

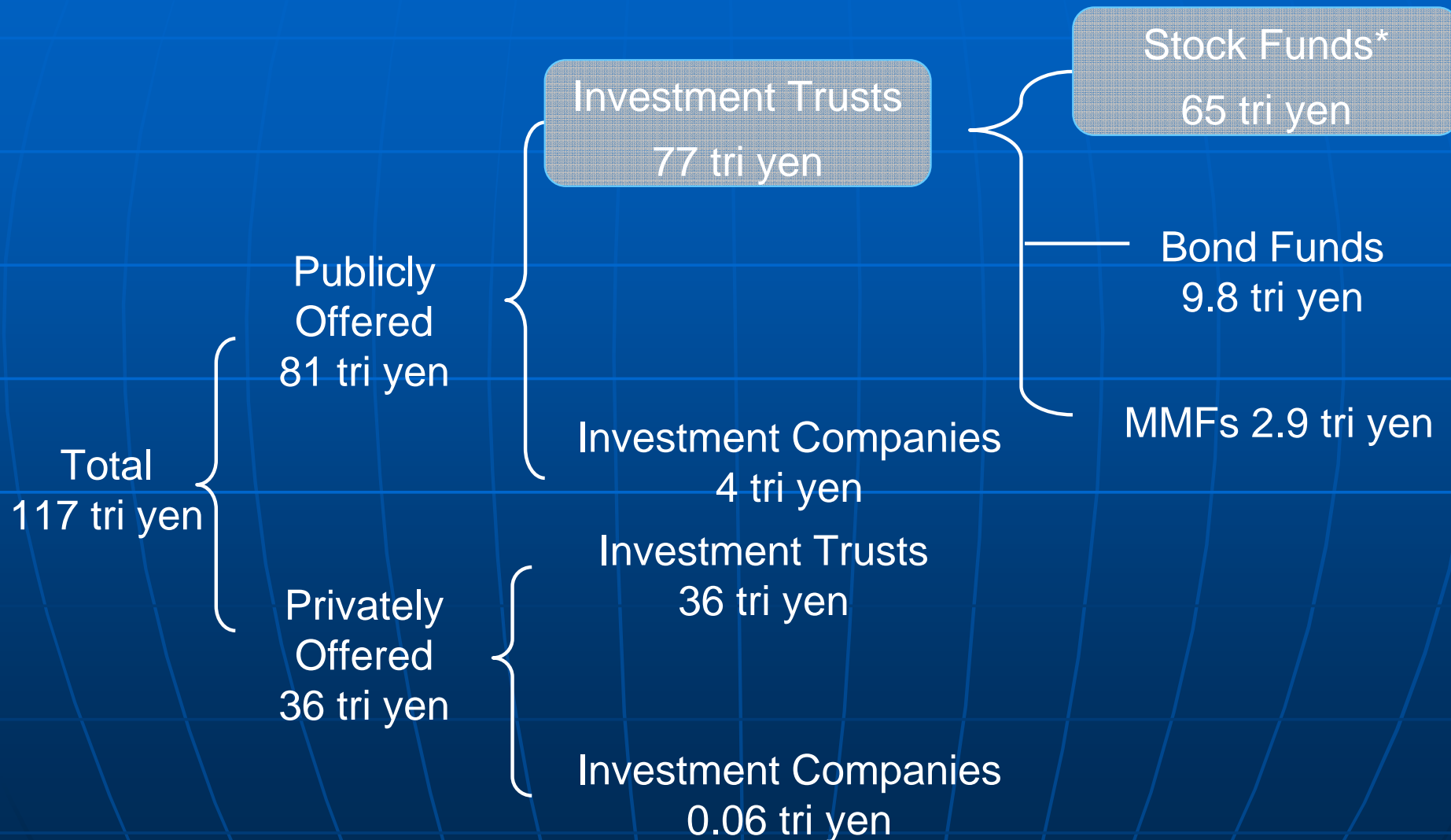
# The Future of Japan's Mutual Fund Industry

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# Overview of Japanese Mutual Funds

- Majority of mutual funds in Japan take form of the investment trusts, of which 97 % are open-end.



