The Composition of Personal Financial Assets in the Wake of Japan's "Big Bang"

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The aim of Japan's "Big Bang" program, announced in November 1996 (under the banner of "free, fair and global") as one of six programs of radical economic reform, has been to use financial deregulation to reinvigorate the economy and, in particular, to correct a structural bias favoring savings and bank deposits, and thereby make market-based direct finance the cornerstone of the financial system.

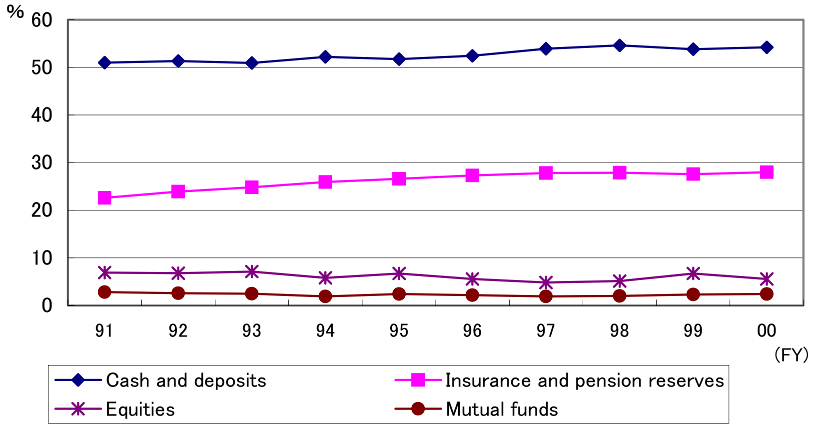
The policies that it produced have more or less gone according to plan and, as a result, charges for financial services have come down, new financial products and services have been developed, and new distribution channels have been opened up. This report, written not long before the deadline for the program's completion (March 2001), examines the program's effects on the composition of personal financial assets.

1. Composition of Personal Financial Assets Remains Unchanged

Although the Bank of Japan ended its zero-interest-rate policy in August 2000, deposit rates are still close to zero. In spite of this, however, households still hold the bulk of their financial assets in the form of bank deposits. In other words, there has been virtually no change in the composition of personal financial assets since the beginning of the 1990s (Figure 1).

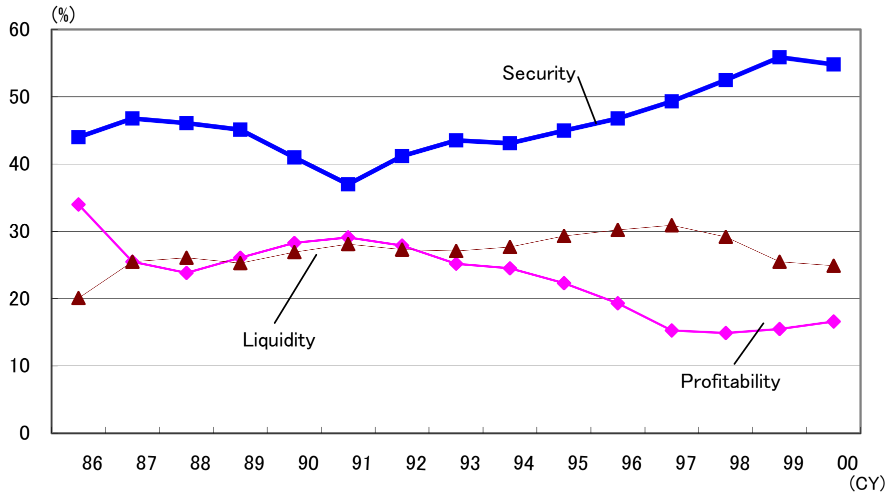
With the Japanese economy showing no signs of being able to break out of its current impasse and with major financial institutions and major companies still failing, households have made security a higher priority than profitability when choosing financial assets (Figure 2).

Figure 1 Composition of Personal Financial Assets



Note: The way the data are compiled changed in fiscal 1997. The figure for fiscal 2000 is that for end-September.
Source: NRI, from Shikin Junkan Kanjo [Flow of Funds Accounts], Bank of Japan.

Figure 2 Criteria for Choosing Financial Products



Source: Chochiku to Shohi ni Kansuru Yoron Chosa [Survey of Savings and Spending], Central Council for Savings Information.

According to a survey by the Japan Institute for Securities Information and Public Relations,[1] equities have accounted for about 20% of personal financial assets for the past 10 years. Mutual funds, which accounted for 15.1% of personal financial assets in the fiscal 1991 survey, accounted for only 8.8% in the fiscal 2000 survey. Similarly, when asked under what circumstances they would consider investing in equities, 76.3% of households that had never invested in them replied that they would not consider this under any circumstances—a good indication of their lack of interest in equity investment.

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1 Shoken Chochiku ni Kansuru Zenkoku Chosa (2000nendo) [Nationwide Survey of Securities Saving (Fiscal 2000)], Japan Institute for Securities Information and Public Relations, 2000.

Statistics and surveys therefore indicate that Big Bang has not had any significant effect on household investment patterns. However, a closer examination of particular aspects (e.g., the choice of financial assets and the channels through which they can be purchased) shows that there *have* been signs in recent years of a number of changes in the way households invest and in the investment climate.

