

Assessing the influence of European financial institutions on the economies of Hong Kong and Macau

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Preface

The European Chamber of Commerce in Hong Kong, The European Union Business Information Programme (EU-BIP) and Asian Banker Research are pleased to present this report on assessing the impact of European financial institutions on the Hong Kong and Macau economy.

The objective of the report is twofold: firstly, to give the reader an overview on the financial services business in Hong Kong and Macau; secondly, to determine the influence of the European players in the various sub-industries such as commercial and investment banking, insurance, private banking, hedge funds, private equity, fund management and brokerages.

This report evaluates the influence of European financial institutions (FIs) between 2005-2009 in six key areas : the number of institutions, assets size, revenues, tax contribution, number of employees and revenue to Hong Kong's GDP ratio.

Despite the impact of the financial crisis and the subsequent exit of western financial institutions from Asia, most European financial institutions remained in Hong Kong and Macau - indeed many European players in Hong Kong intensified their presence and looked for new engines of growth to take advantage of the island's favourable tax regime and its access to the booming Chinese economy. European players, with rare exceptions, were remarkably resilient, and some became even stronger on all measurable indicators after the crisis. Despite this reliance, European players now face new threats from the increasingly fierce competition by local players in the Mainland and Hong Kong.

Between 2005 and 2009 European FIs contributed HK\$ 86.05 billion in tax from corporate profits to the Hong Kong economy and by the end of 2009 employed more than 67,000 people. European FIs in commercial/investment banking and insurance contributed MOP 146.5 million during the same period in Macau.

Findings were calculated using extensive assessment of public domain data, members' directories of industry associations and were supported and validated by selective interviews with industry players. The research was funded by EUBIP.

With this report, we hope to offer decision makers and executives a detailed understanding of the contribution of European FIs to the economies of Hong Kong and Macau and further insights into likely trends.



Wilhelm Brauner

Chairman 2010

The European Chamber of Commerce in Hong Kong



Chris Kapfer

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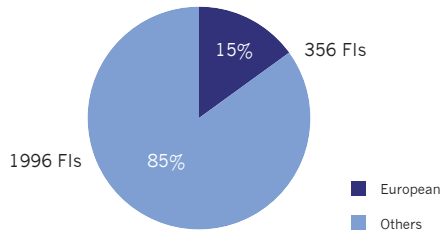
Key Insights

- European commercial and investment banks have a huge presence in Hong Kong, making up nearly 47% of total market share in terms of assets and 36% of revenue.
- European commercial and investment banks paid HK\$ 75.6 billion in direct corporate taxes to Hong Kong authorities between 2005-2009 and employed over 32,000 people in 2009.
- Asset size for European commercial and investment banks remains stable however they are increasingly marginalised in Macau with diminishing revenue generation, despite a superior performance in productivity and profitability.
- European insurances is the largest FI sector in Hong Kong, in terms of the number of firms. The European insurances industry contributed HK\$ 2.76 billion in direct taxes between 2005 and 2009 to Hong Kong and in 2009 employed the second largest workforce of all European FI segments
- The contribution of European insurances to Macau's GDP has been improving since 2007, indicating the growing power of European players in Macau's economy.
- European private banks commanded a 56% market share in assets under management in 2009 and European and Swiss players are expected to have a growing presence in Hong Kong due to strong HNWI growth and Hong Kong's role as a gateway to China.
- European hedge funds paid HK\$ 1.34 billion in taxes between 2005 and 2009 and employed a headcount of 443 in 2009.
- European private equity players were relatively resilient after the 2008 crisis but growth will be difficult as there has been an explosion of China-focused funds.
- Although the European fund management industry is small, representing 11% of players in the industry in Hong Kong with a market share in assets of 6%, they have recovered close to pre-crisis levels.
- European brokerages represent only 5% of total industry players with US firms, local and Mainland Chinese dominating the field.

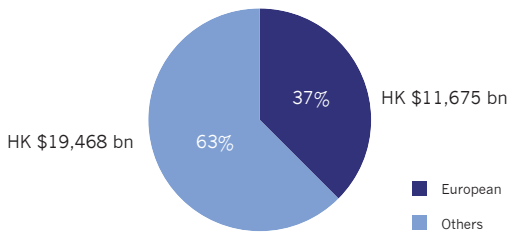
SHARE OF EUROPEAN FINANCIAL INSTITUTIONS (FIs) IN THE FINANCIAL SECTOR IN HONG KONG

Industry Structure (2009)

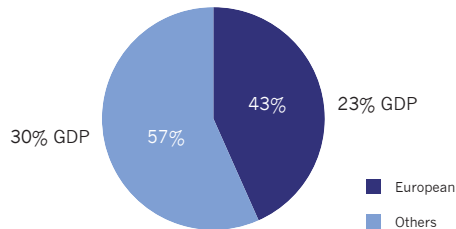
Number of FIs



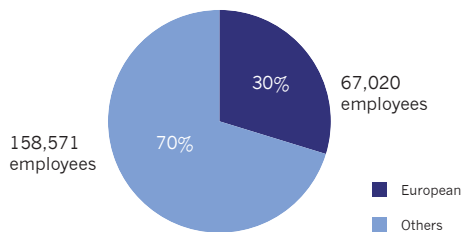
Asset Size



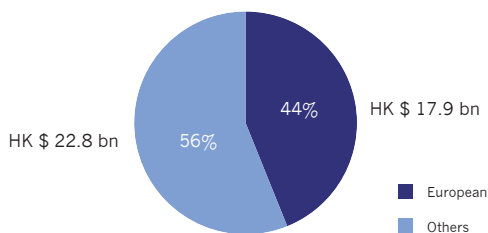
Revenue to GDP Ratio



Number of Employees



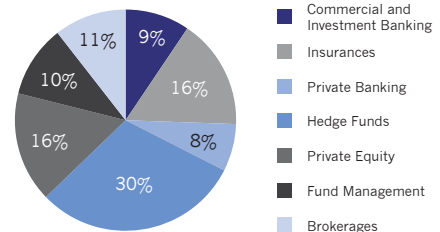
Tax Contribution



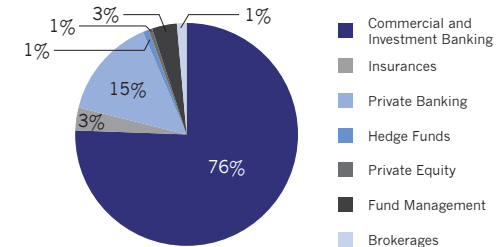
Source: Asian Banker Research

European FI Structure (2009)

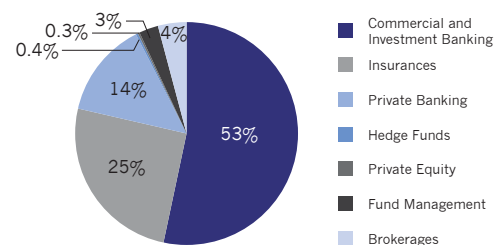
Number of European FIs



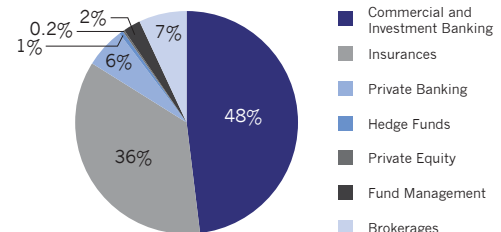
Asset Size



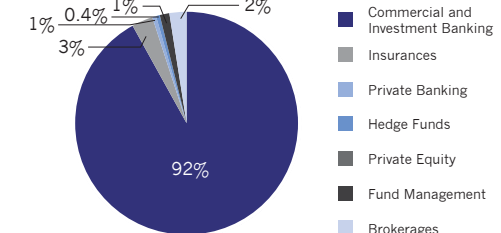
Revenue to GDP Ratio



Number of Employees



Tax Contribution



Source: Asian Banker Research

European FIs contributed HK\$ 86.05 billion in taxes from corporate profits to the Hong Kong economy between 2005 and 2009 and employed more than 67,000 people at the end of 2009. Commercial and investment banking and the insurance industry employed by far the largest number of people in the industry and contributed 12.4% and 5.9% respectively to Hong Kong's GDP. The European hedge funds and private equity industries, although resilient in the aftermath of the crisis, remained minority players in Hong Kong. In Macau, the European presence is much less significant than it once was, and European commercial and investment banks are becoming increasingly marginalized. However European insurers there have raised their revenue to GDP ratio since 2007.

