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Evolution of the US Retail Securities Market (Volume 1)

—Financial institutions prepare for retiring baby boomers—

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In the United States, after 2008, approximately 78 million baby boomers born during the 17 years from 1948 to 1964 will begin retiring at a rate exceeding 4 million people annually.

There, where most social insurance systems such as pensions and medical insurance are already being handled by the private sector, the burdens of living expenses on retirees are much heavier than are those in Japan. Accordingly, there is an extremely high need for savings to support post-retirement living and their maintenance and management.

With this situation forming the background, when we see the household financial assets that are on deposit, we find a significant shift to securities investments among older people, in particular, baby boomers. This shift is considered to reflect an investment stance of "long-term investment" to support life after retirement.

In response, securities firms have shifted the focus of their services from investment services simply to build up assets to advisory services related to the utilization, maintenance and inheritance of assets, etc. with the aim of acquiring baby boomers as clients. Among these new services, securities accounts for which brokerage commissions are not charged, but for which fees are charged based on the balance of deposited assets, are successfully meeting the asset management needs of baby boomers. This is because such accounts can improve the client's outlook for the planning of funds.

In one type of these fee-based securities accounts, separately managed accounts (SMAs), which are called wrap accounts in Japan, the balance of account has been rapidly increasing in the United States. In particular, unified managed accounts (UMAs), which provide consolidated management for SMAs and other securities accounts, have facilitated the response by registered representatives of securities firms in expanding investment areas as well as offering baby boomers a wide array of asset management options. UMAs are expected to become the core product of asset management accounts in the future.

I Impact of Baby Boomer Retirement

1 Accelerated Trends towards Aging in Developed Countries

In Japan, increased attention is being given to the social impact caused by the retirement of the first baby boomers (those who were born in 1947 to 1949), which has been dubbed the "Year 2007 Problem." Because approximately 5.2 million people will retire from active work within a short period of three years, studies are now under way on raising the mandatory retirement age from 60 to 65 and passing on technical skills to younger generations. At the same time, in the financial market, competition is intensifying among financial institutions in relation to retirement allowances totaling some 20 to 30 trillion yen.

The issue of an aging society is not limited to Japan. It is also a common problem in Europe and the United States. Figure 1 shows the ratio of employees aged 15 to 64 to the population of retirees aged 65 or over in Japan, Europe and the United States. While the trend in aging has been accelerating faster in Japan, the issue of aging has also been becoming increasingly critical in the United States and Europe. Incidentally, the year when the number of those aged 65 or over exceeds 20 percent of the total population is 2006 in Japan, 2009 in Germany and 2036 in the United States and China (Table 1).

Table 1. Extent of Acceleration of Aging

	Year when the population aged 65 or over exceeds the following percentages	
	10%	20%
China	2017	2036
Japan	1985	2006
Italy	1966	2006
Germany	1952	2009
US	1972	2036
France	1943	2018

Source: *United Nations World Population Prospects 1950 → 2050: The 2002 Revision,* edited by the Population Division, Department of Economic and Social Affairs, 2005.