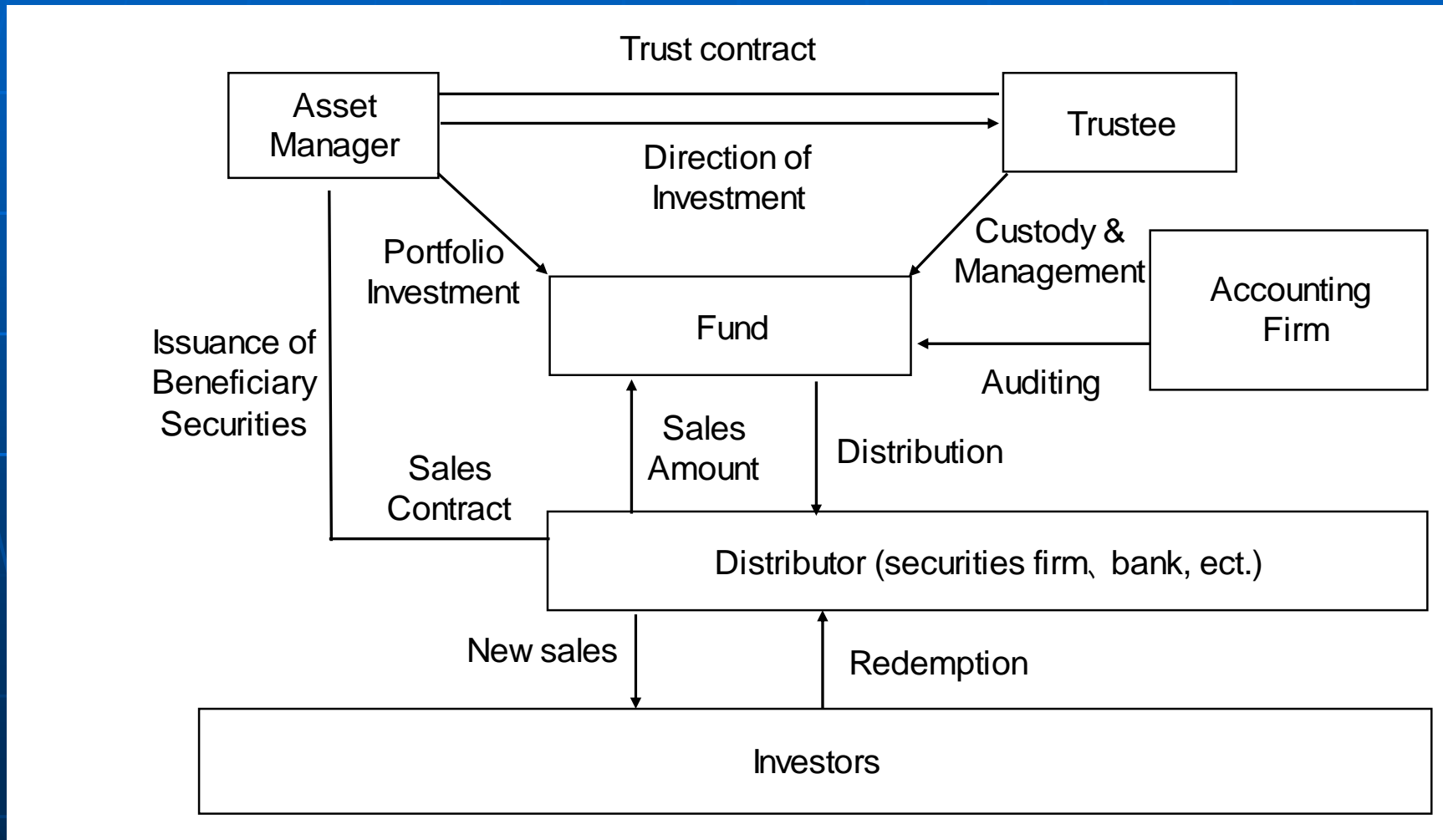
\*Note: "Stock Funds" means the investment trusts that are allowed to invest in stocks in their stipulation. Data is as of August, 2007.

Source: The Investment Trusts Association, Japan

# Structure of Japanese Investment Trusts

- Investment Trusts are not structured as corporation but as contract.

## Structure of Investment Trusts



# Market Share by Types of Asset Manager

- Japanese market is more concentrated than U.S. market.
  - Top 5 market share: US=38% vs. Japan=64%
  - HHI: US=400-500 vs. Japan=1,059
- Major asset managers are typically affiliated companies of large financial groups.