Hong Kong

Between 2005-2009, European FIs paid HK\$ 86.1bn in direct taxes from corporate profits to the HK economy. In 2009 alone they paid HK\$17.9 billion with commercial and investment banks contributing over 90% of European FIs corporate taxes. The larger European players performed better relative to their smaller peers. US firms earn only a fraction of the corporate profits in commercial and investment banking, while European insurers are the industry leaders making the largest contribution in their sector to Hong Kong's GDP.

Hong Kong's private banking industry is expected to accelerate its growth rate over the next few years providing. This will be a boon for European private banks which dominate the industry when measured by all relevant indicators, with a market share in excess of 55%.

Over the 5 years to the end of 2009, the fund management sector including European hedge funds doubled the size of their assets and experienced the highest employment growth in the financial industry. Hedge Funds employee growth was spectacular, expanding over 300% despite the 2008 financial crisis that led to the loss of jobs in banks and brokerage companies. Together with their US peers European hedge funds dominate the industry.

Hong Kong is the largest regional center for private equity funds, managing about 24% of the total capital pool in Asia. The overwhelming majority of private equity funds in Hong Kong come from overseas and include major European players investing in companies in the region. European funds steadily increased their presence in Hong Kong between 2005 and 2009.

However Hong Kong remains a challenging place for European brokerages. It is dominated by US players and local and Mainland Chinese firms, which cater mainly to retail investors, are on the rise. While there are only 38 European brokerages and

they focus on institutional clients, they provide a disproportionately higher contribution in value to the Hong Kong economy.

As European FIs face stricter regulations and anaemic growth in their home markets, they will continue to look towards expanding into emerging economies, including the lucrative Chinese market via gateways such as HK and Macau.

Macau

Between 2005-2009, European FIs in commercial and investment banking and insurance contributed MOP 145.3 million (HK\$ 140.3 million) in direct corporate taxes to the Macau economy.

In 2009, both industries contributed close to MOP 10 million in direct corporate taxes.

The market for both industries is dominated by European FIs from Spain, Portugal, UK and France. US firms make up less than 1% in terms of asset size, and their European peers commanded a market share 11 times higher. Currently, 10 European FIs operate in both sectors.

The 2008 financial crisis had a disproportionate impact on European financial institutions in Macau. Assets of European insurers quadrupled, whereas assets of commercial and investment banks remained relatively stagnant. Both sectors saw significant downsizing of their employment pool due to the crisis.

Despite having a share of over 93% of the total workforce in the industries under review, the commercial and investment banking sector has become increasingly marginalised and revenue is declining.

Similar to Hong Kong, European insurers in Macau are relatively more efficient in their utilisation of assets to generate revenue.

EUROPEAN FINANCIAL INSTITUTIONS' (FIs) CONTRIBUTION TO HONG KONG AND MACAU'S ECONOMY

Figure 1.1 Overview of FI Structure and Contribution to Hong Kong Economy

European FIs in HK	Commercial and Investment Banking	Insurances	Private Banking	Hedge Funds	Private Equity	Fund Management	Brokerages*
2005-2009							
% Asset Growth	-0.4%	55.9%	36.9%	136.4%	21.8%	106.6%	-25.2%
% Employment Growth	-6.8%	20.6%	21.7%	352%	22.1%	87.8%	-0.64%
Total Tax Paid (HK\$, mn)	75,600	2,756	1,310	1,335	N.A.**	2,854	2,196
Profile of European FI's in HK (2009, HK\$)							
Total European Asset Size 11,675 bn	Asset Size 8,833 bn	Asset Size 366 bn	Asset Size 1,731 bn	Asset Size 101 bn	Asset Size 67 bn	Asset Size 405 bn	Asset Size 172 bn
Total Number of European FIs 359	Number of FIs 34	Number of FIs 57(19 Life)	Number of FIs 28	Number of FIs 107	Number of FIs 58	Number of FIs 37	Number of FIs 38
Total Employees 67,020	Employees 32,186	Employees 23,957	Employees 3,970	Employees 443	Employees 105	Employees 1,662	Employees 4,697
Total Revenue 380 bn	Revenue 201.7 bn	Revenue 97 bn	Revenue 51.9 bn	Revenue 1.6bn	Revenue 1.2 bn	Revenue 9.8 bn	Revenue 16.8 bn
Total Profit Tax 17.853 bn	Profit Tax 16.4 bn	Profit Tax 0.56bn	Profit Tax 0.12 bn	Profit Tax 0.077bn	Profit Tax N.A.**	Profit Tax 0.262 bn	Profit Tax 0.434 bn
	Revenue to GDP Ratio 12.4 %	Revenue to GDP Ratio 5.9%	Revenue to GDP Ratio 3.2%	Revenue to GDP Ratio 0.09%	Revenue to GDP Ratio 0.07%	Revenue to GDP Ratio 0.6%	Revenue to GDP Ratio 1.0%

Source: Asian Banker Research

Note: * 2007-2009, ** Private equity firms are exempted from taxes here. Profits are recognized as capital gains/carried interest in nature and therefore are not subjected to any tax legislation in HK. Tax Contribution and GDP figures in nominal terms

 Largest contributor among all segments

Figure 1.2 Overview of FI Structure and Contribution to the Macau Economy

European FIs in Macau	Commercial and Investment Banking	Insurances
2005-2009		
% Asset Growth	0%	357%
% Employment Growth	-27.6%	-20.0%
Total Tax Paid (MOP, mn)	100.2	45.3
Profile of European FI's in Macau (2009, MOP)		
European Asset Size 28.4 bn	Asset Size 25 bn	Asset Size 3.34 bn
Number of European FIs 10	Number of FIs 6	Number of FIs 4
Employees 596	Employees 552	Employees 44
Revenue 1.9 bn	Revenue 1.2 bn	Revenue 0.7 bn
Profit Tax 10 mn	Profit Tax 5 mn	Profit Tax 4.7 mn
	Revenue to GDP Ratio 0.7%	Revenue to GDP Ratio 0.4%

Source: Asian Banker Research

MARKET SHARE OF EUROPEAN FIs IN HONG KONG AND MACAU'S FINANCE INDUSTRY

In Hong Kong, European FIs in commercial and investment banking, insurance and private banking command a significant market share despite having a disproportionately lower number of players. Of all the sectors, European FIs in private banking employ the highest proportion of employees and contribute the highest percentage of tax to the government. European brokerages play a significant role in their industry in terms of employment and tax contributions. In Macau, the share of European FIs of the respective key factors, namely employment, assets, revenue, taxes and revenue to GDP ratios averages between 1% and 22%.