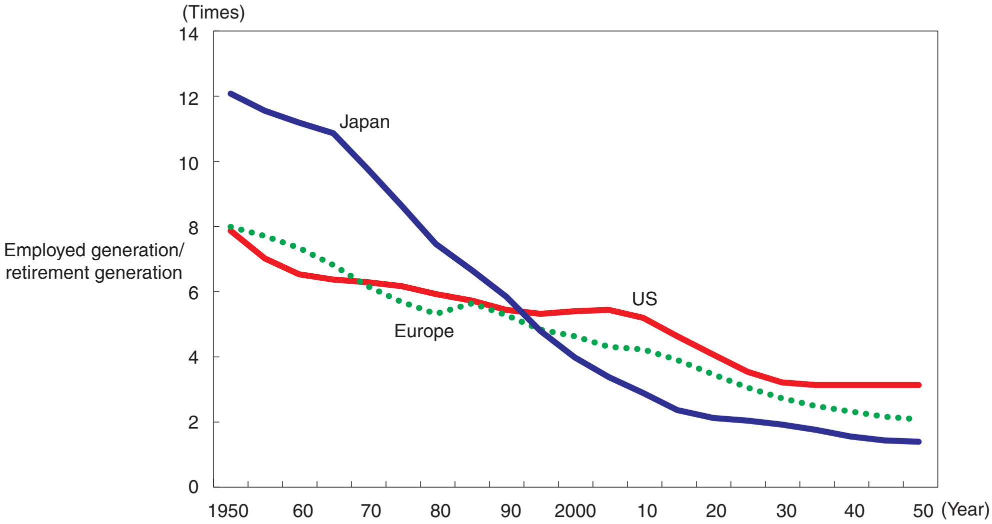
2 US Baby Boomers Reaching Retirement Age

In the United States, the term "baby boomers" refers to people who were born during the 17 years from 1948 to 1964 and constitutes a large segment of the population totaling approximately 78 million persons. In and after 2008, more than 4 million people will reach the retirement age of 60 every year.

When we see the social infrastructure supporting the lives of these retired seniors, we find that, similar to Japan, the public pension issue is a critical issue in the United States. In 2018, the total pension benefit is expected to exceed the total pension premiums paid into the system and, in 2042, the pension finance system is predicted to collapse. Because of this, it is estimated that the current level of benefits will be cut by more than 27 percent in and after 2042.

In 1974, more than 30 years ago, about 56 percent of yearly income received at the time of retirement could be made up by combining public and corporate pension benefits. According to Principal Financial Group, this amount is estimated to be reduced to 24 percent in 2030. This reduction is affected by the collapse of corporate pension programs, such as the United Airlines corporate pension default involving 6.6 billion dollars and the suspension of company contributions to employees' 401k plans (defined contribution pension plan) by Ford Motors, which were recently announced.

Figure 1. Increase in the Retirement Generation in Developed Countries



Note: The employed generation represents people aged 15 to 64, and the retirement generation represents people aged 65 or over; forecast values for 2005 and subsequent years are average values.
Source: *United Nations World Population Prospects 1950 → 2050: The 2002 Revision,* edited by the Population Division, Department of Economic and Social Affairs, translation supervised by Makoto Atoh, Hara Shobo, 2005.

Twenty years ago, 80 percent of the employees of major companies were entitled to receive pension benefits after their retirement by means of defined benefit pension plans. In 1997, this percentage was reduced to 50 percent. According to the US Bureau of Labor Statistics, it is expected to be further reduced to 21 percent in 2005.

A more critical situation is reported in the area of medical and nursing costs. While public medical insurance (Medicare) is available for seniors aged 65 or over and handicapped persons in the United States, benefits are limited to treatment and medication, and the level of benefits is low. Although corporate group medical insurance plans can be used at a monthly cost of about 100 dollars while one is working, most medical costs must be borne by the individual employees after retirement. Accordingly, monthly medical costs jump to 700 to 800 dollars after retirement, increasing concerns over life after retirement. Because the public nursing care insurance that is available in Japan is not available in the US, self-help efforts by the use of savings accounts are essential.

In his book, *The Future for Investors*,[1] Professor Jeremy J. Siegel of the University of Pennsylvania pointed out the following estimate with respect to economic burdens to be brought about by the increase in the number of retired seniors in the future.

At present, Americans retire from active work at an average age of 62 and live a post-retirement life for another 20 years. If retirees consume 90 percent of their pre-retirement annual income for post-retirement life including pension benefits and other revenues, the total consumption amount for the 45 years from 2005 to 2050 reaches about 123 trillion dollars. This means that post-retirement life must be supported by one's own savings. As of the end of 2004, the household financial asset balance in the United States was approximately 37 trillion dollars. Many of these assets are expected to be liquidated for living expenses. Acceleration of such asset liquidation at a rapid pace will have a substantial impact on the bond and stock markets.

