lakyara

2011

Kyara, which means "precious" in ancient Japanese,
is an aromatic resin regarded as the highest quality of all agarwood.
"lakyara [la-kǽla]" aims to deliver the same quality as Kyara together with
NRI's endeavour for continuous excellence and innovation to provide
the most advanced and up-to-date information to our readers worldwide.

vol.116 (10.August.2011)

Regional banks' path to renewed growth in investment trust assets

Nomura Research Institute, Ltd.

Japanese regional banks' investment trust assets decreased in fiscal 2010 as asset outflows substantially exceeded inflows. To achieve renewed growth in investment trust assets, regional banks must get back to basics, most notably by expanding their customer base and offering products that meet customers' needs.

Decline in regional banks' investment trust assets

Customer assets in investment trust accounts at Japanese regional banks (including second-tier regional banks; likewise below) declined 6% in fiscal 2010. Even on an individual basis, very few regional banks saw growth in investment trust assets in fiscal 2010. In their earnings reports, a number of banks attributed their declines in investment trust assets to reduction in fund NAVs due to poor equity market performance. However, investment trusts themselves actually did not perform badly in fiscal 2010. Although Japanese equity funds returned -8% on average, foreign bond funds and foreign real estate funds, which currently account for a majority of investment trust assets, respectively returned +2% and +8% on average[1]. Additionally, the decline in investment trust assets did not extend to other types of financial institutions. Investment trust assets held at megabanks and trust banks ended fiscal 2010 roughly unchanged, while such assets held at securities brokerages increased roughly 9% year on year. Why are regional banks alone experiencing a decline in investment trust assets?

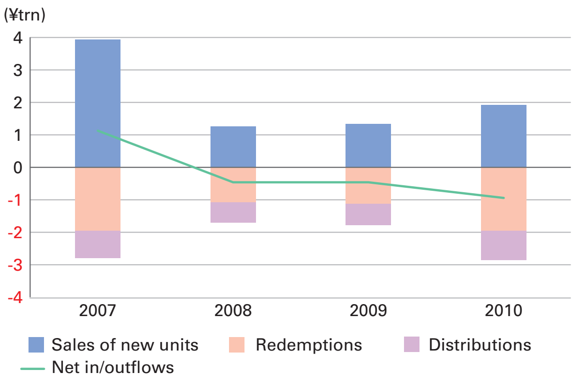
Regional banks' third straight year of investment trust net-outflows

In recent years, regional banks have not seen much growth in investment trust assets even during periods of favorable market performance[2]. This lack of growth is attributable to two factors. First, asset outflows due to redemptions have nearly offset inflows from sales of investment trust units. In fiscal 2008–09, regional banks' investment trust sales totaled ¥1.2–1.3 trillion annually, while redemptions totaled an estimated ¥1.1 trillion annually. Annual net inflows were thus a mere ¥100–200 billion. In fiscal 2010, regional banks' investment trust sales increased more than 40% from fiscal 2009 to ¥1.9 trillion. Redemptions, however, increased by 70% to ¥2.0 trillion over the same timeframe. Fiscal 2010 was the first year that redemptions surpassed sales since regional banks began selling investment trusts.

The second factor detracting from growth in regional banks' investment trust assets is outflows in the form of distributions, which can no longer be overlooked as a drain on assets. Distributions return a portion of a fund's investment income to its investors. Distribution amounts are determined by the investment trust management company. When the fund pays a distribution, its NAV and assets decrease by the amount of the distribution. Although distributions differ from redemptions in that they do not involve conversion of investment units to cash at the customer's volition, both have the same effect of returning invested funds to customers.

Investment trust outflows in the form of distributions have recently been growing year after year, largely because investment trusts with high distribution yields have accounted for the bulk of investment trust sales in recent

Exhibit. Regional banks' equity investment trust in/outflows



Note: Net in/outflows = sales of new units - redemptions - distributions
Source: NRI estimates based largely on Investment Trusts Association of Japan data

years. In regional banks' investment trust accounts, fiscal 2010 distributions totaled nearly ¥900 billion, equivalent to almost half of regional banks' fiscal 2010 investment trust sales. If these distributions are counted as asset outflows, outflows have exceeded inflows for three consecutive years through fiscal 2010.