Figure 1.3 Value Contribution of European Financial Institutions to the HK Economy (2009)

Hong Kong	Commercial and Investment Banking			Insurances			Private Banking		
	European	Industry	%	European	Industry	%	European	Industry	%
Number of Players	34	71	19.9%	57	178	32.0%	28	45	63%
Assets (HK\$, bn)	8,833	18,927	46.7%	366	785	46.6%	1,731	3,101	55.8%
Revenue (HK\$, mn)	201,700	562,400	35.9%	97,005	184,600	52.5%	51,900	93,000	55.8%
Employees (#)	32,186	120,990	26.6%	23,957	53,688	44.6%	3,970	7,111	55.8%
Tax (HK\$, mn)	16,400	33,600	48.8%	560	1,248	44.9%	120	200	60.0%
Revenue to GDP Ratio	12.4	26.1	47.5%	5.9	11.3	52.2%	3.2	5.7	56.1%
Macau	European	Industry	%	European	Industry	%			
Number of Players	6	31	19.4%	4	23	17.4%			
Assets (MOP, bn)	25	379	6.6%	3.34	20.61	16.2%			
Revenue (MOP, bn)	1.2	11.8	10.2%	0.7	4.7	14.9%			
Employees (#)	552	4,600	12.0%	44	407	10.8%			
Tax (MOP, mn)	5	374.3	1.3%	4.7	52.3	9%			
Revenue to GDP Ratio	0.7	5.1	13.7%	0.4	1.9	21.1%			

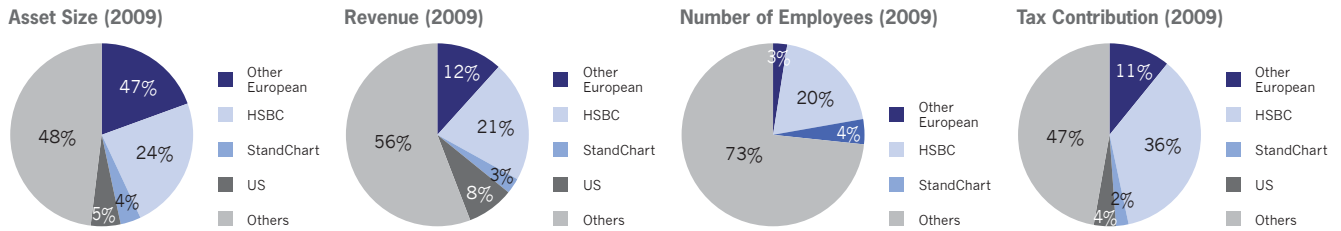
Source: Asian Banker Research

Figure 1.4 Value Contribution of European Financial Institutions to the HK Economy (2009)

Hong Kong	Hedge Funds			Private Equity			Fund Management			Brokerages		
	European	Industry	%	European	Industry	%	European	Industry	%	European	Industry	%
Number of Players	107	542	19.7%	58	317	18.3%	37	330	11.2%	38	769	4.9%
Assets (HK\$, bn)	101	429	23.5%	67	438	15.3%	405	6,745	6.0%	172	718	24.0%
Revenue (HK\$, mn)	1,547	8,612	18.0%	1,170	10,930	10.7%	9,800	108,800	9.0%	16,819	45,457	37.0%
Employees (#)	443	1,967	22.5%	105	720	14.6%	1,662	27,695	6.0%	4,697	13,420	35.0%
Tax (HK\$, mn)	77	567	13.6%	N.A.	N.A.	N.A.	262	2,979	8.8%	434	2,098	20.7%
Revenue to GDP Ratio	0.09	0.53	17.0%	0.07	0.67	10.4%	0.6	6.7	9.0%	1.0	2.8	35.7%

Source: Asian Banker Research

Thanks to one of the highest quality banking industry regulatory environments in Asia as well as access to the China market, Hong Kong has attracted 73 of the world's 100 largest banks including European commercial and investment banks; the largest value contributor to Hong Kong's economy of all other European FI sectors. Although growth is highly uneven within this segment, the largest European players have become stronger since the crisis, gaining market share, revenue and asset growth. European FIs are also more productive in the utilisation of their assets and employees than their counterparts.



The total number of commercial and investment banks has shrank from 186 in 2005 to 171 in 2009 with only 3 European players exiting the market, underlining their resilience in a challenging period for banking in Hong Kong.

Generally the largest European firms in commercial and investment banking became stronger after the crisis in terms of asset growth, market share of revenue and tax contributions at the expense of their smaller European peers. Growth rates were uneven for individual players and were not dependent on size. This variability explains why aggregated European FIs revenue growth was negative despite total industry growth of 1.1 % in 2009.

European banks were more productive in terms of their use of assets and employees than their counterparts, yielding a

46.7% market share in terms of assets and 35.9% in terms of revenue generation, while their US peers only held 5.2% of the assets and 8.4% share of the revenue. European firms also appeared to be more resilient than the other players during the crisis of 2007-2009 as reflected in their lower decline in tax contributions.

As indicated in table 1.5, four players in the overall top 10 by asset size are European FIs. Between 2007 and 2009, Societe Generale emerged as the 6th largest bank in Hong Kong in terms of assets at the expense of other players such as Citibank, while HSBC Bank widened its lead in market share to 23% by the end of 2009. Standard Chartered Bank showed the highest asset growth in the same period.

Figure 1.5 Top 10 Commercial and Investment Banks in Hong Kong (Assets)

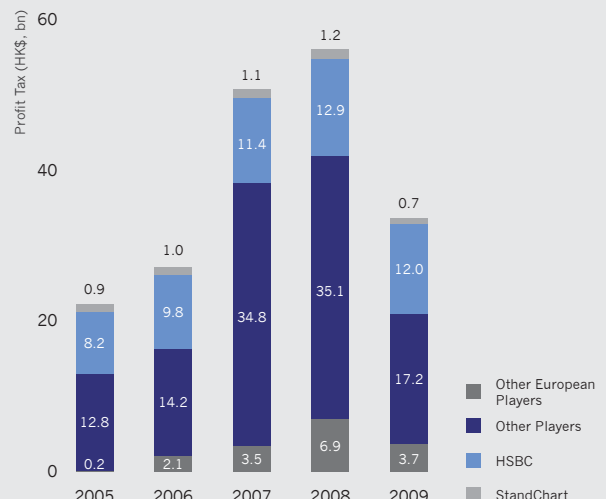
	2007	2008	2009
1	HSBC	HSBC	HSBC
2	BOC	BOC	BOC
3	HANG SENG BANK	HANG SENG BANK	HANG SENG BANK
4	STANDARD CHARTERED	STANDARD CHARTERED	STANDARD CHARTERED
5	BANK OF EAST ASIA	BANK OF EAST ASIA	BANK OF EAST ASIA
6	CITIBANK	BNP PARIBAS	SOCIETE GENERALE
7	BNP PARIBAS	CITIBANK	BNP PARIBAS
8	DBS	CREDIT AGRICOLE	CITIBANK
9	CALYON*	SOCIETE GENERALE	BANK OF TOKYO MITSUBISHI UFJ
10	JPMORGAN CHASE BANK	BANK OF TOKYO MITSUBISHI UFJ	DBS

* CALYON WAS RENAMED CREDIT AGRICOLE IN 2008

■ Lost Market Share YoY
■ Gained Market Share YoY

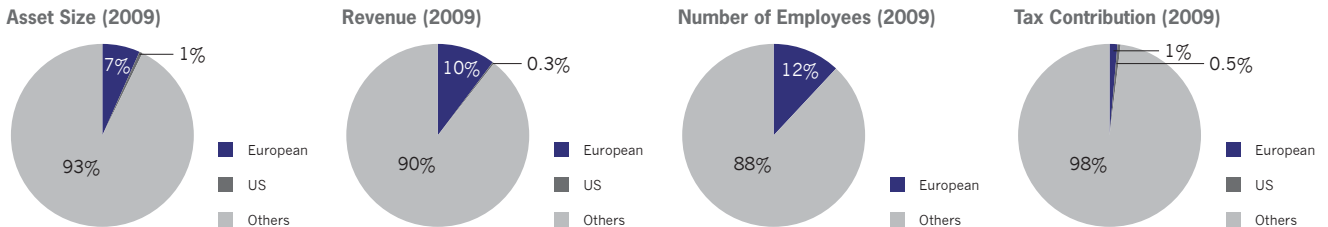
Source: Asian Banker Research

Figure 1.6 Corporate Profit Tax (Hong Kong)



Source: Asian Banker Research

Although asset size remains stable European commercial and investment banks now face an increasingly uphill battle against mainland Chinese banks, and are under threat of becoming marginalised as their ability to generate revenues diminishes.