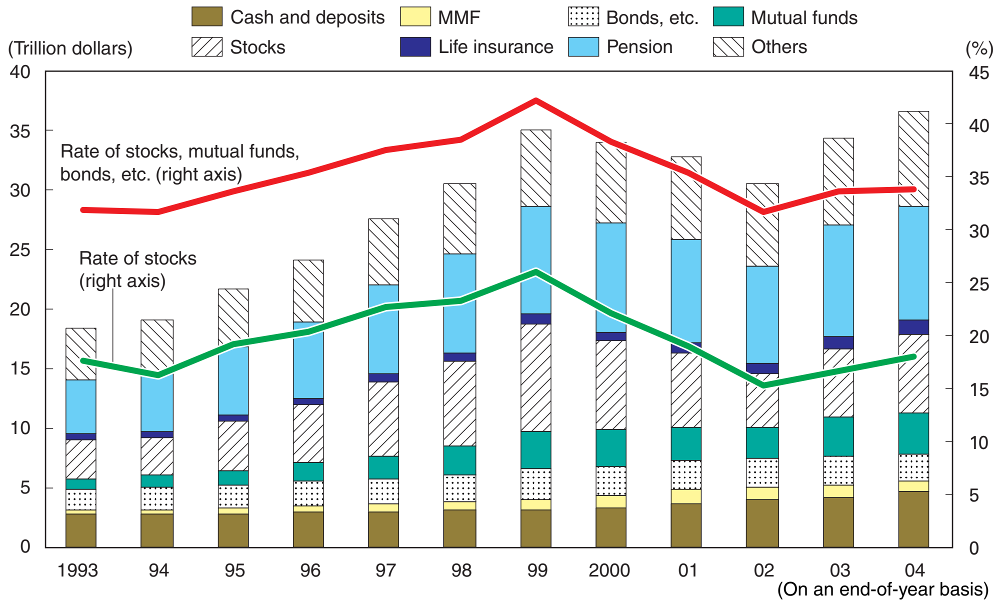
However, this estimate by Professor Siegel does not consider yields from the investments of financial assets owned by individuals, such as interest, dividends and capital gains. Moreover, revenues from house rental, etc. and fund procurement by reverse mortgages (borrowing funds against the value of one's own house and repaying the borrowed funds by selling the house at the time of the borrower's death) are not included in this estimate. Accordingly, it is not clear to what extent the required funds are obtained by selling financial assets.

3 Personal Savings Leaning toward Risk Assets

Figure 2 indicates changes in the household financial asset balance in the United States. From 1993 through 1999, the household financial asset balance increased at a rapid pace as influenced by increases in the stock market. In particular, the holdings of risk assets, such as stocks, mutual funds, bonds, etc. for which the principal is not guaranteed due to an increase in the interest rate or a decline in stock prices, have been increasing. At the end of 1999, the rate of stock holdings among household financial assets increased to 25 percent. The rate of investments in risk assets that include bonds and mutual funds (excluding money market funds (MMF)) in addition to stocks rose to as high as 42 percent.

Inflated increases in the amounts of family income during this period also contributed to this increase in the

Figure 2. Changes in Household Financial Asset Balances



Notes: (1) Amounts of non-profit organizations are included. (2) MMF = Money Market Fund.
Source: FRB, "Flow of Funds Accounts."

Table 2. Number of Households by Income Level (2002)

(Unit: 1,000 households)

	Total	Under $25,000	$25,000 to under $50,000	$50,000 to under $100,000	$100,000 or over	Median income (dollars)
All households						
1980	82,368	28,335	26,440	22,816	4,860	36,608
1990	94,312	29,425	28,671	26,879	9,148	39,949
2000	108,209	30,190	30,082	32,138	15,690	43,848
2001	109,297	31,478	30,275	32,024	15,629	42,900
2002	111,278	32,604	30,490	32,604	15,690	42,409
White only						
1980	71,872	23,430	23,430	20,987	4,600	38,621
1990	80,968	23,886	25,019	24,209	8,421	41,668
2000	90,030	23,498	24,938	27,639	13,865	45,860
2001	90,682	24,393	25,028	27,477	13,784	45,225
2002	91,645	25,019	24,927	27,952	13,747	45,086

Source: US Census Bureau, "Current Population Survey."