2. The Deregulation of Commission Rates and the Appearance of Internet Trading

For a long time, brokerage commission rates in Japan were fixed. However, rates for large transactions were deregulated in April 1998, while those for all other transactions were deregulated in October 1999. At the same time, competition to win new accounts has increased as stockbrokers have reappeared as online discount brokers while new companies have entered the stockbroking business.[2] Whereas a transaction worth ¥1 million would have attracted ¥11,500 in commission when rates were fixed, there are now online brokers that charge a less than ¥1,000.

The big brokers, which have tried to make the fact that they offer a comprehensive range of services their main selling point and concentrated on improving their research and their human interface, have also lowered their commission rates, although not to the same extreme extent as the discount brokers. At the same time, they have attempted to offer a competitive Internet dealing service from the outset while rationalizing the way in which they provide research and process orders.

As a result, there has been a rapid increase in the number of private investors who use the Internet. The number of online accounts began to increase significantly once commission rates were deregulated on all transactions in October 1999, and has continued to increase steadily, albeit at a more modest rate in recent months, reaching 1.6 million by the end of 2000—roughly five times as many as in October 1999 (Figure 3).

Also, figures from a survey by the Japan Securities Dealers Association show that, while online trading accounted for only 3% of the value of transactions by private investors in October 1999, the figure had risen to 9% by March 2000, and to 26% by September 2000. Moreover, while the value of all the transactions by private investors in the first half of 2000 was more than 40% less than in the second half of fiscal 1999, the value of online transactions was roughly 50% greater (Table 1).

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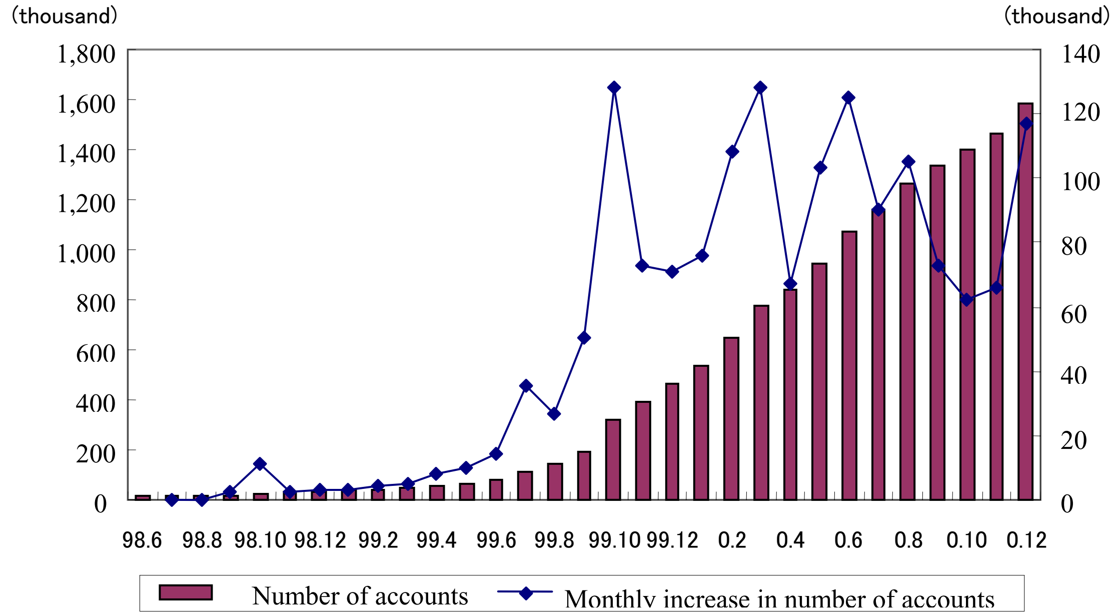
2 One of the reasons for the increase in the number of new stockbroking companies was the relaxation in 1997 of the requirements for a stockbroking license in anticipation of the abolition of the licensing system and its replacement by a system of registration in December 1998.

Figure 3 Number of Online Trading Accounts and Monthly Increase in Number of Accounts



Source: NRI, from Bloomberg data.

Table 1 Online Trading as a Percentage of the Value of Transactions by Private Investors

(¥ million)

	Online trading			Value of equity transactions by private investors on Tokyo, Osaka and Nagoya exchanges and OTC market.	Percentage of online trading
	Cash transactions	Margin transactions	Total		
1999/10	222,778	-	222,778	8,158,294	2.7%
2000/3	968,756	196,700	1,165,456	12,367,898	9.4%
2000/9	856,438	278,324	1,134,762	4,362,757	26.0%
1999/10-2000/3	3,784,991	748,687	4,533,678	67,809,743	6.7%
2000/4-2000/9	5,499,835	1,437,398	6,937,233	36,977,224	18.8%