The total number of European firms remained stable in Macau between 2005 and 2009. The six European players in Macau are HSBC (UK), Banco Espírito Santo Asia (Portugal), BNP Paribas (France), Standard Chartered Bank (UK), Banco Comercial Português, S.A (Portugal) and Caixa Geral De Depositos (Portugal). European commercial and investment banks command a market share of assets 11 times higher than their US peers.

Despite a contraction in revenue for all players, Bank of China accelerated its growth between 2005-2009 and generated more than MOP 3.2 million in revenue. It is the largest single bank in the world today and poses a key threat to further expansion by European banks.

Revenue for European banks declined at a faster rate in recent years than their non-European counterparts after briefly peaking in 2007. European banks that saw revenue decline in 2009 included BNP Paribas (-31%), Standard Chartered Bank (-13%) and Caixa Geral De Depositos from Portugal (-21%).

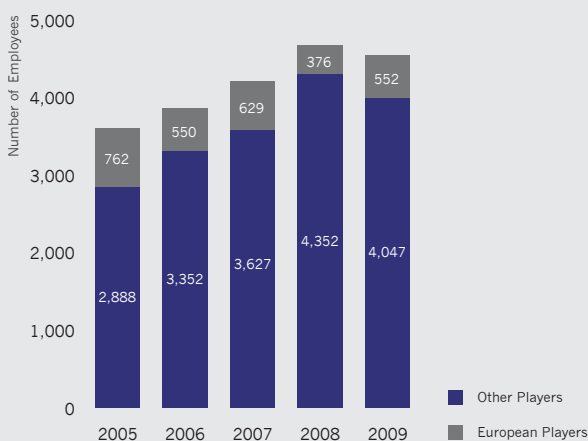
Only Banco Comercial Português (Portugal), maintained its revenue in 2009.

European banks outgrew the non-European banks in taxes on profits during 2006-2007. However, European players experienced a sharper decrease in taxes than their non-European counterparts during 2007-2009. In fact, taxes on profits paid by European banks declined from a high of MOP 32.7 million to 5 million in 2009.

European banks contributed 1.3% to total industry taxes on profit, while US banks made up 0.5% of the total industry taxes on profits.

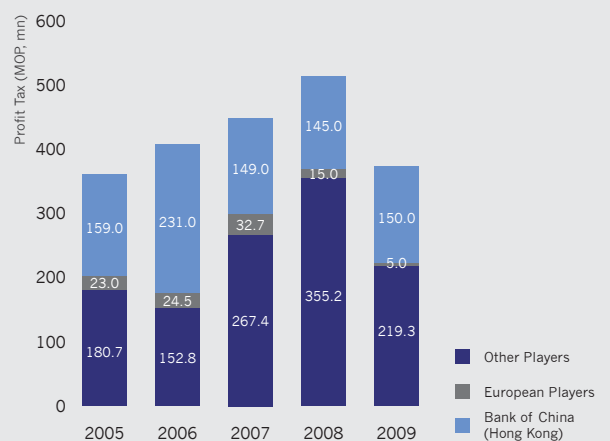
European banks need to evaluate their business models in anticipation of severe competition in the Macau commercial and investment banking industry. As one possible response, European commercial and investment banks began increasing their headcount in the Macau market from 376 in 2008 to 552 in 2009.

Figure 1.7 Number of Employees (Macau)



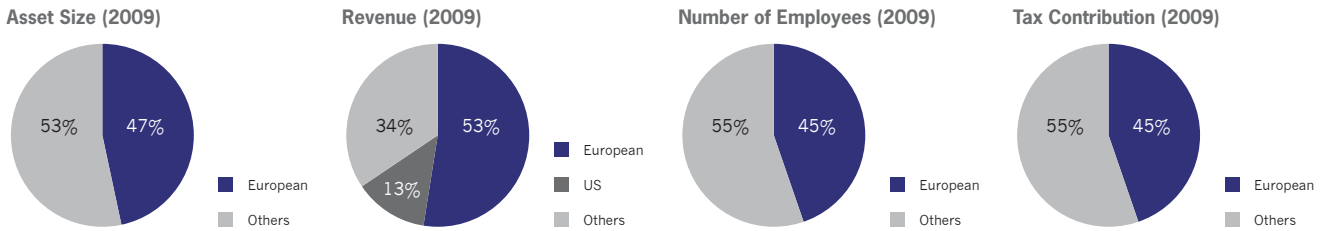
Source: Asian Banker Research

Figure 1.8 Corporate Profit Tax (Macau)



Source: Asian Banker Research

Hong Kong's geographic location, credible legal system and effective regulatory framework have helped it to become a leading insurance centre in Asia and to attract many of the world's top insurers. The insurance sector holds the largest number of European firms relative to all other sectors, and they play a significant role in Hong Kong's economy, contributing HK\$ 2,756 million of direct corporate tax between 2005 and 2009 and employing a workforce of nearly 24,000 people in 2009.



With 57 European insurers, including 19 life insurers, the European insurance industry represents the largest group in the FI industry in the Hong Kong economy.

The European presence was not only relatively stable between 2005 and 2009, but the number of life insurers increased in the same period. Assets managed by all European insurers grew in line with the industry in 2009, with a market share of 46.4%.

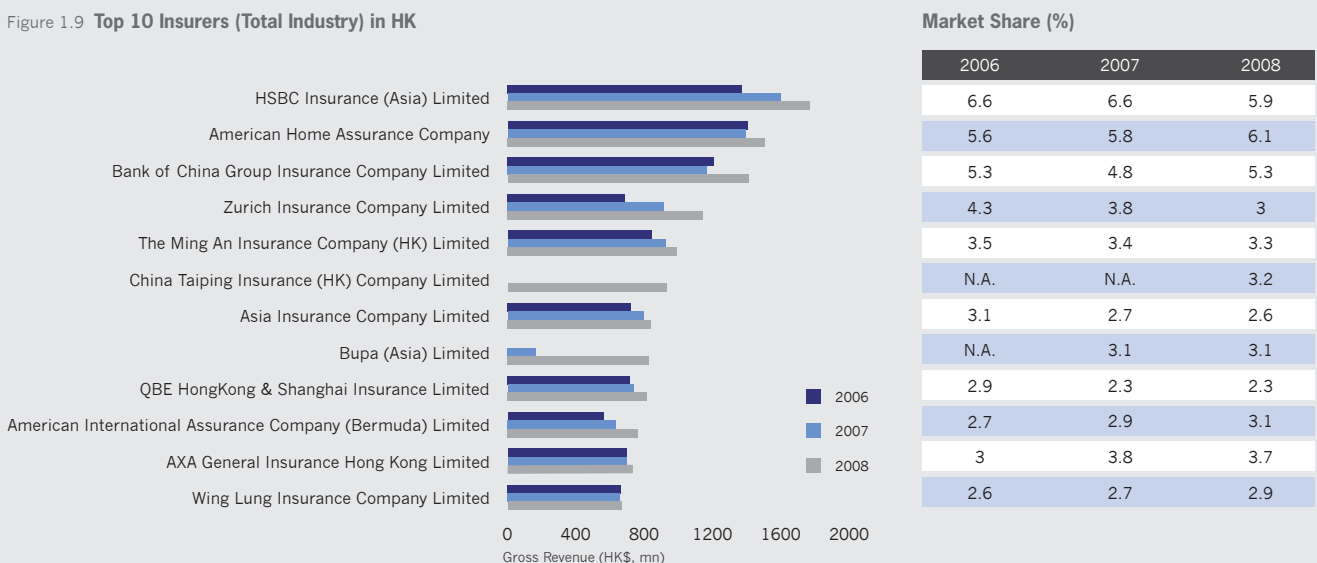
European insurers play an important role in Hong Kong's insurance industry contributing 52.5% to total industry revenue. European life insurance giants HSBC Life and Prudential UK had a market share for revenue of 28% and 20% respectively in 2009. US insurers only accounted for 13% of total revenue in 2009.

