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What kind of added-value are investors seeking from fund-wrap accounts?

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Executive Summary



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NOTE

1) A wrap account is a service whereby an investor and financial institution enter into a discretionary investment advisory agreement authorizing the financial institution to manage the investor's account, including stock selection, order execution/management, etc. Fees are charged based on the account balance. The main types of wrap accounts are fund-wrap accounts, which invest in investment trusts, and separately managed accounts (SMAs), which invest in an unconstrained investment universe in accord with the investor's instructions.

2) According to the Japan Investment Advisers Association, wrap account assets at March 31, 2014 totaled ¥1,376 billion, a roughly 80% increase from a year earlier, while the number of wrap accounts approximately doubled to 105,706 over the same timeframe. Both have subsequently continued to grow, reaching ¥1,643 billion and 129,492, respectively, as of June 30, 2014.

3) NRI estimates based on Fundmark data.

4) Survey responses were collected mainly in Greater Tokyo and the Kinki and Tokai regions, the major fund-wrap markets.

5) Of the 471 respondents, 340 are current fund-wrap account holders and 131 are former fund-wrap account holders who have closed their accounts.

An NRI survey of fund-wrap account holders revealed the importance of the initial consultation with customers interested in opening a fund-wrap account and follow-up service after the account has been opened. It is crucial for fund-wrap account providers to improve not only investment performance but their overall services' added-value.

Wrap accounts¹⁾ are growing rapidly in number and asset value, both of which have roughly doubled²⁾ over the past year. The chief driver behind their growth is fund-wrap accounts, a type of wrap account used to invest in investment trusts. Fund-wrap accounts account for some 80%³⁾ of total wrap-account assets.

In August 2014, we conducted an online survey of male and female fund-wrap account holders over age 50 with at least ¥10mn of financial assets⁴⁾. We obtained responses from 471 fund-wrap account holders⁵⁾. Additionally, we interviewed 15 of the survey respondents and qualitatively analyzed their responses.

Why investors open fund-wrap accounts

When a customer wants to open a fund-wrap account, financial institutions consult with the customer using a questionnaire to ascertain the customer's investment goals and preferences, including how much risk the customer is willing to assume to achieve his or her goals. Once the account has been opened, the financial institution invests the customers' assets in diversified funds pursuant to a discretionary investment advisory agreement, periodically reports investment performance and otherwise services the customer's account.

Our survey asked respondents why they use fund-wrap accounts. The top three responses were "to have financial institutions' expert staff invest my assets on my behalf" (57%), "to build wealth through medium/long-term diversified investment" (54%), and "to avoid having to select individual investment products myself" (39%). In sum, fund-wrap users find the convenience of discretionary investment services appealing. It bears noting, however, that 24% of respondents reported that one of the reasons they opened wrap accounts was that they expected to earn high returns by

virtue of their accounts being professionally managed. If fund-wrap account holders are overly optimistic about the investment returns they will earn, they may evaluate their financial institution's service based solely on investment performance. If so, they could end up becoming dissatisfied and redeeming their wrap-account holdings in response to market volatility.

The keys to stable growth are consultation and follow-up service

For financial institutions to prevent customer dissatisfaction and redemptions and stably grow their fund-wrap businesses, it is important for them to enhance their reputation for overall service by increasing their wrap-account services' added-value aside from investment performance through such means as consulting with customers seeking to open a fund-wrap account and providing ongoing service after the account has been opened.

The first point is consultation with customers interested in opening fund-wrap accounts. A financial advisor typically spends about 30-60 minutes consulting with such customers, ascertaining their investment goals and preferences. According to our survey, actions that made a favorable impression on survey respondents during such consultations included taking sufficient time to thoroughly explain, listening carefully to investment needs and preferences, and conveying a high degree of expertise. Few respondents reported that the process of opening their fund-wrap accounts was a hassle. Among respondents who had closed their fund-wrap accounts, relatively small percentages reported that their financial advisors had spent enough time thoroughly explaining matters to them or had listened carefully to their investment needs and preferences (Exhibit 1). Their financial institutions may have failed to adequately engage these respondents in dialogue during the initial consultation.