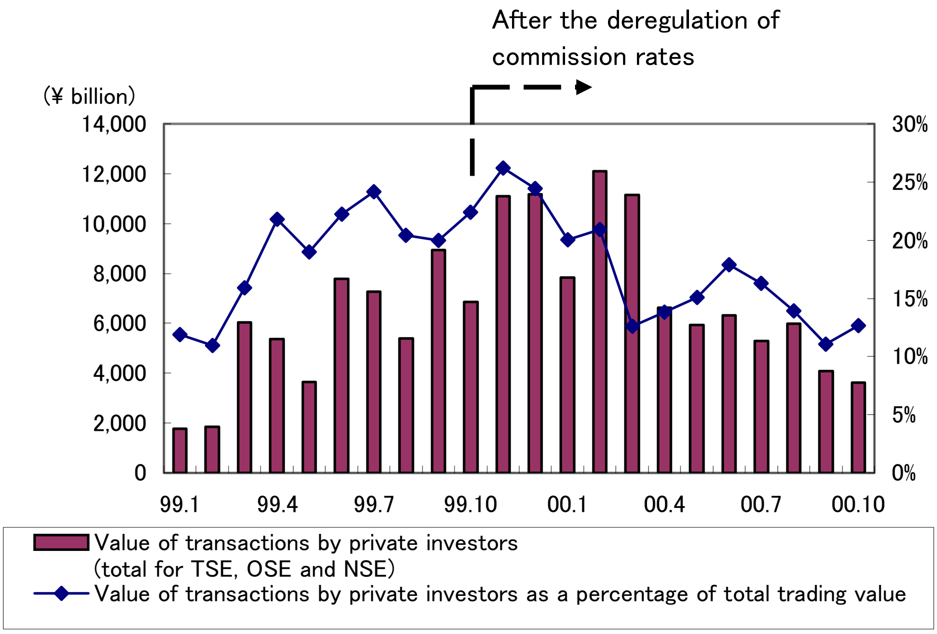
Notes: 1 No data for margin transactions conducted via the Internet in October 1999.
2 The underlying figure for the Tokyo, Osaka and Nagoya exchanges represents the total value of orders placed with stockbrokers capitalized at ¥3 billion or more. The underlying figure for the OTC market represents the total value of orders placed with full-service stockbrokers.

Source: NRI, from Tosho Tokei Geppo [TSE Monthly Statistics] and Shoken Gyoho [Japan Securities Dealers Association Bulletin] data.

The majority of private investors who use the Internet to deal online are in their 30s or 40s (i.e., relatively young), and the number in their 20s who are doing so is growing. Given that the majority of private equity investors have traditionally been in their 50s and 60s, online trading has extended the age range of equity investors to groups that previously had little experience of equity investment.

However, so far, these lower brokerage commission rates have not led to significantly more trading activity by private equity investors. Activity did increase until March 2000 as the stock market rallied, but it tapered off again when the rally ran out of steam, and, since then, private investors have been net sellers.[3] Private investors' share of total trading value has also been declining since it peaked in November 1999 (Figure 4).

Figure 4 Value of Equity Transactions by Private Investors in Absolute and Percentage Terms



Source: NRI, from Tosho Tokei Geppo [TSE Monthly Statistics], Tokyo Stock Exchange.

The low level of trading activity by private equity investors has made it more difficult for online discount brokers specializing in the retail market to improve their margins. As of the end of 2000, there were some 65 Japanese brokers offering an online trading service. Of these, nearly 20 were online discount brokers. In the year or so since commission rates were deregulated, the gap has even widened between those online brokers that were among the first to offer such a service (and captured a large number of accounts, many of which are relatively active) and those that entered the market later. Some of these late entrants have started to reorganize their businesses

[3] As of December 2000.

(e.g., by merging with other late entrants) in order to catch up with the front runners or even just to survive.

In November 2000, eWing Securities (principal shareholder: Sanwa Bank Group) and Japan Online Securities (principal shareholder: Itochu) announced a plan to merge their businesses by April of this year. The following month, Nikko Beans (a subsidiary of Nikko Securities) and Internet Trading Securities (a joint venture by Fujitsu and Nikko Securities) announced a plan to merge their businesses by March of this year, while MONEX (principal shareholder: Sony) and Saison Securities (a subsidiary of Credit Saison, one of Japan's leading credit card companies) announced a plan to merge their businesses by June of this year. Then, in January, Wit Capital (a broker specializing in newly listed information technology companies) announced a strategic partnership whereby it will transfer its online trading business to the new company to be formed by the merger of eWing Securities and Japan Online Securities (to be known as Kabu.com) and concentrate its resources on investment banking. In addition, it will entrust Kabu.com with the sale of any new shares it underwrites in newly listed companies. The companies concerned hope that by joining forces they will be in a stronger position (e.g., by having more accounts and an expanded customer base, and by being able to offer a wider range of financial products).

