

lakyara vol.156

Financial institution should prepare for ISAs' advent as an urgent priority

Hisashi Kaneko

10. January. 2013

Executive Summary



Hisashi Kaneko

Senior Researcher

Financial Technology and
Market Research Department

In September 2012, we surveyed banks about their preparations for the coming advent of ISAs. We found major differences in their state of preparation, with some cautious about ISAs and others aggressively targeting them. With little time remaining until ISAs' launch date, advance preparations will be a key determinant of success or failure in the ISA market. Financial institutions should hasten to prepare.

Interest in the Japanese version of ISAs (tax-exempt individual savings accounts) is growing ahead of their 2014 launch. Banks and securities brokerages were initially skeptical of ISAs' appeal, considering that the time period for purchasing assets in an ISA is limited to only three years. Additionally, ISAs will entail cumbersome paperwork and require specialized IT systems. Many financial institutions consequently expressed concern about ISAs' profitability. In response, the government, in its national revitalization strategy unveiled in July 2012, repositioned ISAs as a vehicle to aid a wide range of investors in building wealth through diversified, long-term investment. The government set an ambitious target of ¥25 trillion of total ISA assets within a mere seven years of ISAs' advent. As specific measures to realize this target, the Financial Services Agency (FSA) has requested that the fiscal 2013 tax reform bill extend the period during which assets may be purchased in ISAs indefinitely, raise the limit on total nontaxable investments, and add bonds and bond investment trusts as ISA-eligible products. In the wake of the FSA's proposal, the financial industry's attitude is steadily changing. Financial institutions' receptivity toward ISAs is expected to change dramatically depending on the extent to which the FSA's proposed reforms are adopted and prove effective.

Reaction to FSA's proposed reforms

In the latter half of September, immediately after the FSA released its tax reform proposals, we surveyed banks that use the BESTWAY investment trust sales management system to ascertain how they are preparing for ISAs. The survey respondents comprised 53 regional banks¹⁾, nearly 90% of which intend to offer ISAs. The remainder are in the process of deciding whether to do so. None of the respondents has decided not to offer ISAs. The percentage of respondents planning

NOTE

1) Thirty-seven first-tier and 16 second-tier regional banks.

to offer ISAs has increased in comparison to a previous survey conducted before ISAs' scheduled launch date was pushed back two years. We surmise that the overall increase in affirmative responses reflects that ISAs are now more likely to become reality and the government has revealed its specific intentions in terms of improving the ISA scheme.

Our survey also inquired about banks' response to the FSA's proposed expansion of ISA-eligible products. Nearly 40% of the respondent banks reported that they plan to offer bonds as an investment option for ISA holders, while only two banks indicated that they will not do so. The remaining 60% are still undecided. The main reason cited for such indecision was IT system challenges or difficulty reaching a decision. Another widely cited reason was insufficient time to consider whether to offer bonds for ISAs, given the survey's timing so soon after the FSA's proposed tax reforms were announced. Regarding bond investment trusts, over 30% of respondent banks plan to offer them while nearly 30% plan not to. The remaining 40% are undecided. Many of the undecided respondents expressed negative opinions about bond investment trusts (e.g., "there is no demand for them at current interest rate levels"). In contrast to bonds, which many undecided respondents would like to offer if they are able to make the requisite IT system modifications in the short time available, bond investment trusts pose relatively little difficulty in terms of system compatibility. From this perspective, the widespread negative attitude toward offering bond investment trusts is particularly notable.

Wide range of ISA customer targets

The survey also asked about the banks' ISA customer targets expressed as a percentage of their existing investment trust customers. The median response was 50%, roughly in line with our expectations, which took into account that some customers have investment trust accounts at more than one financial institution and not all customers would be willing to go to the trouble of opening an ISA. What was surprising, however, was that the responses were spread over a wide range. Nearly 20% of respondents set cautious targets of "10–20% of existing investment trust customers" (the "Cautious Respondents"). Conversely, nearly 20% set ambitious targets of "100–150% of existing investment trust customers" (the "Aggressive Respondents"). Given the survey's timing, these responses may not necessarily be officially adopted targets, but they nonetheless offer insight into different banks' attitude toward ISAs.