## Market Share by Types of Parent Company in Japan

(tril yen, marker share)

Types of Parent Company/Group	Number of Asset Managers	All Mutual Funds	
		Net Asset	share
Securities Firm	4	40.9	50%
Banking	11	24.2	30%
Insurance	7	2.2	3%
Independent	17	1.3	2%
Foreign Company	32	13.3	16%
Total	71	82.0	100%

# Relative Market Size

- Japanese mutual fund industry ranks 8<sup>th</sup> globally, small market for the second largest economy.
- Does this mean potential for future growth ?

## Country Ranking of Mutual Fund Industry

Rank	Country	Total Net Asset (\$billions)	World Market Share
1	United States	10,414	47.8%
2	Luxembourg	2,188	10.1%
3	France	1,769	8.1%
4	Australia	864	4.0%
5	U.K.	787	3.6%
6	Ireland	768	3.5%
7	Hong Kong	631	2.9%
8	Japan	579	2.7%
9	Canada	566	2.6%
10	Italy	453	2.1%

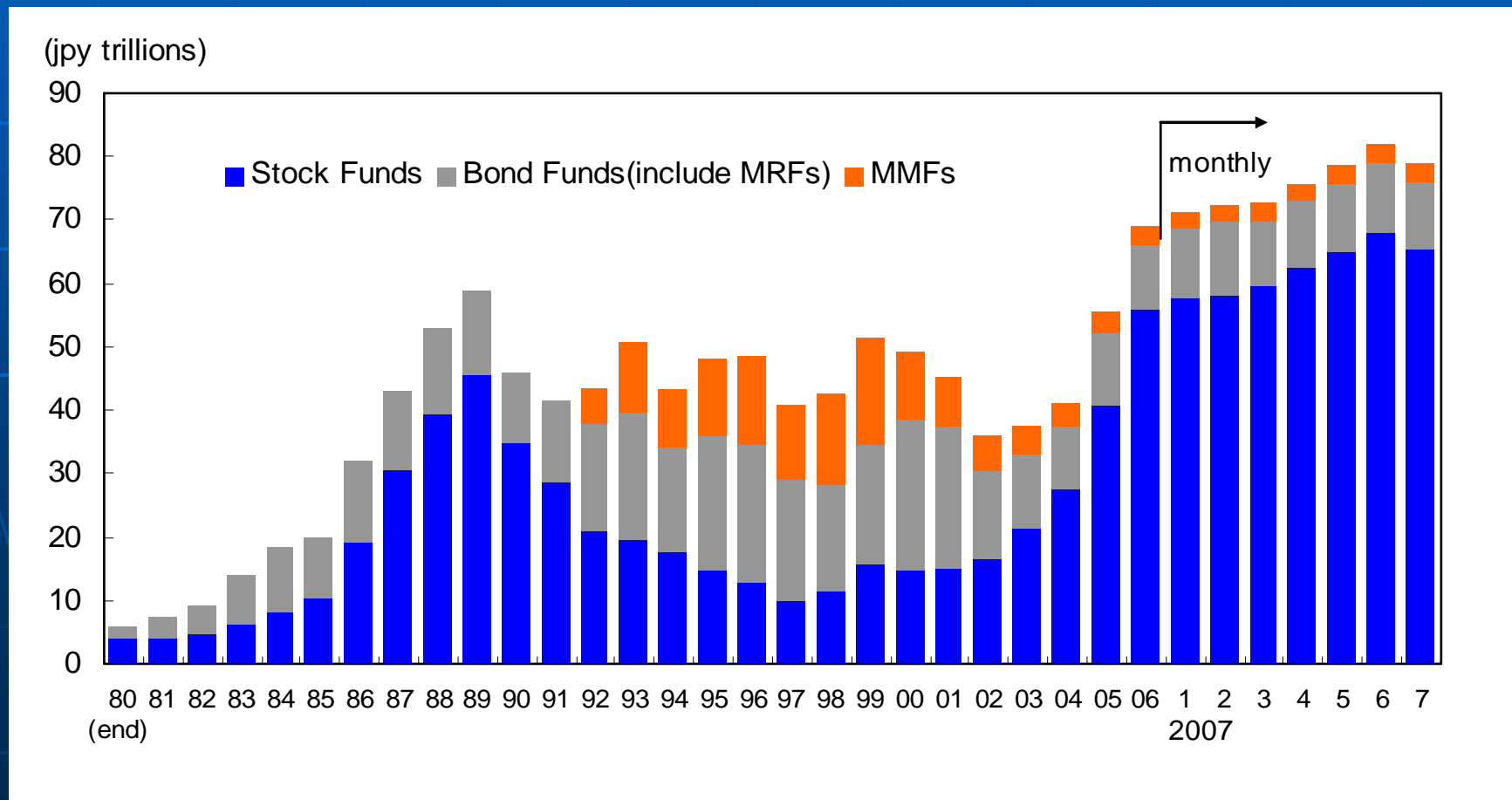
Note: data as of December, 2006

Source: The Investment Company Institute, U.S.