Despite the growing presence of Asian/Chinese insurers, 2 out of the top 5 insurers are European players (see figure 1.7.). They maintained or strengthened their market share during 2006-2008. European insurers had a 46.4% market share in assets in 2009.

In terms of revenue, the market share of European life insurance giants HSBC Life and Prudential UK was 28% and 20% respectively in 2009, whereas all their US insurers accounted for only 13% of total revenue in 2009.

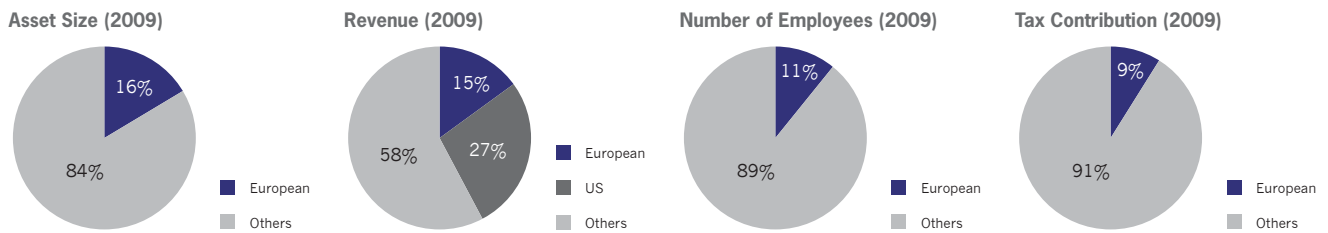
The dominance of European insurers is even more profound in the life insurance business. From 2007 to 2009, seven European players ranked amongst the top 10 life insurers, with an total market share exceeding 30%.

Figure 1.9 Top 10 Insurers (Total Industry) in HK



Source: Asian Banker Research, Office of the Commissioner of Insurance of Hong Kong (OCI)

The revenue to GDP ratio of European insurers in Macau has been improving since 2007, indicating the growing influence of European players in driving Macau's economy, despite the financial crisis and the smaller size of European insurers relative to their peers. Their revenue and assets grew faster compared to peers between 2005 and 2009.



Out of a total of 23 insurers operating out of Macau, only 4 are European. The insurance industry in Macau is dominated by AIA (US), which held 27.1% market share of earnings in 2009.

Despite this small presence in Macau, European insurers comprise one of the strongest groups of competitors, with higher revenue growth than their counterparties between 2005 and 2009. Revenue from European insurers in Macau increased from MOP 546 to 707 million between 2007 and 2009 and asset growth also increased in this period despite profitability issues.

Between 2005 and 2009, three European insurers entered the top 10 list and grew their market share steadily; these were AXA (France), ING (Netherlands) and HSBC Life (UK). In terms

of average industry weighting, European players gained market share more rapidly than their counterparties.

The headcount contribution of European insurers to the total insurance workforce was 10.8% in 2009 reflecting a YoY decrease of 2%, mainly due to the downsizing of AXA's employment pool, despite other European firms maintaining their headcount.

Direct corporate profit tax contribution by the insurance industry declined by 56% in 2008 but recovered quickly in 2009. The tax contribution by European insurers however remained subdued in 2009, contributing MOP 4.7 million to the state coffers. The decline in profit by ING Life (Netherlands), HSBC Life (UK) and Fidelidade-Mundial's (Portugal) were key catalysts that drove down taxes paid in 2009.

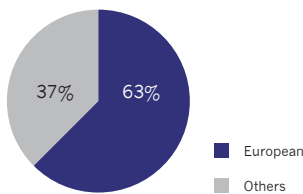
Figure 1.10 Market Share in Gross Revenue (Macau)



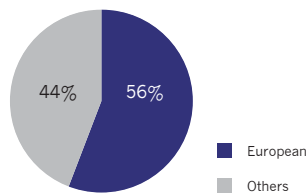
Source: Asian Banker Research, Monetary Authority of Macao

Compared to other financial sectors, the private banking industry did not face the same decline in business and 2009 set a new record for total assets under management. Based on indicators such as assets, revenue, employees and taxes paid, European players recovered from the crisis faster than their peers. Hong Kong's private banking industry is expected to experience accelerating growth in the next few years, providing a boon for European private banks which dominate the industry for all relevant indicators, with a market share in excess of 55%.

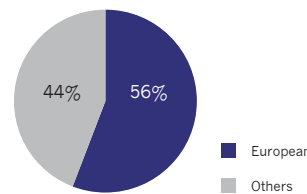
Number of Private Banks (2009)



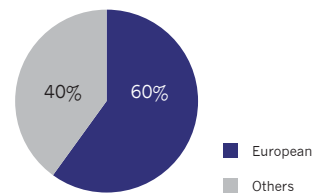
Asset Size (2009)



Number of Employees (2009)



Tax Contribution (2009)



Hong Kong witnessed the strongest HNWI growth in 2009 YoY for the entire Asian region when it grew by 104%, almost reaching pre-crisis levels. Hong Kong aspires to be a global leader in private banking and it already had more than HK\$ 3 billion in private banking assets by the end of 2009. European private banks are keen on doubling their asset size within the next few years, as they are looking to expand their presence in Hong Kong as a gateway into China.

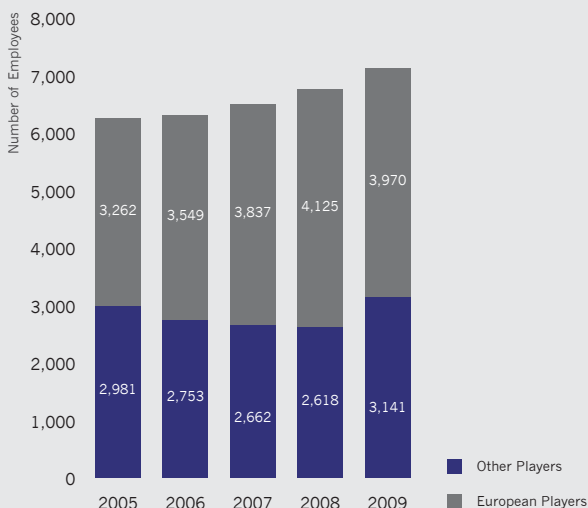
The industry as a whole suffered a decline of 24% in 2008, but gained 14% in 2009 in revenue terms with European players one of the best performing segments.

European private banks contributed HK\$ 1.34 billion in taxes between 2005 and 2009 and engaged a work force of 3,970 in 2009. The performance of European private banks between 2007 and 2009 was in line with overall industry figures, although commanding a higher market share.

Due to extensive tax moratoriums, the overall tax contribution of the industry decreased from HK\$ 590 million in 2007 to HK\$210 million in 2009. European private banks had a share of 60%.

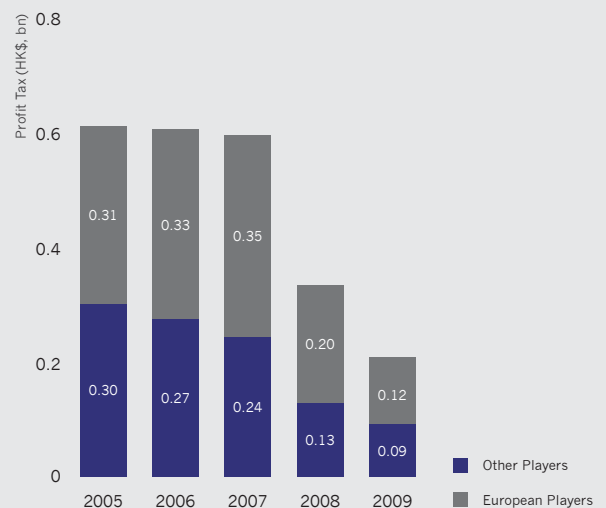
European players have also retained more employees than their peers since 2008. They continue to have higher employee growth rates than their non-European peers, although the trend was temporarily reversed in 2009. Their revenue to GDP ratio is consistently higher than their non-European peers.