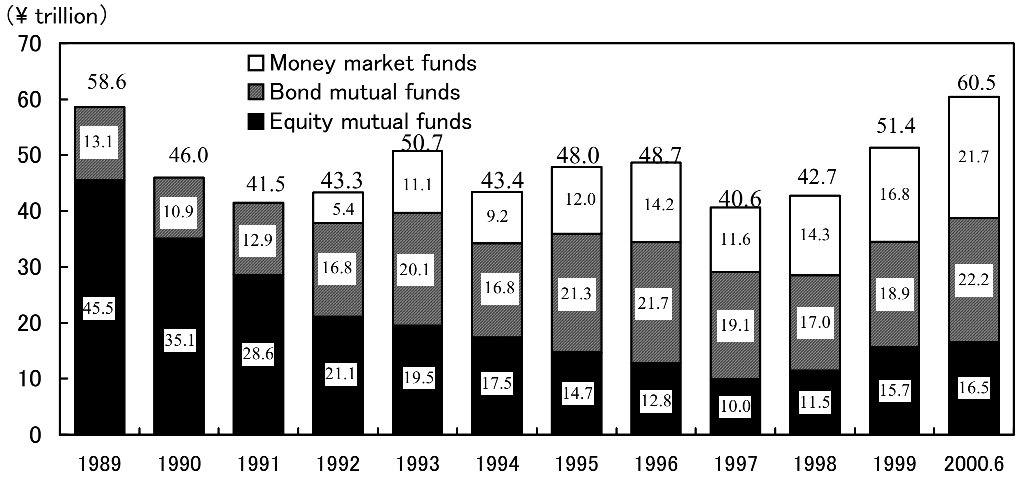
3. Impact of the Lifting of Restrictions on the Sale of Mutual Funds by Banks and Other Financial Institutions

Throughout the 1990s, mutual funds accounted for a steady 2%-3% of personal financial assets—a figure that has not increased significantly since Big Bang. However, the figure for the amount of mutual funds outstanding started to increase at the end of 1999 and stood at ¥34 trillion at the end of September 2000.

If the figure for mutual funds owned by corporations is included, the total amount of mutual funds outstanding passed the 1980s' peak of ¥58.6 trillion (recorded at the end of 1989) to reach a new peak of ¥60.5 trillion at the end of June 2000. By the end of 2000, however, it had once again fallen below the ¥50 trillion mark as share prices slumped and corporations redeemed money market funds.

The figure for the outstanding amount of equity mutual funds (including those owned by corporations), which peaked at ¥45.5 trillion at the end of 1989, continued to decline until the end of 1997, when it reached ¥10 trillion, but has been on the increase again since 1998 (Figure 5). Indeed, the figure has continued to increase steadily in spite of the fact that private investors have been net sellers of equities since March 2000 (see above), when the stock market turned lower. In the first half of 2000 the launch of a mega fund with a net asset value of more than ¥1 trillion attracted investor interest, and at the end of 2000 there were about 20 funds with a net asset value of more than ¥100 billion each.

Figure 5 Net Asset Value of Mutual Funds

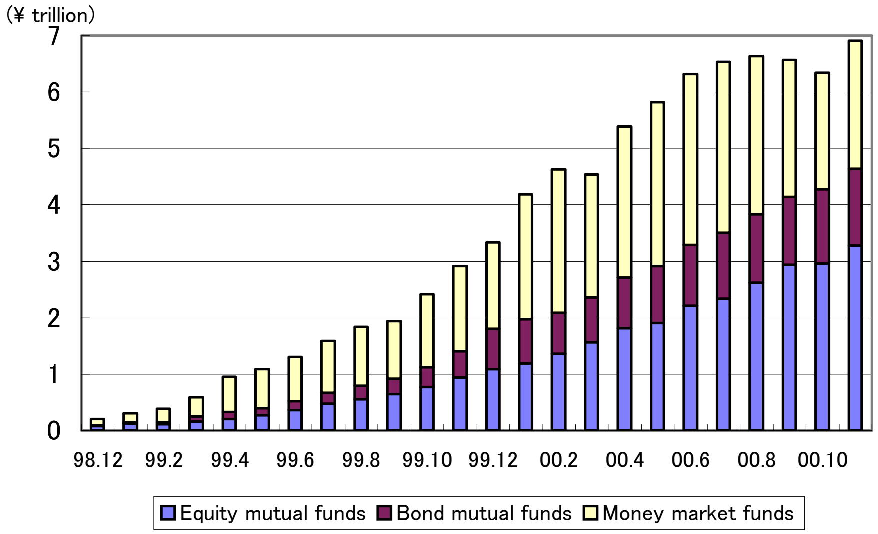


Source: NRI, from Investment Trusts Association data.

One of the reasons the total net asset value of mutual funds has been rising is that mutual funds are now sold via a wider range (and, as a result, a greater number) of channels than ever. Whereas at one time they were virtually only available from stockbrokers, they can now be purchased from most financial institutions (including banks and other deposit-taking institutions, and insurance companies). This follows the lifting of restrictions on their indirect sale by banks (i.e., by mutual fund companies renting space in bank branches) in December 1997 and the lifting of restrictions on their direct sale by banks in December 1998. Mutual fund companies have also been making an effort to sell their products directly over the Internet and from call centers, thereby dramatically increasing the number of channels via which private investors can purchase them.

