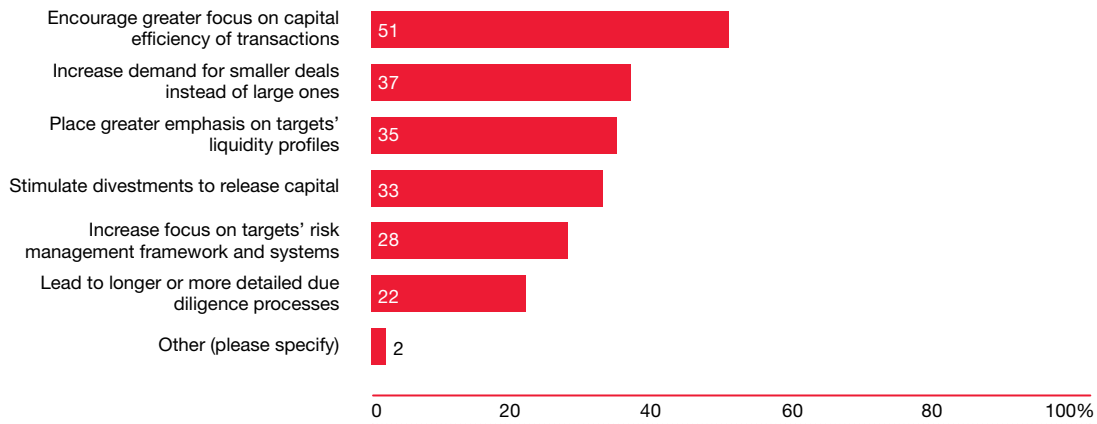
Source: PwC Financial Services M&A in Asia Survey 2011.

Q10 What challenges do you think management teams face during or after a merger or acquisition?



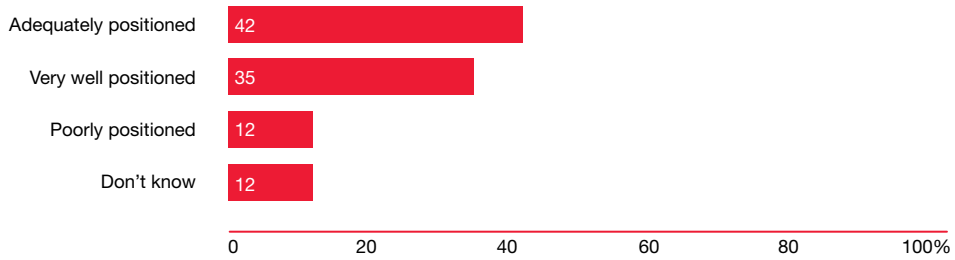
Source: PwC Financial Services M&A in Asia Survey 2011.

Q11 What particular effects do you expect Basel III regulations to have on M&A activity in Asia?



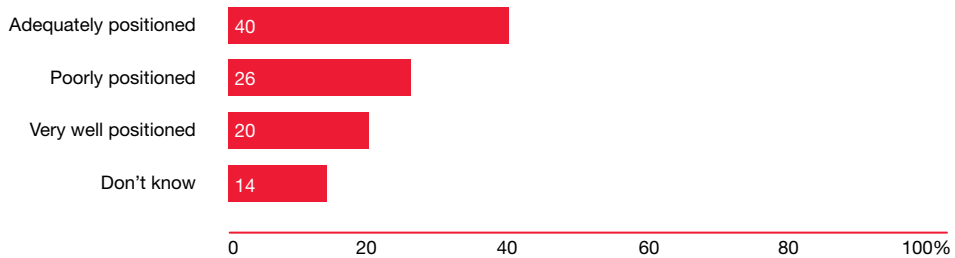
Source: PwC Financial Services M&A in Asia Survey 2011.

Q12 How well positioned is your organisation to execute a small or mid-sized acquisition (<US\$250m) at short notice?



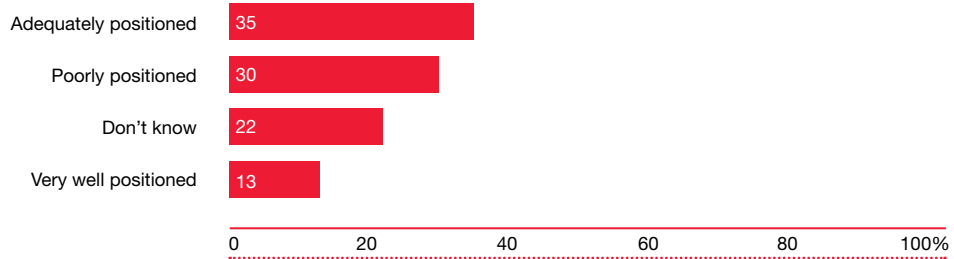
Source: PwC Financial Services M&A in Asia Survey 2011.

Q12a How well positioned is your organisation to execute a large acquisition (> US\$250m) at short notice?



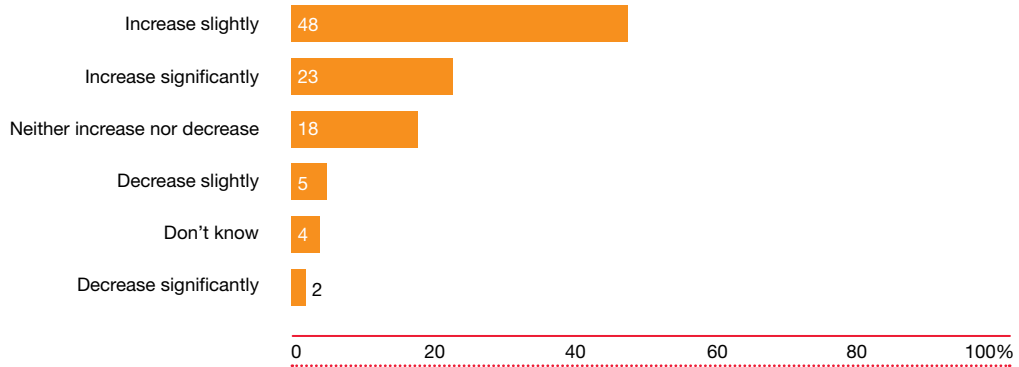
Source: PwC Financial Services M&A in Asia Survey 2011.

Q12b How well positioned is your organisation to execute a cross-border acquisition at short notice?



Source: PwC Financial Services M&A in Asia Survey 2011.

Q13 Do you expect M&A activity to increase in your market during the next 12 months?



Source: PwC Financial Services M&A in Asia Survey 2011.

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