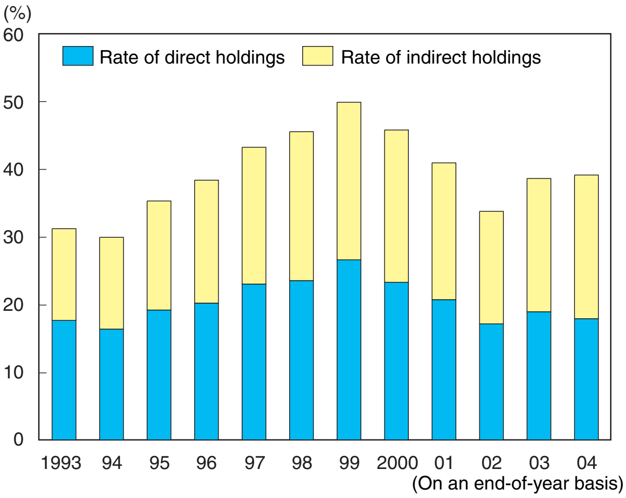
rate of risk assets (Table 2). When we look at the number of families by income level, the amount of median income increased from 39,949 dollars to 43,848 dollars during the period from 1990 to 2000. This increase exceeds the increase recorded during the previous ten years (1980 – 1990) by 16 percent. The number of families with an annual income of 100,000 dollars or more increased from 9.148 million families to 15.69 million families during the period from 1990 to 2000, recording an increase of 6.542 million families. One of the characteristics of this period is that income gaps between white families and families of other races expanded as shown in Table 2.

The balance of household financial assets gradually decreased after 2000 through 2002 as influenced by a slump in the stock market. The rate of stock ownership declined by 10 percentage points to 15 percent during these three years. Subsequently, as supported by an economic recovery, the ownership of mutual funds and stocks was restored, and the balance of household financial assets increased to 37 trillion dollars by the end of 2004. Similarly, the rate of stock ownership increased to 18 percent and the rate of risk assets such as stocks, bonds and mutual funds again gained momentum and increased to 34 percent.

Figure 3 indicates the changes in the rate of direct ownership through investment and indirect ownership through bank deposits, pensions, life insurance, etc. with respect to stocks owned by individuals. When the rate of direct ownership exceeded 25 percent in 1999, as explained at the beginning of this section, stocks accounted for 50 percent of all household financial assets if indirectly owned stocks are included. If bonds, mutual funds, etc. that were owned by individuals are added to this rate, as high as 65 percent of household financial assets were owned in the form of risk assets by the end of 1999.

Following 1999, while the stock direct and indirect ownership rate declined by more than 15 percentage points by the end of 2002, it increased to 39 percent by the end of 2004. These data suggest that, from the beginning of 1999 to the end of 2001 after the September 11 terrorist attacks, individual investors in the United States were put in a situation where they had to be extremely sensitive in reacting not only to stock market conditions but also to interest trends under the circumstances of falling stock prices and increasing interest rates.

Figure 3. Directly and Indirectly Owned Stocks among Household Financial Assets



Source: FRB, "Flow of Funds Accounts."

The following section examines the trend of holdings of financial products from a different angle based on the Survey of Consumer Finances by the Federal Reserve Board (FRB).