Figure 1.11 Number of Employees (Hong Kong)



Source: Asian Banker Research

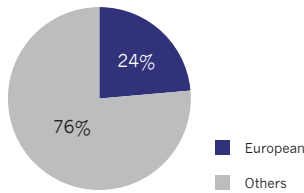
Figure 1.12 Corporate Profit Tax (Hong Kong)



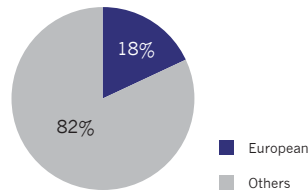
Source: Asian Banker Research

The global hedge funds industry is ramping up its presence in Hong Kong after closing or severely cutting back its Asian operations during the global financial crisis. Even during the crisis, funds continued to grow steadily in numbers and reached a new high in 2009. European hedge funds dominated the industry in Hong Kong, together with US peers, although US hedge funds enjoy a higher market share in terms of number of players, asset size, revenues, employees and corporate tax payments.

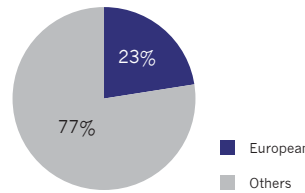
Asset Size (2009)



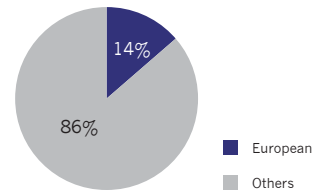
Revenue (2009)



Number of Employees (2009)



Tax Contribution (2009)



The number of European hedge funds in Hong Kong experienced constant growth between 2005 and 2009, growing from 35 to 107. Europe and US players easily dominate the hedge funds industry, with local hedge funds only comprising 1.9% of total investors in 2009.

European hedge funds paid HK\$ 1.3 billion in taxes between 2005 and 2009 and employed a head count of 443 in 2009.

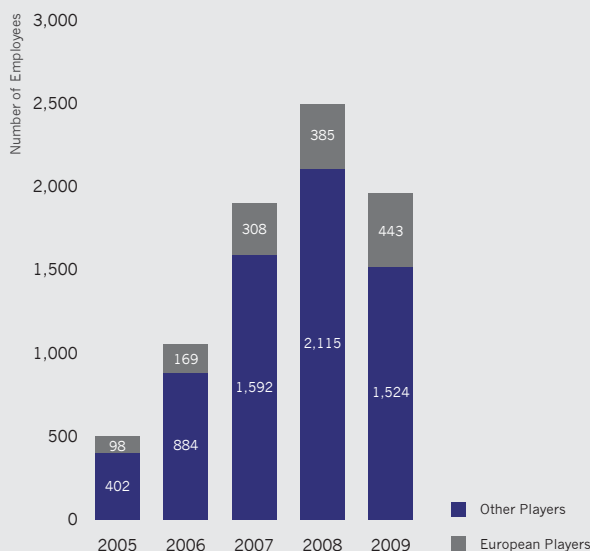
The growth rate of the overall hedge funds industry for assets was 92%, 91%, 91%, 41% and -39% YoY between 2005 and 2009 and apart from 2009, European hedge funds tracked the market average. In 2009 revenues sharply declined, after outperforming their non-European

peers for the first time in 2008. The market share of European hedge funds dropped from 53% to 18% in 2009, with a consequent reduction in contribution to GDP.

Despite challenges to top line growth for European hedge funds employee figures until the end of 2009 steadily increased in anticipation of further growth, while non-European hedge funds scaled back their workforces.

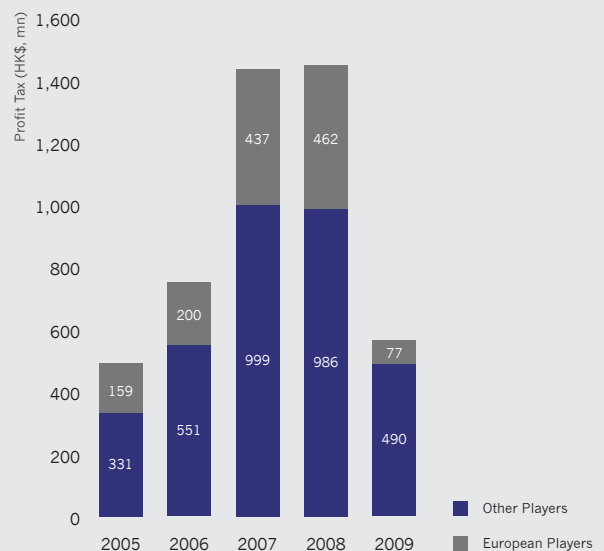
Taxes paid by the hedge funds industry experienced a significant YoY decline of 61% in 2009, since hedge funds were taxed significantly less. European hedge funds paid HK\$ 462 million in 2008 and 77 million in 2009.

Figure 1.13 Number of Employees (Hong Kong)



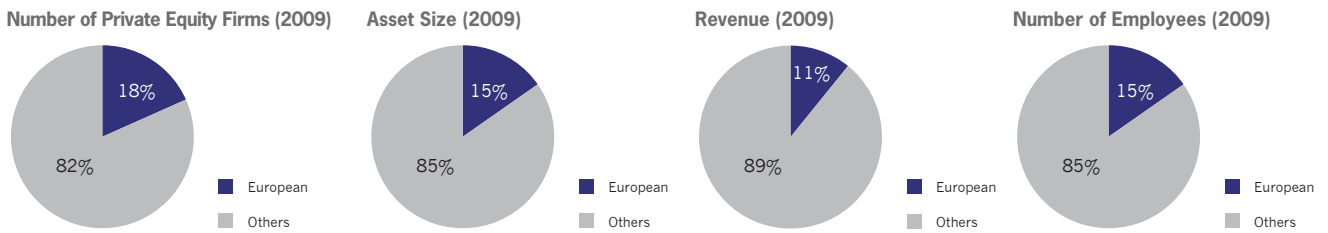
Source: Asian Banker Research

Figure 1.14 Corporate Profit Tax (Hong Kong)



Source: Asian Banker Research

Hong Kong is the largest regional centre for private equity funds, managing about 24% of the total capital pool in Asia. The overwhelming majority of private equity funds in Hong Kong come from overseas including major European players investing in companies in the region. European funds steadily increased their presence between 2005 and 2009.



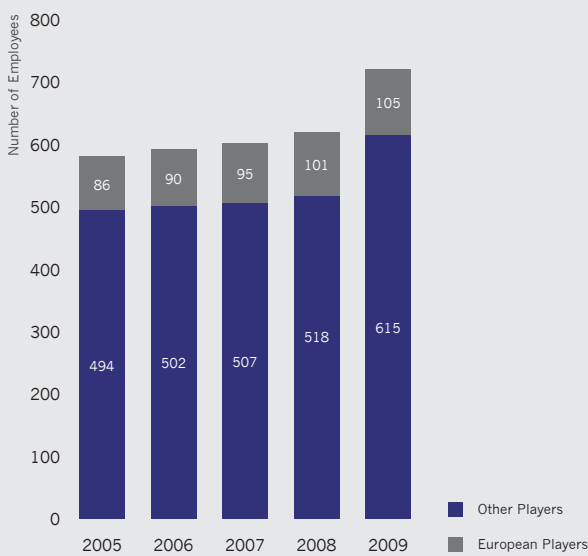
Although holding a market share of only 15% in assets under management, European private equity funds have weathered the financial and economic crisis well so far. Assets under management and revenue gradually increased between 2005 and 2009, in line with industry growth rates. The number of employees also grew from 86 in 2005 to 105 in 2009.

European players have been unable to grow their revenue because of the dominance of large U.S. private equity investors in the private equity market on the Mainland due to the unparalleled funding, international connections and the expertise that many Chinese entrepreneurs require.