# Recent Growth of Japanese Mutual Fund Industry

- After 2003, the market has recovered mainly due to the increase in stock funds.

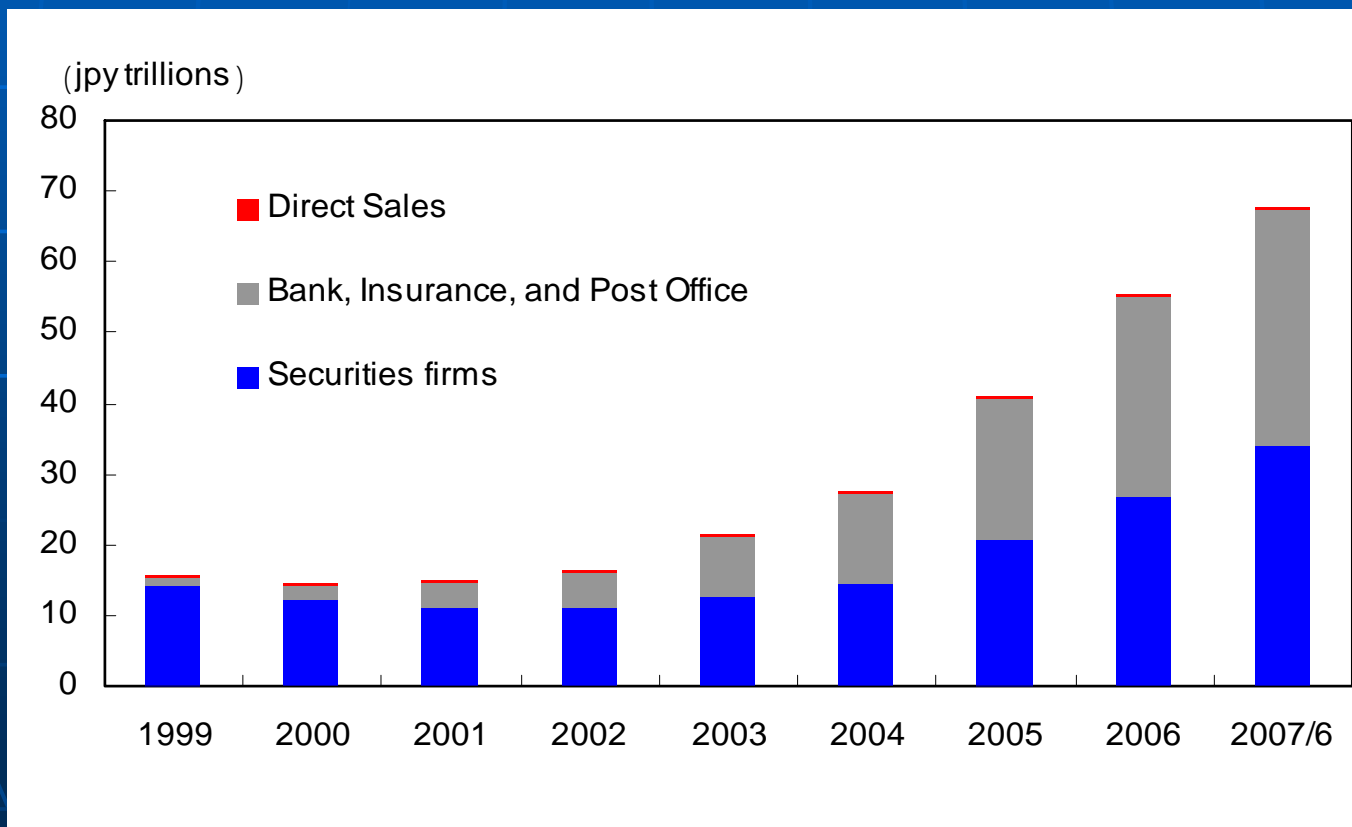
## Net Assets of Investment Trusts by Investment Type



# Driving Forces: Distribution Channels ?

- Distribution channels of investment trusts have been expanded for these years.
- Seems to be reasonable to consider the expanded channels contributed to the recent growth of mutual funds.