Table 3 shows the rates of holdings of financial assets by stratum in terms of age, income, etc. As a matter common to all strata, the holding rate of checking accounts at banks is high. With respect to financial assets entailing price fluctuation risks such as stocks and mutual funds, the ownership rate increases with the increase in the amount of income and amount of assets owned. In particular, in the case of stocks, what is noticeable is an extremely high ownership rate of more than 60 percent recorded by the top 10-percent stratum in the income and asset segments. By age, the ownership rate of stocks, bonds and mutual funds reached a peak in the stratum of people aged 55 to 64. Among people aged 65

Table 3. Survey of Consumer Savings: Ownership Rate of Financial Assets by Age, Income and Assets (2001)

(Unit: %)

	Transaction accounts	Certificates of deposit	Savings bonds	Bonds	Stocks	Mutual funds	Retirement accounts	Life insurance	Other managed assets	Others
All families	90.9	15.7	16.7	3.0	21.3	17.7	52.2	28.0	6.6	9.3
By age										
Under 35	86.0	6.3	12.7	*	17.4	11.5	45.1	15.0	2.1	10.4
35 – 44	90.7	9.8	22.6	2.1	21.6	17.5	61.4	27.0	3.1	9.5
45 – 54	92.2	15.2	21.0	2.8	22.0	20.2	63.4	31.1	6.4	8.5
55 – 64	93.6	14.4	14.3	6.1	26.7	21.3	59.1	35.7	13.0	10.6
65 – 74	93.8	29.7	11.3	3.9	20.5	19.9	44.0	36.7	11.8	8.5
75 or over	93.7	36.5	12.5	5.7	21.8	19.5	25.7	33.3	11.2	7.3
By income										
Lowest 20%	70.9	10.0	3.8	*	3.8	3.6	13.2	13.8	2.2	6.2
20 – 39.9%	89.4	14.7	11.0	*	11.2	9.5	33.3	24.7	3.3	9.9
40 – 59.9%	96.1	17.4	14.1	1.5	16.4	15.7	52.8	25.6	5.4	9.9
60 – 79.9%	98.8	16.0	24.4	3.7	26.2	20.6	75.7	35.7	8.5	9.0
80 – 89.9%	99.7	18.3	30.3	3.9	37.0	29.0	83.7	38.6	10.7	10.8
Upper 10%	99.2	22.0	29.7	12.7	60.6	48.8	88.3	41.8	16.7	12.5
By net worth										
Lowest 25%	72.4	1.8	4.3	*	5.0	2.5	18.9	6.9	*	7.9
25 – 49.9%	93.6	8.8	12.8	*	9.5	7.2	45.3	26.0	1.3	8.6
50 – 74.9%	98.2	23.2	23.5	*	20.3	17.5	63.2	34.5	6.2	8.7
75 – 89.9%	99.6	30.1	25.9	5.3	41.2	35.9	77.6	41.7	13.9	9.4
Upper 10%	99.6	26.9	26.3	18.4	64.3	54.8	87.4	48.6	26.4	16.1
By employment format										
Working for someone else	92.4	11.3	19.4	2.0	20.9	17.3	61.5	27.4	5.3	9.4
Self-employed	95.2	18.7	16.6	6.1	29.8	22.9	58.9	34.6	6.9	12.4
Retired	88.9	27.1	11.4	4.5	19.6	17.3	29.2	29.0	10.4	7.9
Others not working	70.3	7.8	7.5	*	13.3	10.9	26.8	12.9	5.6	6.5

Note: * refers ten or fewer observations.
Source: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin,* January 2003, and unpublished revisions.

or over, the ownership rate of highly liquid deposits increased, which suggests a change in the need for asset ownership after retirement.

Table 4 shows the average amount of assets owned by stratum that was revealed in the same survey. Similar characteristics as seen in Table 3 indicating the rate of ownership are also observed in this table. As the amount of income and the amount of owned assets increase, the amount of owned risk assets, such as stocks, bonds and mutual funds, also increases. In particular, the amount of risk assets including stocks, general bonds and mutual funds exceeded 800,000 dollars in the stratum of people aged 55 to 64, and surpassed 1.3 million dollars in the top 10-percent stratum of the income segment. If the amount of owned assets is seen by asset segment, gaps among the five strata expanded further. The top 10-percent stratum owned an average of 1.3 million dollars of risk assets. In contrast, the amount of owned risk assets is extremely low in the upper 10.1- to 25-percent stratum in the asset segment.