There is a huge incentive to invest in Hong Kong as private equity non-resident funds are exempted from direct corporate profit tax. There is ongoing debate about how to bring this industry under the tax net

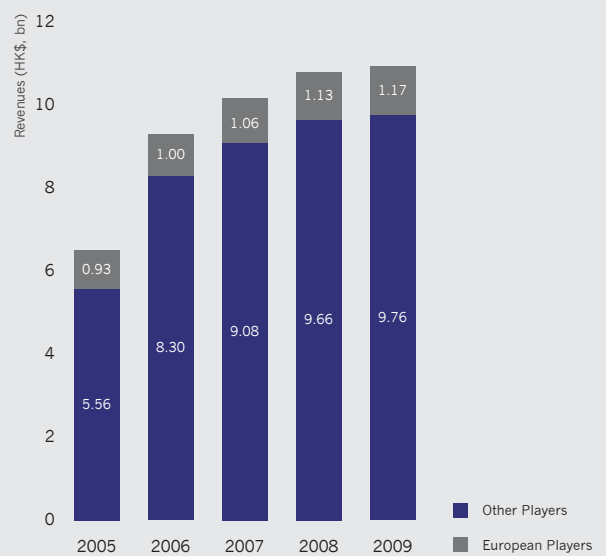
It will be an ongoing challenge for European private equity funds to grow as there has been an explosion of China-focused funds, including a growing number of deep-pocketed and well-connected local investors.

Figure 1.15 Number of Employees (Hong Kong)



Source: Asian Banker Research

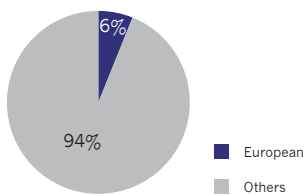
Figure 1.16 Revenue (Hong Kong)



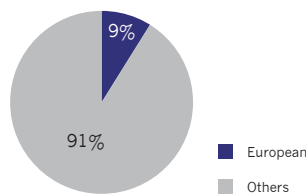
Source: Asian Banker Research

Hong Kong is widely recognised as the leading fund management centre in Asia with the largest concentration of fund managers. In July 2010, the Securities and Futures Commission's annual survey of fund management activities showed that fund management in Hong Kong rebounded strongly in 2009, despite the uncertain economic and investment climate. The survey indicates that international investors including European ones continued to use Hong Kong as their platform for investing in the region including China via the Qualified Foreign Institutional Investors (QFII) scheme.

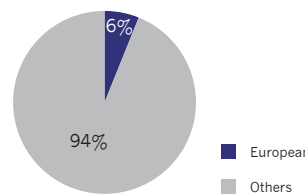
Asset Size (2009)



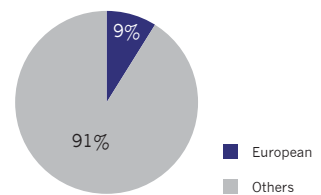
Revenue (2009)



Number of Employees (2009)



Tax Contribution (2009)



The number of European fund management institutions in Hong Kong remained stable between 2005 and 2009 despite decreasing numbers of competitors.

Although the European fund industry is small, they have nearly recovered to pre-crisis levels, due to the strong recovery in global financial markets and a significant inflow of investment capital into the Asia Pacific region.

The asset size of European fund management institutions grew 50.6% in 2009, reaching the pre-crisis growth levels of 2007. In 2009, more than 50% of these assets were invested in Hong Kong, 20% in the remaining Asia-Pacific region and 30% in North America and Europe.

The decrease in revenue market share for European firms and US firms was primarily driven by a drop in the value of transac-

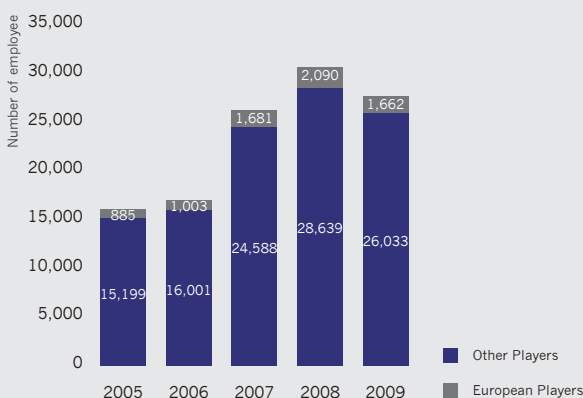
tions handled by major European firms and US firms in 2009. By contrast Mainland firms expanded their revenue market share significantly in 2009.

Staff numbers in the fund management business decreased from 30,729 in 2008 to 27,695 in 2009, as companies consolidated their operations or range of activities, in the aftermath of the financial turmoil.

The total number of staff engaged in fund management activities experienced a moderate decrease of 4.4% from 10,775 in 2008 to 10,306 in 2009, while the sales and marketing staff at these entities dropped by 7.5% during the same period.

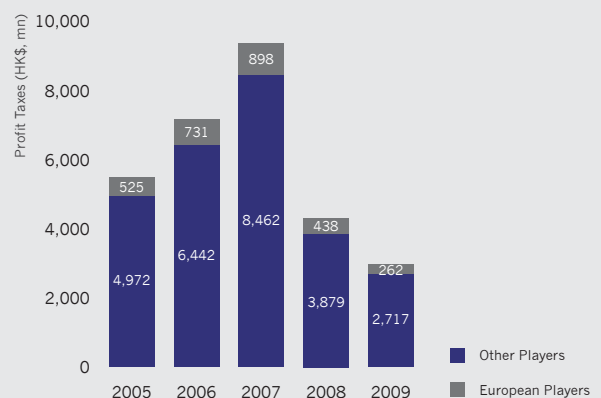
Employee productivity for the European fund management industry consistently outperformed the market. The profitability of European fund managers is also higher compared to industry peers.

Figure 1.17 Number of Employees (Hong Kong)



Source: Asian Banker Research

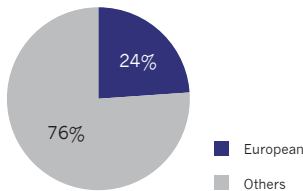
Figure 1.18 Corporate Profit Tax (Hong Kong)



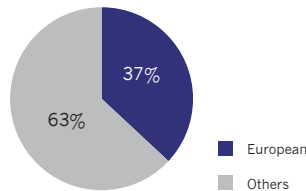
Source: Asian Banker Research

For the European brokerages industry, Hong Kong remains a challenging market, dominated by US players and the rapid rise in local and Mainland Chinese firms, which cater mainly to retail investors. While there are only 38 European brokerages focusing on institutional clients they claim a disproportionately larger share in value contribution to the Hong Kong economy.

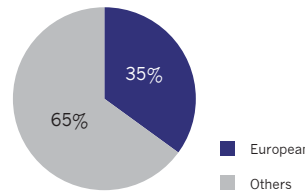
Asset Size (2009)



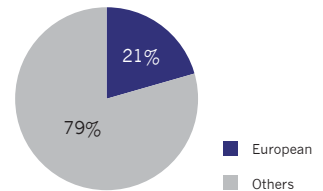
Revenue (2009)



Number of Employees (2009)



Tax Contribution (2009)



Despite the 2008 financial crisis, European firms experienced a relatively stable growth rate for Assets under Management as compared to other firms in the industry, decreasing by less than 4% in 2009 YoY.

European firms had 24% of market share in assets and employed close to 4,700 people in 2009. They contributed HK\$ 2.2 billion of direct corporate profit taxes between 2007 and 2009.

European brokerages had the second largest amount of capital, with an average per firm of HK\$ 1.1 billion in 2009.

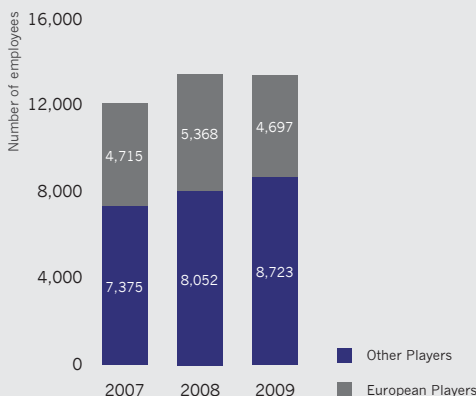
Overall, total industry revenue declined from HK\$ 78 billion in 2007 to HK\$ 45 billion in 2009. Revenues earned on a YoY basis by European brokerage firms (-23.2%) continued to decline more significantly than did revenues earned by their peers (-9.1%) due to the intense industry competition.

