2024 outlook for Japan's retail brokerage industry

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Executive Summary

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The 2024 outlook for Japan's retail brokerage industry hinges largely on how regional brokers decide to navigate the trend toward zero commissions on online trades. Under one potential scenario, this trend could prompt more regional brokers to convert into independent financial advisors. Such an outcome would have wide-ranging impacts on the industry's competitive landscape and functional specialization within the industry.

Competition intensified in 2023 even amid tailwinds

In 2023, Japan's retail brokerage industry saw competition intensify even as it otherwise enjoyed a confluence of tailwinds. One such tailwind was favorable macroeconomic and financial market conditions. For example, Japanese GDP grew YoY in both real and nominal terms in each of the first three quarters of 2023. Meanwhile, Japanese equities have rallied throughout the year against a backdrop of buoyant corporate earnings, with the Nikkei 225 up over 30% year-to-date as of November 30.

Another tailwind is that Japan's income tax code was amended in 2023 to dramatically expand the tax benefits of Nippon Individual Savings Accounts (NISAs) and make the program permanent. The NISA reforms are one component of Prime Minister Fumio Kishida's plan to double Japanese households' income from asset holdings. The entire financial services industry had been lobbying for such reforms ever since NISAs' inception in 2014. The reforms fulfilled the industry's wish list[1].

A third tailwind is that an inflationary mindset has emerged among the Japanese public since 2022. During the 20+ years the Japanese economy was mired in deflation, a deeply ingrained notion that consumer prices would never rise undermined the case for investing in risk assets in the eyes of many Japanese. Such a deflationary mindset largely thwarted the government's efforts to transform Japan from a nation of savers to a nation of investors, but it has now been supplanted by an inflationary mindset, as confirmed by the BOJ's Opinion Survey on the General Public's Views and Behavior[2]. The fact that many households are feeling the pinch of real-income erosion due to inflation before they have gained conviction in the benefits of investing is a serious problem, but it is likely to drive

NOTE

1) In March 2023, NRI conducted an online survey of public awareness of the NISA reforms and consumers' intentions to take advantage of the reforms once they took effect in January 2024. Our analysis of the survey data found that the reforms could potentially drive growth in the number of NISAs to 90% of the government's target.

2) In the BOJ's September 2023 survey, for example, the mean response to where the inflation rate would be in five years was 8.0%, up from an average of 3.9% over the period from June 2013 through December 2021.

long-term growth in Japan's investor class.

Within the retail brokerage industry, price competition intensified in 2023. The most momentous event of the year in terms of the competitive landscape was a "zero-commission revolution" announced by SBI Securities on August 31. After having previously cut commissions to zero on selected trades and products, SBI Securities decided to extend its zero-commission policy virtually across the board. Three years ago, when Japanese brokers started to dip their toes into the commission-free trading trend that originated in the US, I doubted they would embrace the trend given prevailing interest rate differentials between Japan and the US. I thought they could not afford to give up their commission revenues unless short-term interest rates rose enough to provide a replacement revenue stream.

Three years later, short-term rates remain low even as long-term rates have moved higher. Contrary to my expectations, Japanese online brokers have now fully jumped aboard the zero-commission bandwagon. The move is virtually certain to drastically reshape the retail brokerage industry's competitive landscape. The immediate question is how the pivot toward zero commissions impacts the industry's 2024 outlook.

Will more brokers convert into IFAs in 2024?

The major brokers are building business models insulated against the direct impacts of a zero-commission world. Specifically, they are placing priority on serving high net-worth clients and shifting their revenue models away from trading commissions toward fees charged as a percentage of assets under custody. The market segment that would be hardest hit by zero commissions is online brokers. In 2023, Line Financial divested much of online broker Line Securities' operations to Nomura Securities and the Monex Group sold a 49% interest in online broker Monex Securities to NTT Docomo. How many more such exits are forthcoming will be a key focal point of 2024.

Another, generally lower-profile, cohort of brokers that will not be able to ignore the impact of commission-free trading is regional brokers. In FY22, regional brokers were dependent on equity trading commissions for, on average, 27% of their net operating revenues per Japan Securities Dealers Association (JSDA) data [3] For major brokers, the corresponding data point is only 13%. If regional brokers

3) Based on JSDA-compiled data on JSDA members' financial statements. The data are disaggregated between members supervised by the FSA and members supervised by the Ministry of Finance's Local Finance Bureaus. For our purposes herein, we treated the former as major brokers and the latter as regional brokers.

migrate to commission-free trading, they would decimate one of their core revenue sources. Some readers may think that commission-free online trading would not pose much of a threat to regional brokers because their clienteles differ from online brokers'. In my view, few if any regional brokerage CEOs would disregard the zero-commission trend because it is not a direct threat to their firms. I believe the vast majority of them would treat the trend as an opportunity to reassess the value-add they offer to their clients.

In this context, one example that stands out is Shinbayashi Securities, a regional broker based in Toyama Prefecture. In 2023, it converted from a class-one financial instrument dealer (securities brokerage) to an independent financial advisor (IFA), changed its name to Shinbayashi Investment Advisers and partnered with Securities Japan. It outsourced management of client accounts to Securities Japan to reduce its back-office workload. It also added Securities Japan products to its offerings, presumably in the aim of both diversifying its revenue sources and giving clients more choices[4]. Exiting a long-standing brokerage business is a monumental decision. I surmise Shinbayashi Securities took this leap in the aim of expanding beyond securities services to meet a broader range of needs by rethinking the value-add it offers to clients and specializing in front-office functions.

4) See the Okasan Securities Group's June 9, 2023, press release (in Japanese).

Of course, with Japan's population aging and shrinking, regional brokers face existential management challenges such as expanding their clienteles and attracting clients from younger generations. Converting into an IFA is not a panacea vis-à-vis such challenges. That said, as one approach to seriously addressing such challenges, it could very well make sense to give up being a securities brokerage with in-house front-, middle- and back-office operations while pivoting to a new streamlined business model with a broader array of products/services.

In fact, Daitoku Investment Village (formerly Daitoku Securities), the first broker to convert into an IFA, now offers a full suite of financial services needed in its region, including not only securities trading but also insurance, residential mortgage lending, defined contribution pension plans and M&A advisory. In addition to Shinbayashi Investment Advisers and Daitoku Investment Village, three other securities brokers have converted into IFAs[5]. Five is by no means a large number but it is likely to increase as the trend toward zero commissions prompts regional brokers to reassess the value they add for clients.

5) These other three brokers are Hibiki Securities, Iizuka Nakagawa Securities and Takematsu Securities (now Hibiki FA, Nakagawa Securities Advisors and Takematsu Investment Advisers, respectively).

If so, bifurcation of the retail brokerage industry into a front-office cohort of firms and a middle/back-office cohort will likely accelerate, with the former specializing in interfacing with clients while the latter performs functions such as supplying products and managing accounts. Another term for the middle/back-office cohort, which includes major online brokers and middle-market brokers, is IFA platforms. Competition among IFA platforms will likely heat up going forward. Under one scenario of how commission-free trading's impacts might play out, regional brokers' management decisions may spur both changes in the competitive landscape and further functional bifurcation within the retail brokerage industry in 2024.

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