4 Characteristics of Individual Stock Investors

Based on Table 4, if it is assumed that the population is equally distributed for each stratum (although this is a rough approximation), the 35-54 stratum accounts for 21 percent of all American stockholders and the over-55 stratum accounts for 75 percent of all American stockholders in the age category. In the asset category, the top 10-percent stratum accounts for 86 percent of all American stockholders.

Table 5 indicates changes in the number of households owning equities based on a survey of US households owning equities conducted by the Investment Company Institute and the Securities Industry Association in 2002. While the number of households owning equities was about 16 million with a household equity ownership rate of only 19.0 percent in 1983, the number increased to about 53 million households with the ownership rate raised to 49.5 percent in 2002. As explained when we examined the balance of household financial assets, these data also suggest a rise in stock holdings by individuals.

Table 6 outlines the characteristics of individual stock investors profiled under this survey. The median investor is 47 years old, earns an annual income of 62,500 dollars and owns financial assets worth 100,000 dollars. Of the financial assets, equities amount to 50,000 dollars, indicating that 50 percent of all financial assets owned is invested in equities. In the segment of the first baby boomers aged 38 to 55 at the time the survey was conducted, the rate of equities in financial assets is 40 percent, which closely nears the average of the household financial asset statistics. In addition, 48 percent of the first baby boomers are stock investors. This indicates that these baby boomers constitute the most active investor segment among all stock investors.

Table 4. Survey of Consumer Savings: Financial Asset Holdings by Age, Income, Assets

(Unit: 1,000 dollars)

	Transaction accounts	Certificates of deposit	Savings bonds	Bonds	Stocks	Mutual funds	Retirement accounts	Life insurance	Other managed assets	Others
All families	23.8	37.4	7.8	291.3	191.9	130.8	102.6	36.1	301.9	39.2
By age										
Under 35	6.7	21.0	1.3	*	64.8	32.5	18.9	45.8	174.1	14.8
35 – 44	16.0	13.2	5.9	71.9	82.5	75.0	64.4	32.5	219.6	15.8
45 – 54	26.9	29.5	8.5	370.1	192.5	146.5	126.2	50.8	219.0	62.9
55 – 64	36.8	43.9	6.3	346.7	297.4	188.5	192.1	32.9	351.7	70.6
65 – 74	42.0	46.3	10.5	396.1	352.3	186.6	169.7	23.2	363.0	58.3
75 or over	33.4	53.5	27.7	232.3	326.1	193.4	124.4	24.5	358.3	44.7
By income										
Lower 20%	5.1	22.6	4.4	*	22.1	64.4	22.0	9.3	135.5	23.5
20 – 39.9%	8.5	29.3	5.1	*	41.4	45.6	27.6	15.3	150.2	10.4
40 – 59.9%	12.4	27.9	2.8	29.3	45.0	64.6	44.7	26.8	182.2	23.4
60 – 79.9%	17.5	34.3	10.3	102.1	86.4	73.3	67.6	37.0	166.5	22.5
80 – 89.9%	25.6	37.2	3.7	129.2	91.5	92.7	110.6	43.4	219.9	19.0
Upper 10%	111.3	81.4	15.7	564.2	501.2	287.1	305.3	81.4	676.1	167.1
By net worth										
Lowest 25%	1.4	3.5	0.4	*	2.5	2.9	3.8	3.3	*	2.4
25 – 49.9%	4.6	10.5	1.5	*	7.4	11.1	14.0	10.4	19.8	5.2
50 – 74.9%	12.5	22.0	3.8	*	19.3	26.3	41.9	25.1	37.2	10.4
75 – 89.9%	29.1	40.9	9.6	34.8	59.6	66.3	110.7	40.4	99.8	31.4
Upper 10%	129.7	92.4	25.0	451.7	559.8	331.0	369.6	95.9	655.4	175.3
By employment format										
Working for someone else	15.6	22.1	4.0	201.4	102.1	81.7	78.3	33.3	193.1	24.7
Self-employed	50.4	49.5	17.3	428.0	339.8	260.9	197.6	61.9	566.4	81.0
Retired	33.8	50.0	18.9	300.9	321.1	181.2	145.5	24.3	369.3	56.0
Others not working	12.9	39.7	1.7	*	270.3	62.0	75.9	70.4	196.6	11.5