The Aggressive Respondents' most distinctive characteristic is early preparation. Before opening ISAs for customers, financial institutions must obtain the tax authorities' approval for tax-exempt status. They may begin submitting applications for such approval on behalf of customers from October 2013, but there are no restrictions on how early they may begin accepting applications from customers. Our survey asked when respondents would begin accepting applications. On average, Aggressive Respondents plan to do so from July 2013, two months earlier than Cautious Respondents. Additionally, the response rate for questions about operational issues was higher among Aggressive Respondents and their responses to such questions tended to be specific and mainly related to matters of operational efficiency. Their responses imply that they have already made substantial preparations for ISAs.

Another common attribute of Aggressive Respondents is a focus on gaining new customers. When asked about what types of customers they plan to target on a priority basis, both Aggressive Respondents and Cautious Respondents place similar priority on retirees that are existing customers. However, a higher percentage of Aggressive Respondents place priority on gaining new retiree customers and marketing ISAs to the currently employed. Perhaps for this reason, a majority of Aggressive Respondents reported that they are considering accepting ISA applications online. In contrast, not even one Cautious Respondent is doing likewise.

Importance of rapid preparation

To offer ISAs, financial institutions will have to perform various new tasks. One such task is intake of customers' ISA applications accompanied by a residency certificate regardless of whether the application is from a new or existing customer. Financial institutions must submit this information to the tax authorities and notify customers of whether their applications were approved or rejected. They will also have to annually report customers' ISA transactions in a specified format. Financial institutions must make preparations to perform these and numerous other such tasks, some of which are not yet known. Additionally, financial institutions can begin marketing ISAs to customers before the official launch date. Prospective competition with rivals will force them to prepare early, leaving little time to do so. Financial institutions will consequently have to act flexibly, proceeding with decision-making in descending order of certainty while monitoring the authorities' progress toward finalizing the ISA scheme.

Additionally, many of the preparations will be labor-intensive. In addition to the

aforementioned application process, financial institutions will also have process transactions in opened ISAs, including accurately calculating each ISA customer's remaining tax exemption. Yet, with ISA contributions limited to a maximum of ¥1 million per account per year, financial institutions' income from ISAs will be limited. Financial institutions consequently must draft simple operational guidelines for processing ISA applications and transactions. Another priority is improving sales efficiency to reduce the cost of customer acquisition per account.

With their investment trust businesses in the doldrums, banks are understandably cautious about new investments, particularly from a profitability standpoint. However, ISAs will indisputably enlarge the ranks of investment trust investors. From a medium-term perspective, ISAs should launch the investment trust business on a renewed growth path. Financial institutions cannot afford to miss out on the opportunity presented by ISAs.

about NRI

Nomura Research Institute, Ltd. ("NRI", TYO: 4307) is an independent, global IT solutions and consulting services provider with annual sales of 335.5 billion yen as of FY ended March 2012. With front-to-back support for the buy- and sell-side, NRI's tradition of innovation has positioned them as a trusted international market leader. Leveraging NRI's global consulting business, NRI is able to provide innovative financial IT solutions for investment banks, asset managers, banks and insurance providers. For more information, visit www.nri.com.

.....

The entire content of this report is subject to copyright with all rights reserved.
The report is provided solely for informational purposes for our UK and USA readers and is not to be construed as providing advice, recommendations, endorsements, representations or warranties of any kind whatsoever.
Whilst every effort has been taken to ensure the accuracy of the information, NRI shall have no liability for any loss or damage arising directly or indirectly from the use of the information contained in this report.
Reproduction in whole or in part use for any public purpose is permitted only with the prior written approval of Nomura Research Institute, Ltd.

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

<http://www.nri.co.jp/english/opinion/lakya>

.....