The outstanding amount of mutual funds sold via banks and other financial institutions has increased steadily since December 1998, reaching ¥6 trillion in June 2000 (Figure 6). When the restriction was first lifted, money market funds accounted for far and away the largest share of mutual funds sold via this channel; but the share of equity mutual funds has increased in line with the overall increase in the outstanding amount of mutual funds, exceeding that of the former in September 2000. As of the end of November 2000, the breakdown was as follows: equity funds (47.5%), money market funds (32.8%) and bond funds (19.7%). This compares with the following breakdown (as of the end of November 2000) for mutual funds sold by stockbrokers: equity funds (28.6%), money market funds (23.4%) and bond funds (48.0%).

Figure 6 Net Asset Value of Mutual Funds Sold via Banks



Note: Total for public and private placements.
Source: NRI, from Investment Trusts Association data.

A breakdown of the net asset value of mutual funds by sales channel shows that sales by banks and other financial institutions have been rising steadily, accounting for 10.3% of all publicly placed funds and 12.7% of equity funds (as of the end of November 2000). According to a survey carried out last year by the Investment Trusts Association, Japan, "banks and other financial institutions" were the preferred channel of investors considering purchasing mutual funds (31.9%), followed by "stockbrokers" (29.2%).[4] If the growing range of sales channels leads to more private investors becoming aware of mutual funds, their outstanding amount can be expected to continue to increase.

Another interesting point about mutual funds sold by banks and other financial institutions is the fact that redemption rates are lower than for mutual funds in general. For example, while the annual redemption rate of open-end mutual funds between November 1999 and October 2000 was 77%, that of equity funds, which are sold mainly by banks, was generally in the 20%-29% range. While this may partly be explained by a reluctance on the part of banks and other financial institutions unused to selling volatile financial products to recommend their customers to switch funds, it would appear that a growing number of investors purchasing mutual funds via these new channels may be long-term holders.

4 Noteworthy is the fact that 10.9% of respondents gave " the Internet " as their preferred channel.

4. The Fate of Record Amounts of Maturing Postal Savings Accounts

As of March 2000, there was roughly ¥260 trillion on deposit in postal savings accounts in Japan (¥212 trillion in *teigaku* savings accounts, ¥15 trillion in time savings accounts, and ¥31 trillion in ordinary savings accounts[5]), equivalent to roughly 20% of personal financial assets in Japan. Of this amount, roughly ¥106 trillion is thought to consist of principal and interest on *teigaku* deposits made in fiscal 1990 and 1991 (when interest rates were at record high levels). These deposits began to mature in April 2000, and Japan's financial markets are keen to see what will happen to the money when it is repaid.

The Ministry of Posts and Telecommunications has estimated that 70% of the reinvestable amount (i.e., the total principal and interest less (1) any amount in excess of the maximum investable amount of ¥10 million and (2) any interest deductible as tax at maturity) would be reinvested in *teigaku* and time savings accounts. In fact, however, 71.8% of the reinvestable amount was reinvested in these products between April and December 2000. The fact that the majority of private investors are reluctant to invest their money in assets where they might lose some of their original investment (even though the rate of interest on 10-year *teigaku* savings accounts is only 0.2%) is an indication of just how risk-averse Japanese investors are.

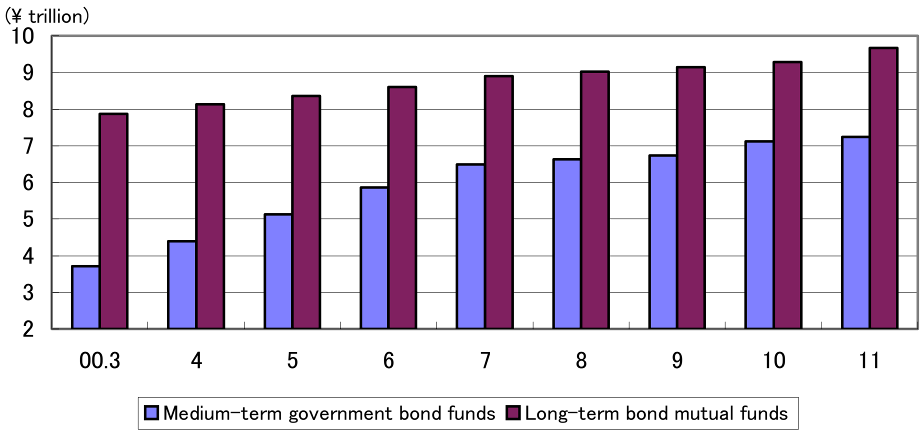
In contrast, some ¥40 trillion in matured savings accounts is expected to be withdrawn from private-sector financial institutions. So far, little of this appears to have found its way into the stock market—no doubt partly because of the latter's weakness. The same is true of equity mutual funds. Two products that do appear to have benefited from these matured savings accounts, however, are medium-term government bond funds and long-term bond mutual funds. Neither guarantees the original investment, but both offer a high degree of security.

