Impact of Changes in Best-Selling Investment Trusts on Sales Commission: Asset Class-Based Analysis[1]

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In our report "The Rapid Growth of Open Architecture in the Japanese Investment Trust Industry" (Nomura Journal of Capital Markets, Summer 2012, Vol. 4, No. 1) we analyzed the development of open architecture in Japan as the debate on amending the Investment Trust Law gets under way. In this report we adopt a similar approach to analyzing the current state of sales commissions in the Japanese investment trust industry.

I. Need for asset class-based analysis of sales commission

It is often claimed that Japanese investment trust sales commissions have been rising. However, we need to analyze sales commission on the basis of asset class if we are to properly understand how it has changed. This is because the way funds are managed and the amount of explanation customers require (i.e., the degree of difficulty and the amount of time expended) vary from asset class to asset class.

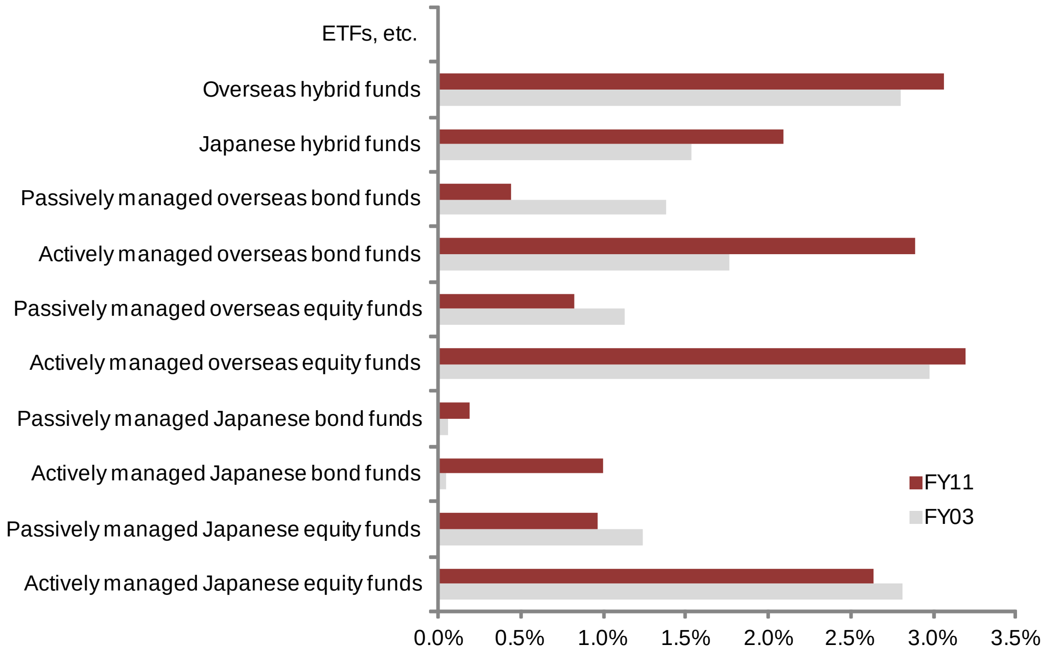
This report therefore examines the changes in the sales commission on each asset class between FY03, the earliest year for which data are available, and FY11, using Nomura Research Institute's Fundmark database. Readers should note that the sales commission data used in this report are upper limits. Therefore the actual commission will sometimes be lower than this.

II. Changes in best-selling investment trusts a major factor

Figure 1 compares the (average upper limit of the) sales commission on different asset classes in FY03 and FY11. If we take passively managed funds first, we can see that their sales commission has either declined or trended sideways. The same is also largely true of actively managed funds, with the sales commission on actively

1 This report was written with the help of Hisashi Kaneko of Nomura Research Institute's Financial IT Innovation Research division.

Figure 1: Breakdown of average (upper limit on) sales commissions (on open-end equity investment trusts)



Note: The (upper limits on) pre-tax sales commission are sales-weighted averages. FY11 data are to December 2011.
Source: Nomura Institute of Capital Markets Research, from NRI Fundmark data

managed Japanese equity[2], overseas equity, and overseas hybrid funds either lower or at the same level in FY11 as in FY03.