## Net Assets of Stock Funds by Distribution Channels



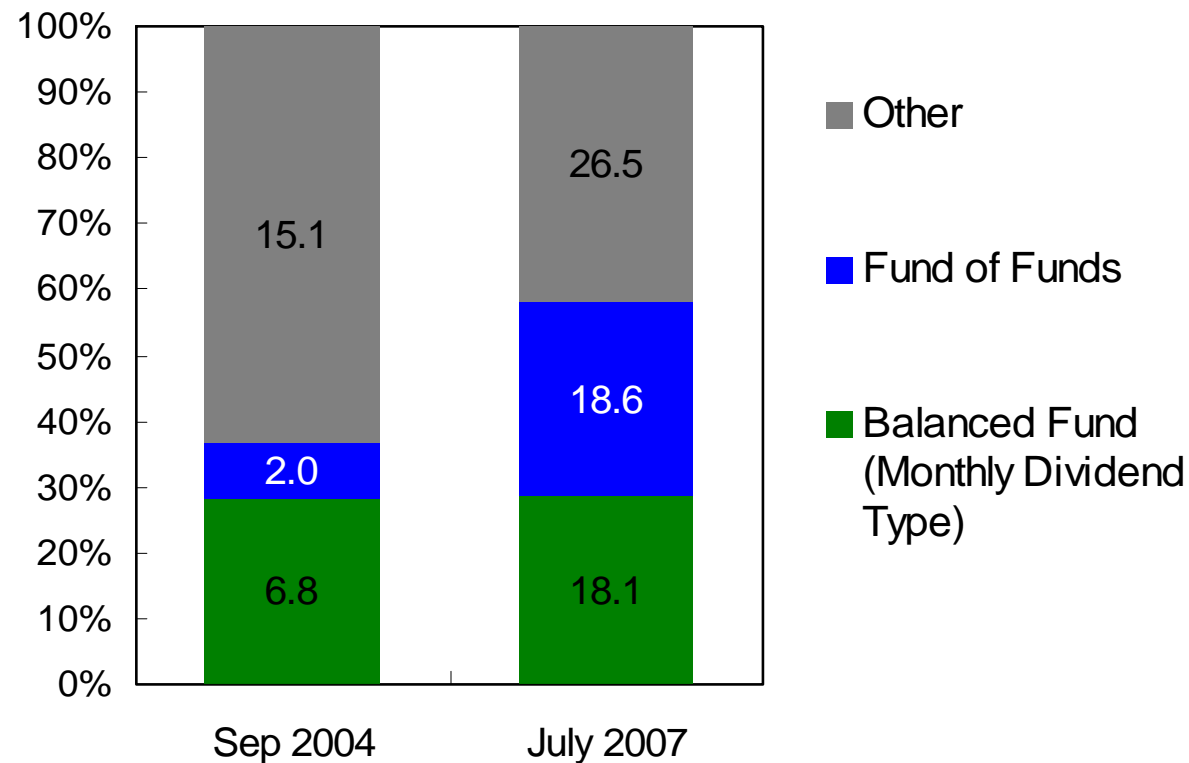
Note; Sales at Post Offices began at October 2005.  
Source: The Investment Trusts Association, Japan

# Driving Forces: Product Innovation ?

- Recently, balanced funds and fund-of-funds which primarily invest in foreign bonds and paying monthly dividends are growing rapidly.
  - Paying dividends monthly (bimonthly) reduces the performance of the funds, but they are growing

## Share of Stock Funds by Investment Type

(share, jpy trillions)