Between April and November 2000 the outstanding amount of medium-term government bond funds increased by a net ¥3.5 trillion to ¥7.2 trillion. During the same period, the outstanding amount of long-term bond mutual funds increased by ¥1.8 trillion to ¥9.7 trillion (Figure 7). The reason these products have benefited from these matured savings accounts (in addition to their high degree of security) is the fact

5 The Postal Services Agency's English-language Website defines these three savings products as follows:
"*Teigaku* savings: a savings certificate that can be closed at any time six months after opening and that can be maintained for up to 10 years; interest is compounded semiannually."
"Time savings: a savings certificate to which the depositor may designate a fixed term in accordance with fund planning."
"Ordinary savings: a savings account that acts like a wallet, allowing the customer to deposit and withdraw money anytime, anywhere."

that a number of stockbrokers have been advertising relatively high dividend yields on such funds, which they will be able to achieve by realizing existing gains. This reflects the fact that from fiscal 2001 they will have to value most of their bond holdings at market as dividends will have to be based on realized returns rather than (as in the past) expected returns.

Figure 7 Net Asset Value of Medium-Term Government Bond Funds and Long-Term Bond Mutual Funds



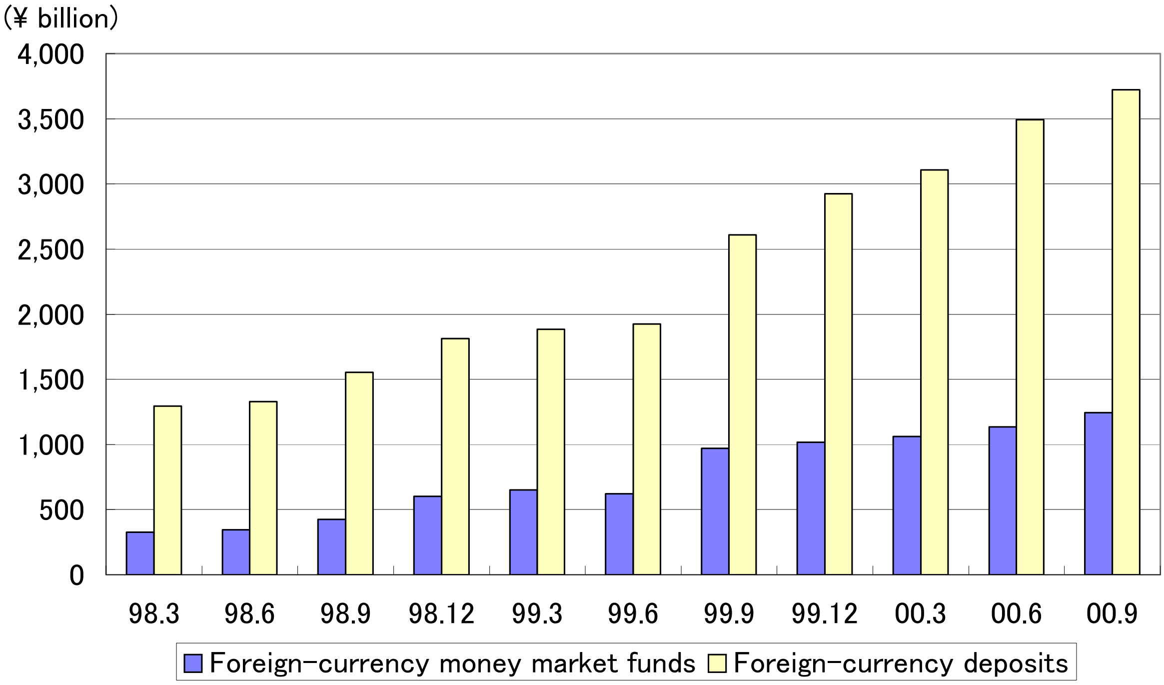
Source: NRI, from Investment Trusts Association data.

The other product that is reported to have benefited from these matured savings accounts is government bonds (especially those with short maturities such as 2-year coupon bonds and 3-year discount bonds). The main reason for the popularity of government bonds is said to be the high degree of security they offer and the fact that recently issued bonds tend to have relatively attractive coupons. However, it has also been pointed out that post offices often recommend them to customers not wishing to reinvest the proceeds of their matured savings accounts in similar accounts or to customers seeking to invest the balance of their matured accounts in excess of the maximum reinvestable amount of ¥10 million. Between April and November 2000, Japanese post offices sold some ¥1.6 trillion worth of government bonds. (This compares with the ¥2.5 trillion worth of bonds the Post Office has committed itself to underwriting in fiscal 2000 as a whole.) Demand for 2-year coupon bonds has been particularly strong, and the Post Office has managed to sell all of its monthly commitment since April of last year. Given that the Post Office's annual sales of government bonds have averaged some ¥500 billion over the past five years, it would seem that it has anticipated demand from holders of savings accounts maturing in fiscal 2000 by increasing its underwriting commitment. In fiscal 2001, the Post Office expects to sell a similar amount (i.e., about ¥2.5 trillion) of (mainly medium-term) government bonds.

5. Strong Demand for Foreign-Currency Deposits and Foreign-Currency Money Market Funds

Since the revised Foreign Exchange Law came into effect in April 1998 and restrictions on foreign exchange dealing were lifted, there has been a sharp increase in the demand for foreign-currency deposits and foreign-currency money market funds—helped by the fact that financial institutions have stepped up their marketing of such products. By the end of September 2000 private investors held some ¥3.7 trillion in foreign-currency deposits—roughly three times as much as 2½ years previously (Figure 8). As of the end of November 2000, there was about ¥1.25 trillion outstanding in foreign-currency money market funds—the sixth record month in a row. Deposits and money market funds are available in a large number of foreign currencies (including US dollars, euros, sterling and Swiss francs), but the most popular currency for both products is the one Japanese investors are most familiar with—the US dollar.