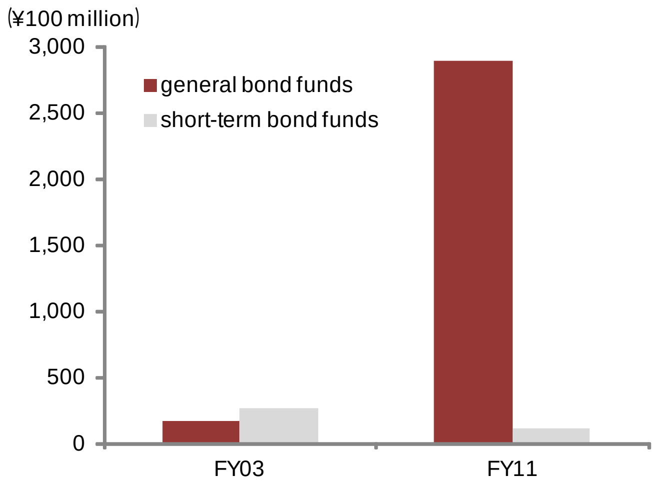
However, the sales commission on actively managed Japanese bond, overseas bond, and Japanese hybrid funds appears at first sight to have risen. In actual fact, however, although the main investment products belonged to the same asset classes in FY03 and FY11, they were different in type. Therefore it was not necessarily the case that the sales commission for the same type of product rose.

1. Actively managed Japanese bond funds

The sales commission on actively managed Japanese bond funds appears at first sight to have risen from 0.05% in FY03 to 1.00% in FY11. However, we account for this by the fact that, whereas the best-selling funds of this asset class in FY03 were short-term bond funds, by FY11 they were general bond funds. Figure 2 shows a breakdown of actively managed Japanese bond funds in FY03 and FY11. Whereas in FY03 39% of the funds were general bond funds and 60% short-term bond funds, this had changed to 95% and 4%, respectively, by FY11. We account for the increase in

2 Readers should note that in Japan investment trusts are categorized as "equity" funds if they are allowed to invest in equities, regardless of whether they actually do so.

Figure 2: Breakdown of main constituents of actively managed Japanese bond funds



Note: Units are ¥100 million. Classification is that used by Nomura Research Institute's Fundmark database. FY11 data are to December 2011.
Source: Nomura Institute of Capital Markets Research, from NRI Fundmark data

sales commission by the fact that the best-selling actively managed Japanese bond funds in FY11 were either high-yielding corporate bond funds or JGB ladder funds and that salesmen need more time to explain such funds to customers than short-term bond funds.

2. Actively managed overseas bond funds

The sales commission on actively managed overseas bond funds appears at first sight to have risen from 1.76% in FY03 to 2.88% in FY11. However, we account for this by the fact that, whereas the best-selling funds of this asset class in FY03 were developed economy bond funds, by FY11 they were emerging economy bond funds. Figure 3 shows a breakdown of actively managed overseas bond funds in FY03 and FY11. Whereas in FY03 58% of the funds were invested globally, 9% in Asian currency (including Australian and New Zealand dollar) bonds, and 3% in emerging economy bonds, this had changed to 25%, 22% and 23%, respectively, by FY11.

As we can see from Figure 3, the sales commission on Asian currency (including Australian and New Zealand dollar) bond funds and emerging economy bond funds was largely unchanged during this period. We account for the increase in the sales commission on global and US dollar bond funds by the fact that, whereas in FY03 these funds were invested mainly in developed economy sovereign bonds, by FY11 they were invested mainly in high-yielding bonds. Also, by FY11 currency selection had become an option. Whereas developed economy sovereign bonds are seen as a low credit risk not requiring much explanation to customers, explaining high-yielding

Figure 3: Breakdown of main constituents of actively managed overseas bond funds

Category	FY03			FY11		
	Sales	%	Commission	Sales	%	Commission
Asian currencies (including Australian and New Zealand dollars)	4,465	9%	2.16	16,974	22%	2.25
Emerging markets	1,359	3%	2.96	17,427	23%	3.02
Global	30,256	58%	1.59	18,854	25%	3.10
US dollar	14,093	27%	1.85	14,925	20%	3.02