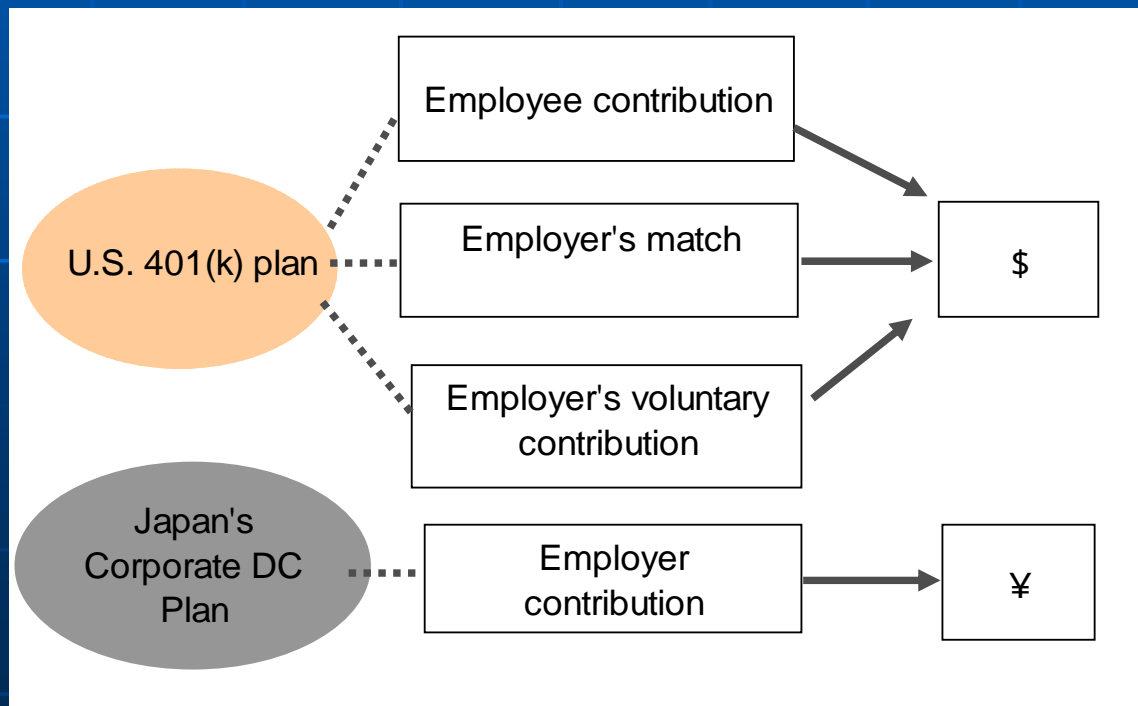
# Other Driving Forces

- Demographic factor.
  - Elderly people hold more mutual funds than younger people
  - Rapid aging is under way in Japan
- Favorable market conditions.
  - Upward trend of stock market and yen depreciation since 2003
  - Market conditions might be favorable to invest in equity and/or foreign assets

# Challenges for Future: Pension reforms

- Potential positive effect of DC plan on the growth in investor base.
- Big differences in plan eligibility, contribution method and contribution amounts between US DC plans and Japanese ones.

## US-Japan Differences in Defined Contribution Pension Plans



Individual Status		U.S. IRA	Japan Individual DC Plan
Self-employed			
Company employees	No corporate pension from employer		
	Have corporate pension from employer		x
Government employees			x
Spouse with no income			x

# Challenges for Future: Increase competition

- Large financial groups have their own manufacturing and distribution channel.
- Many regional banks have close relationships with large financial group(s) through equity (cross-)holdings.
  - Different from the “open-architecture” system in U.S.
- Under these circumstances, how do distributors choose mutual funds to sell at their branches?
  - Hypothesis1: Large banks/securities firms tend to choose the funds of their affiliated asset manager
  - Hypothesis2: Regional banks tend to choose funds from financial groups that are their major shareholders.

# Increase Competition: Empirical Results

- Investigate the patterns of fund choice behavior among distributors by a logit model.

$$Pr(\text{Distributor}_i \text{ choose mutual fund}_j) = F_L(\text{group variables, control variables}_j)$$

- Results confirm preferential treatments are there.

## Result of Logit Model

	Large Banks (10 firms)	Regional Banks (111 firms)	Securities Firms (18 firms)
Group variables	+	+	+
Commission variables	?	?	?
Size variables	+	+	+
Performance variables	?	?	?
Fund age variable	-	+	+

Note: Results are for balanced funds and fund of funds, as broadly categorized by the Investment Trusts Association, Japan.  
Source: NICMR

# Other Challenges for Future

- Investor Education
- Rule for Fund Mergers
- Possible Competition with ETFs, SMAs in the Future

# Summary & Policy Implications

- Demands for investment trusts have restored since 2003.
- Behind the scene, structural forces and cyclical force at work.
  - Without doubt, expanded distribution channels contributed to recent growth
  - Demographic dynamics will support the market expansion for a while
  - But, favorable market conditions have been at work, implying possible downturn in case of stock price decline and/or yen appreciation
- For the future growth, need to consider the followings;
  - Further reforms on the DC pension plan
  - Keep eye on the development of the preferential treatment and its possible bad effect on competitiveness in the market
  - Further Investor education, rule for fund mergers merit some attention