Figure 8 Outstanding Amount of Foreign-Currency Money Market Funds and Foreign-Currency Deposits



Note: The figure for foreign-currency money market funds covers both private and corporate investors. The figure for foreign-currency deposits covers only private investors.
Source: NRI, from Japan Securities Dealers Association and Bank of Japan data.

The main reason for the rapid increase in the outstanding amount of foreign-currency deposits and money market funds is the much higher interest rates and yields they offer than equivalent yen products. Whereas the highest rate offered by Japanese high-street banks on 1-year yen deposits is only about 0.15%, similar US$ deposits offer about 5%. Similarly, US$ money market funds offer a yield of about 6%, compared with only 0.2%-0.3% on their yen equivalents.

The second reason is the fact that for the past year or so the yen's foreign exchange rate has been relatively stable, moving in a fairly narrow range. When the dollar weakened to ¥104 in September 1999, Japanese investors who anticipated that it would later strengthen began to increase their exposure to dollar assets. Between then and the end of 2000, the dollar traded in a range of ¥102-112, and it would seem that private Japanese investors who reckon that their foreign exchange risk is relatively small have been increasing their exposure to foreign currencies.

The third reason is that many banks, which have found it difficult to attract customers with low-rate yen deposits, have been marketing foreign-currency deposits as mainline products. It is now common to see newspaper and magazine advertisements for foreign-currency deposits with their interest rates, which are much higher than those for equivalent yen products, printed in large letters. One likely reason why banks have been marketing these products so aggressively is that the commission they earn when customers switch between yen and foreign currencies makes their foreign exchange business more profitable than their yen deposit business.

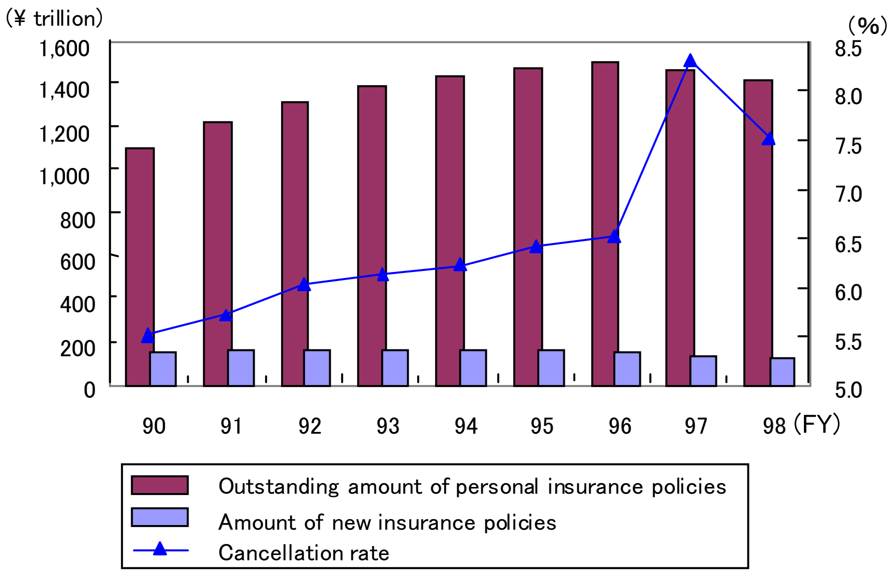
The number of such accounts has also been rising in line with the increase in their outstanding amount. Whereas there were only 300,000 foreign-currency deposit accounts in Japan as of the end of September 1998, the number had risen to some 1.5 million accounts by the end of September 2000—an increase of about 400%. Although this is still far fewer than the number of yen deposit accounts, the number of Japanese investing in foreign currencies can be said to be increasing steadily. According to a survey of savings and spending by the Central Council for Savings Information, 12.3% of households with an annual income of at least ¥10 million are considering opening a foreign-currency deposit account.

6. Declining Popularity of Life Insurance Products

Since peaking in 1997, life insurance and pension products as a percentage of personal financial assets have remained flat without actually declining (Figure 1). As of the end of September 2000, the figure was 28%.

However, the outstanding amount of personal insurance policies taken out with private-sector insurance companies has been declining since it peaked at ¥1,496 trillion in fiscal 1996. The amount of new policies has also been declining (since fiscal 1995), while the cancellation rate rose gradually in the 1990s, rising sharply in fiscal 1997 to 8.3% (Figure 9).

Figure 9 Outstanding Amount of Personal Insurance Policies, Amount of New Insurance Policies, and Cancellation Rate



Source: NRI, from Seimei Hoken Fakutobukku [Life Insurance Factbook], JILI.