In our interview survey, some of the interviewees who were satisfied with their initial consultations with their financial advisors reported that they felt well taken care of during their one-on-one consultations with their advisors and that their financial institutions had prepared investment proposals or portfolios for them in accord with their wishes. Such respondents felt substantial trust in their financial institutions and/or were highly satisfied with their financial institutions' investment proposals.

The second key point is follow-up service after an account has been opened. Our online survey asked respondents why they have increased or plan to increase their investments in their fund-wrap accounts⁶⁾. The third most popular response was

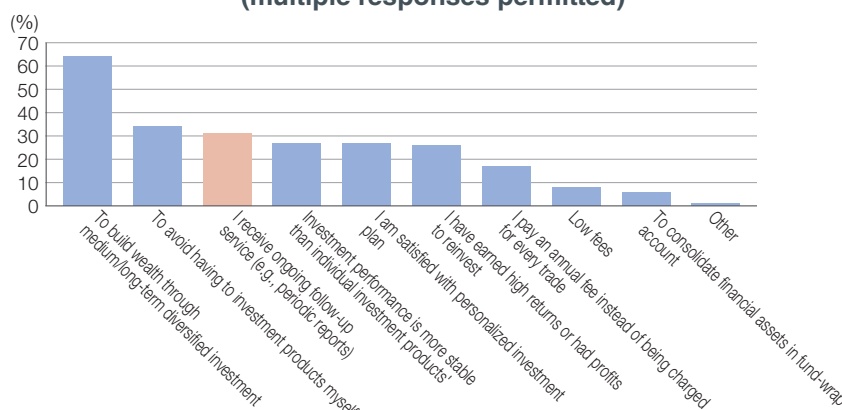
⁶⁾ Respondents to this question were restricted to current fund-wrap holders who reported that they have increased or plan to increase the amount invested in their fund-wrap accounts (n = 191).

Exhibit 1. Customer impressions when opening fund-wrap account (multiple responses permitted)



Source: NRI Fund-Wrap Account User Survey

Exhibit 2. Reasons for increasing amount invested in fund-wrap account (multiple responses permitted)



Source: NRI Fund-Wrap Account User Survey

"[because] I receive ongoing follow-up service (e.g., periodic reports)", behind "to build wealth through medium/long-term diversified investment" and "to avoid having to select individual investment products myself" and ranked higher than "[because] I have earned high returns or had profits to reinvest" (Exhibit 2). These responses bespeak the importance of follow-up service after an account has been opened.

When interviewees were asked about how well their financial institutions have provided follow-up service since they opened their fund-wrap accounts, some replied that they have been contacted only by mail (e.g., in the form of multipage account statements) or that their account representatives ceased contacting them once their account started incurring investment losses. Other interviewees reported that their account representatives have been regularly telephoning or visiting them whenever a new account statement arrives. Some even said that they see their financial institution as a sort of "life navigator."

Financial institutions are thus able to provide substantial added-value to customers through periodic follow-up service. When financial institutions take good care of their customers, their customers are more likely to deposit additional money in their fund-wrap accounts. Financial institutions can also differentiate their services from competitors' based on their frequency and methods of follow-up contact and what their account representatives discuss when contacting customers.

From our survey, we learned that fund-wrap account holders highly value their initial consultations with their financial institutions and periodic follow-up service after they have opened their accounts. To prevent customer dissatisfaction and redemptions and maintain stable growth in fund-wrap account assets, financial institutions should thoroughly consult with customers when they open fund-wrap accounts, adequately follow up with customers who have opened accounts, and make more effort to improve not only their discretionary account management services' convenience and investment performance but also their overall services' added-value.

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