Net profit declined for all securities dealers and securities margin financiers in Hong Kong in 2009. The decrease was mainly due to a decline in turnover and commission income. US firms saw a 33% decrease in total net profits in 2009 YoY, mainly due to a reduction in turnover of major firms, and partly due to the winding down of Lehman Brothers Securities Asia Limited. European firms showed a similar percentage decrease.

In terms of average net profit per company, European firms had the third largest average net profit, after the US, at 2009 (HK\$ 102 million) and local firms (HK\$ 9 million), followed by Mainland firms (HK\$ 78 million) and other firms (HK\$ 22 million).

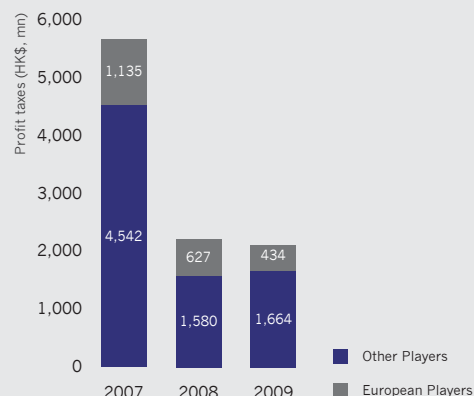
In terms of active securities clientele, local Hong Kong firms accounted for 56% of the market total while Mainland firms had 26%. Both types of firms mainly focus on the retail market. On the other hand, US firms and European firms, which mainly focus on institutional clients, made up only 2% of the total active securities clients in Hong Kong.

Figure 1.19 Number of Employees (Hong Kong)



Source: Asian Banker Research

Figure 1.20 Corporate Profit Tax (Hong Kong)



Source: Asian Banker Research

For this study, we analyzed information gathered from the following resources:

- Regulators
- Annual reports of financial institutions
- Professional industry bodies
- Interviews with financial institutions
- Surveys published

We conducted 10 interviews with senior executives in the various sub sectors to further affirm data validity. For the purpose of this study we considered institutions with their ultimate parent company headquarters in Europe. All figures pertain to the end of 2009 calendar year. Revenue to Hong Kong's or Macau's GDP ratios are based on the revenue generated by the aggregated revenue of European players to total nominal GDP. To determine the contribution of direct corporate profit taxes we used net profit figures and a tax rate of 16.5% for Hong Kong between 2008-2009 and 17.5% between 2005-2007. For Macau, we have applied the corporate tax rate of 12% between 2005-2009.

Commercial and Investment Banking

We established the total list of industry and European players by comparing the list of banks from the Hong Kong Monetary Authority (HKMA) with the banks covered by KPMG's Hong Kong and Macau banking survey report 2010, 2005 and 2009 which provided additional data on key indicators of individual players. We further identified key data points in banks' annual reports which were not covered in the KPMG survey. After calculating all European banks' assets, revenue, corporate taxes paid we extrapolated this to 34 (excluding outliers e.g. the largest players HSBC and Standard Chartered). Workforce data was gathered from the Census and Statistics Department in Hong Kong with the European portion estimated by assuming a link between asset and employee size. We applied the same bottom up approach to Macau.

Insurances

The starting point was to establish the number of players, asset size and revenue from the Office of the Commissioner of Insurance of Hong Kong (OCI) and incorporated tax data from the Inland Revenue Department of Hong Kong which excluded insurers that did not report any premiums between 2007-2009. For Macau, most of the key indicators came from the

Monetary Authority of Macao including the European proportion. Tax contributions were estimated using the corporate profit tax rate of 12% applied to the operating profit of all Macau insurers.

Private Banking

The total number of players and assets under management between 2007-2009 was determined by leveraging off various sources such as Calamander Group, the Korn/Ferry institute Private Banking Survey, BCG and OCBC Bank Hong Kong. By interviewing four senior private banking management executives we identified the European share. To determine total industry tax, revenue and employee size we used the European/Total Industry asset ratio and multiplied it by European data points such as revenue, tax and employees.

Private Equity

We obtained the list of private equity firms in Hong Kong from Hong Kong Venture Capital and the Private Equity Association (HKVCA). Total industry assets and the workforce of private equity firms in Hong Kong was estimated using the Asian Venture Capital Journal (AVCJ). Based on interviews with senior industry practitioners, we assumed that European firms had a share of 15% of Assets under Management (AUM) between 2007-2009. A link between asset size and employees was applied to determine the European portion. Revenue for total and European private equity industry was estimated based on an average 4% return on AUM in 2005-7, 2% in 2008 and 1.5% in 2009 due to the deteriorating operating environment in 2008/2009. Private equity firms are exempted from taxes on profit under the Profits Tax Exemption for Offshore Funds Bill passed in 2005. Based on our conversations, private equity firms, whether onshore or offshore, pay practically zero tax in Hong Kong. Most foreign private equity firms are registered as limited partnership firms in Cayman Islands (~90-95%) and are tax exempt in Hong Kong. Those that are registered in Hong Kong (not tax exempt), are structured in such a manner that they only draw advisory fees from a parent in a tax neutral location.

Hedge Funds

All indicators were established from the Securities and Futures Commission in Hong Kong with the exception of the tax contribution. We applied a cost to income ratio on revenue

to determine industry profits which we increased from 62.5% in 2007 to 80% in 2009 before applying the profit tax rate. The European proportion was determined by interviewing four senior industry practitioners. We extrapolated the data for 2005 and 2006.

Fund Management and Brokerages

For both fund management and brokerages, we started with data from the Securities and Futures Commission in Hong Kong (SFC) to identify the number of institutions, assets and revenues generated. Direct corporate tax paid was determined by applying the tax regime to industry profits available from the SFC. The total number of employees was sourced from the Census and Statistics Department in Hong Kong. European revenue, employees and taxes paid was determined by using the European to total industry asset ratio.

Computation of Contribution to GDP (Hong Kong, Macau)

To compare different financial services industry segments, we used the *revenue to GDP* ratio which is a simplified version compared to the HKMA approach in calculating GDP contribution. Nevertheless, The Asian Banker Research approach allows the determination of the relative weight of each segment to GDP. Unlike the methodology used in the study, HKMA

calculates contribution to GDP based on operating profit: for instance, the contribution to GDP for commercial banks is the sum of the net interest margin of the lending business and other fees received, while taking into account the operating cost of the bank; for investment banks, private banks, hedge funds, private equity firms and fund managers, the GDP contribution is calculated as the sum of management fees, interest and dividends received from the company's investments, while also taking into the operating cost of the firm. For general insurances, GDP contribution is evaluated from the sum of gross premiums received and income from investments, taking into account net claims paid out, commissions and other operating costs. For life insurances, ideally, GDP contribution is estimated from the present values of future premiums and claims and net additions to life funds. However due to the lack of sufficient information, the cost method is used instead for estimation.

Sources used in the analysis:

1. Hong Kong Monetary Authority
2. Monetary Authority of Macao
3. Securities and Futures Commission in Hong Kong
4. Census and Statistics Department in Hong Kong
5. Office of the Commissioner of Insurance of Hong Kong (OCI)
6. Inland Revenue Department of Hong Kong
7. Hong Kong Venture Capital and Private Equity Association (HKVCA)
8. KPMG Hong Kong and Macau Banking Survey Reports (2005-2010)
9. Korn/Ferry Institute Private Banking Survey
10. Asian Venture Capital Journal

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- To facilitate information to the general public concerning the EU, its structure, policies, regulations and business related topics.
- To organize events to raise awareness on key issues for the EU industry in Hong Kong and Macau, ranging from financial services, to environment, EU standards, trade, IPR amongst others.
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