The main reason for the declining popularity of life insurance products with Japanese investors is the blow to public confidence in the industry caused by the failure of six life insurance companies between April 1997 and the end of 2000. The second reason is probably the fact that, the longer the recession continues, the greater the (actual or perceived) financial burden of keeping up premium payments and the greater the likelihood that policyholders will decide to cancel their policies.

Japan's life insurance market is now mature, and it is unlikely that there will be any significant increase in the number of new policies. The decline in the popularity of life insurance products is therefore likely to continue for the foreseeable future. However, there have been some new developments. First, the industry is having to restructure. A number of foreign insurers have acquired some of the Japanese insurance companies that have failed in recent years and are expanding their operations in Japan. Most foreign life insurance companies have actually succeeded in attracting more business (e.g., more new policies) in spite of the industry's general malaise. At the same time, Japanese life insurers are trying to attract more business—for example, by forming alliances with non-life insurance companies with a view to moving into the so-called "third sector" (i.e., areas such as healthcare and disability insurance) when this is deregulated. The second new development is the launch of innovatory insurance products that are creating new demand. Those insurance companies that have devised hit products have seen big increases in new business.

7. Outlook

Of particular interest in trying to forecast possible changes in the composition of personal financial assets in Japan are a number of factors that could lead private investors to transfer some of their assets from savings and deposit accounts to other financial products.

The first of these factors is how people are likely to respond to the fact that Japanese society is aging rapidly. The proportion of households where the householder is aged at least 65 is expected to increase from 29.8% in 2010 to 35.2% in 2020.[6] This rapid increase in longevity will inevitably be a strain on public finances and may lead either to an increase in the pensionable age or to a reduction in the pension itself. In the survey of savings and spending mentioned above, roughly 80% of the respondents said that they were worried about their old age. The figure was even higher (roughly 90%) for those in their 30s and 40s. The two main reasons given (by nearly 70% of the respondents in each case) were inadequate savings and inadequate pension/insurance cover. In addition, 70% of those in their 30s and 40s who replied that they did not think that their pensions would enable them to live in comfort gave as the reason the fact that they believed that their pensions would be reduced.

This fear that they may be unable to make ends meet in their old age means that couples in the prime of their working lives (i.e., their late 30s to early 50s) will have to set money aside for their old age in addition to their pensions. Most members of this generation, however, will have debts (especially a mortgage)[7] and financial obligations (such as school and university fees) that leave little to save. Therefore, if they are to make the most of their limited financial resources, they will probably have to invest them in more profitable assets than the savings accounts that have accounted for the bulk of household financial assets in the past.

Fiscal 2001 will see the introduction in Japan of defined contribution pension plans (similar to 401(k) plans). Plan members choose one or more of a number of investment approaches offered by the company responsible for managing the plan's assets, and their contributions are allocated accordingly. Their pension benefits will depend on the success of these investments. At the moment, it looks as though only relatively small amounts will be eligible for such treatment; but once such plans become commonplace, the public will become better informed about and more interested in such investment products.

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6 According to the National Institute of Population and Social Security Research.

7 According to a survey by the Management and Coordination Agency's Statistics Bureau (Chochiku Doko Chosa Hokoku, 99nen [Survey of Savings Trends, 1999]), the average debt of each age group is as follows: 30-39: ¥6.7 million; 40-49: ¥9.0 million; 50-59: ¥7.2 million; and 60-plus: ¥2.7 million.

The second factor that could lead private investors to transfer some of their assets from savings and deposit accounts to other financial products is the introduction of a payoff system in April 2002. Under this system, bank deposits would be guaranteed a maximum of ¥10 million per depositor per institution should a bank fail. Given the low level of public confidence in deposit-taking institutions, an increasing number of depositors can be expected to look for safer homes for their savings (or safer assets in which to invest the money) as the deadline approaches.

Surveys show just how interested the Japanese public is in this payoff system and the credit risk of financial institutions. According to the above-mentioned survey of savings and spending, 33% of households have already taken some sort of action to safeguard their savings. Of these, 45% replied that they had transferred them to a more sound and creditworthy financial institution, while 32% replied that they had deposited their savings with a number of institutions so that no more than ¥10 million was deposited with any one of them. Similarly, more than 60% of all the respondents said that they intended to take some sort of action in due course, while in a separate survey of depositors by the Bank of Japan some 40% of the respondents said that they were on their guard for any problems that might arise at financial institutions.

Even if we assume for the reasons just mentioned that Japanese savers may start to reallocate the money they have on deposit to other financial assets, any sudden increase in the proportion they hold in high-risk, high-return assets such as equities is unlikely. What is more likely is that investors who have traditionally avoided investment risk will start to look for financial products that offer a better return than bank deposits but with minimum risk. At the moment, however, there are not many financial products that are likely to appeal to the majority of savers in this way. Thus, while medium-term government bond funds, bond mutual funds and government bonds have attracted some of the money from maturing postal savings accounts, the fact remains that 70% of this money is being redeposited in *teigaku* and time savings accounts.

Big Bang has removed many of the restrictions that used to constrain the development of new financial products, and it is now up to Japan's financial services industry to develop basic products that will appeal to private investors. Whether or not it can do so will be the touchstone of whether there will be any real changes in the composition of personal financial assets.