Further growth in investment trust sales is needed

What should regional banks do to halt the outflows that have reduced their investment trust assets? Given the sharp increase in redemptions in fiscal 2010, they might first consider trying to reduce redemptions. However, they are unlikely to be able to do because their investment trust redemption rate (ratio of redemptions to assets) is not high. Although their redemption rate rose in fiscal 2010 in comparison to fiscal 2008–09, when investors were hesitant to sell risk assets to cut their losses amid the post-Lehman market downturn, it was still no higher than in fiscal 2006–07. Additionally, regional banks' investment trust redemption rate is perennially lower than megabanks and trust banks' redemption rate[3].

Halting asset outflows due to distributions would likewise be unfeasible. Investment trust distributors have no influence in determining distribution amounts, which are set by the investment trust management company as mentioned above. Regional banks have to recognize that large outflows in the form of distributions will inevitably continue, not least because they have been promoting high distribution yields as a selling point in marketing investment trusts.

Ultimately, regional banks appear to have no effective means of halting the decline in their investment trust assets other than to further expand investment trust sales, which increased substantially in fiscal 2010.

Measures to increase investment trust sales

To increase investment trust sales, regional banks first need to focus strongly on expanding their customer base. Regional banks' investment trust accounts have barely increased in number in recent years[4]. Retirees still are a promising demographic in terms of opening new investment trust accounts. Although the nationwide number of new retirees is set to decline going forward, new retirees will not necessarily decrease across all regions in which regional banks have branches. In quite a few regions, the number of new retirees will remain fairly constant[5]. Online banking platforms that offer opportunities to buy and sell investment trusts should also help expand regional banks' investment trust customer base.

While undertaking initiatives to expand their customer base, regional banks must also reawaken to the importance of providing investment products that meet customers' individual needs. Over the past few years, funds with high distribution yields have become best-sellers even at regional banks. Recently, the best-selling investment trusts have predominantly been funds that pay double-digit distribution yields and entail commensurately high risk, including funds that invest in Australian and/or Brazilian bonds or global REITs. However, such funds' recent brisk sales do not mean that they are favored by most retail investors. According to an NRI survey[6] conducted in September 2010, individuals that invest in financial products in pursuit of double-digit expected yields account for a mere 10% of retail investors, though they tend to be experienced investors. Many retail investors prefer lower-risk products with lower expected yields. For example, 20–30% of survey respondents considered each of 5%, 3% and 2% to be a satisfactory expected yield. Accordingly, if regional banks conclude that most of their customers prefer high-yielding funds, they would end up with a narrow customer base for investment trusts. To expand their customer base, it is crucial for regional banks to offer suitable funds that match customers' risk tolerance.

Banks have been persistently advised to both expand their customer base and offer products tailored to customer needs since they began selling investment trusts. Regional banks must diligently execute these basics to embark on renewed growth in investment trust sales.

Note

1) Based on NRI-FPI investment trust statistics.

2) Consequently, regional banks' share of investment trust assets has fallen sharply in the post-Lehman era. Regional banks' share of open-end equity investment trust assets (ex ETFs) has fallen from 24.6% in March 2009 to 20.1% in March 2011.

3) Regional banks' equity investment trust redemption rate was 22% in fiscal 2006, 12% in fiscal 2009, and 20% in fiscal 2010. Megabanks and trust banks' corresponding redemption rate, which is consistently somewhat higher than regional banks', was 26% in fiscal 2010. (All redemption rates are NRI estimates).

4) Kaneko, Hisashi, "Gaining new customers is the key to growth in regional banks' investment trust sales"(Exhibit 3: Investment trust accounts), Kinyu IT Focus, December 2010 (in Japanese).

5) Kaneko, Hisashi, "Lump-sum retirement benefits still constitute an important market," Lakyara vol. 103, March 2011.

6) NRI Questionnaire Survey of 10,000 Consumers (Financial Edition).

Author's Profile

Hisashi Kaneko

Senior Researcher
Financial Technology and Market Research Department

E-mail : kyara@nri.co.jp

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/lakyara