Note: Units are ¥100 million. Classification is that used by Nomura Research Institute's Fundmark database. FY11 data are to December 2011.
Source: Nomura Institute of Capital Markets Research, from NRI Fundmark data

Figure 4: Breakdown of main constituents of Japanese hybrid funds

Category	FY03			FY11		
	Sales	%	Commission	Sales	%	Commission
Asset allocation	215	22%	2.07	21	1%	1.53
Balanced	419	44%	0.87	781	23%	0.27
Real estate funds	300	31%	2.07	2,580	76%	2.66

Note: Units are ¥100 million. Classification is that used by Nomura Research Institute's Fundmark database. FY11 data are to December 2011.
Source: Nomura Institute of Capital Markets Research, from NRI Fundmark data

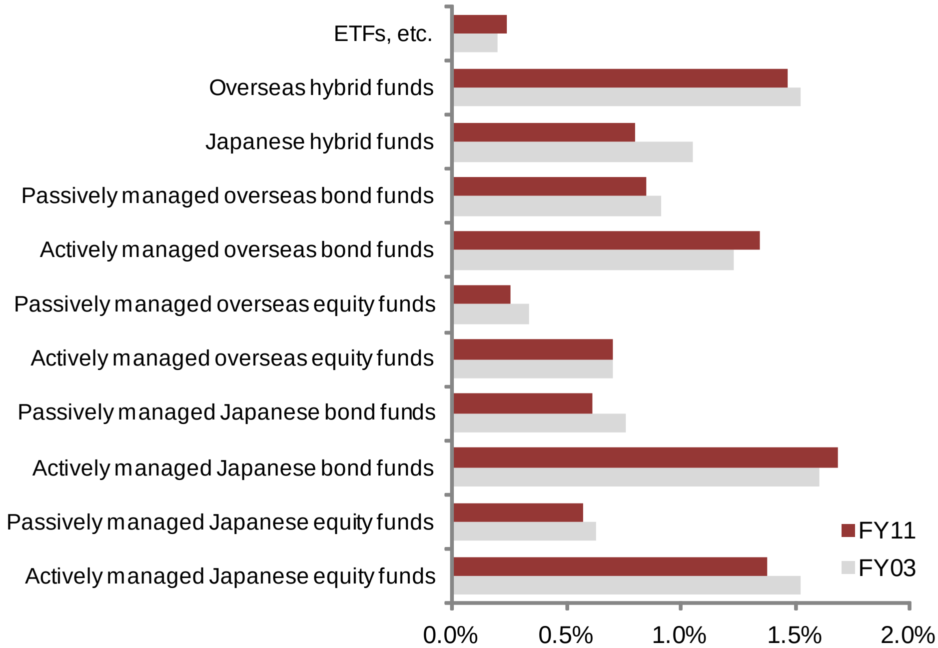
bonds and currency selection to customers takes more time. We see this as the main reason for the increases in sales commission.

3. Japanese hybrid funds

The sales commission on Japanese hybrid funds appears at first sight to have risen from 1.53% in FY03 to 2.09% in FY11. However, we account for this by the fact that, whereas the best-selling funds of this asset class in FY03 were balanced funds, by FY11 they were real estate funds. Figure 4 shows a breakdown of Japanese hybrid funds in FY03 and FY11. Whereas in FY03 44% of the funds were balanced and 31% invested in real estate, this had changed to 23% and 76%, respectively, by FY11.

As we can see from Figure 4, the sales commission on funds other than real estate funds declined during this period. We account for the increase in the sales commission on real estate funds by the fact that, whereas in FY03 the (upper limit on the) sales commission on the best-selling real estate funds was 2%, by FY11 it had risen to 3% on the best-selling fund (the DIAM J-REIT monthly dividend open-end fund, launched in December 2003).

Figure 5: Breakdown of average expense ratios
(of open-end equity investment trusts)



Note: The (upper limits on) pre-tax real expense ratios are NAV-weighted averages. FY11 data are to December 2011. The real expense ratio includes the expense ratios of the funds in which funds of funds invest.
Source: Nomura Institute of Capital Markets Research, from NRI Fundmark data

Appendix: expense ratios

Figure 5 shows the expense ratios of different asset classes in FY03 and FY11. They largely declined or were unchanged during this period.