Note: * refers ten or fewer observations.
Source: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin,* January 2003, and unpublished revisions.

Table 5. Equity Ownership in the United States

	1983	1989	1992	1995	1999	2002
Equity ownership rate (%)	19.0	32.5	36.6	41.0	48.2	49.5
Households owning equities (million households)	15.9	30.2	34.6	40.6	49.2	52.7
Individuals (million persons)	42.4	52.3	61.4	69.3	78.7	84.3

Source: Investment Company Institute and the Securities Industry Association, “Equity Ownership in America, 2002.”

Table 6. Characteristics of Equity Investors by Generation (2002)

	All equity investors	**Generation X** (born in 1965 or later)	**Baby boom generation** (born between 1946 and 1964)	**Silent GI generation** (born in 1945 or earlier)
Rate of stock investors	100	25	48	27
Median				
Age	47	30	46	65
Annual income (dollars)	62,500	60,000	70,000	50,000
Financial assets (dollars)	100,000	35,000	125,000	350,000
Financial assets in equities (dollars)	50,000	25,000	51,000	69,600
Number of equities owned	4	3	5	5
Method of Acquiring Individual Stocks				
Inside employer-sponsored retirement plans (%)	17	18	20	11
Outside employer-sponsored retirement plans (%)	41	34	41	48

Source: Investment Company Institute and the Securities Industry Association, “Equity Ownership in America, 2002.”

In terms of the method of acquiring stocks, 17 percent of all stock investors purchased stocks through employer-sponsored retirement plans (defined contribution pension plans such as 401k). Investors who purchased stocks by means of other methods account for 41 percent. With respect to the first baby boomers, 20 percent of them purchased stocks through employer-sponsored retirement plans, indicating a slightly higher dependence on employer-sponsored retirement plans as compared to investors in each age segment.

Table 7 lists responses to the question about financial institutions used for equity transactions, which was asked in the same survey of equity ownership (including multiple responses). In both 1999 and 2002, more than 40 percent of individual investors used full-service brokerage houses. With respect to discount brokerages only available online, the usage increased from 9 percent in 1999 to slightly less than 20 percent in 2002. In 2002, the share of independent financial planning firms and banks also increased. What is noticeable is the share of "Direct from the company issuing individual shares." It is thought that this channel specifically means the purchase of equities issued by the employee's own company through an employee stock ownership plan, stock option or employer-sponsored retirement plan. The share of this channel exceeded 30 percent in 2002, which is the largest share next to full-service brokerage houses.

Tables 8 and 9 list responses to the questions of financial goals for equity investments and views on equity investing (including multiple responses), which were made as part of the same survey of equity ownership. "Preparations for post-retirement life" was considered the primary goal, with slightly less than 90 percent of respondents selecting this goal in both 1999 and 2002. This goal was followed by "Preparations for emergency," which was selected by 40 to 30 percent of respondents. It appears that the intention of making equity investments is not for goals in the near future such as "education expenses" and "purchase of home, etc."

With respect to views on equity investing, in reflecting these investment goals, more than 80 percent of respondents selected "I view my equity investments as savings for the long term" and "I tend to follow a buy-and-hold investment strategy." The fact that around 60 percent of investors rely on advice from professional financial advisers suggests the cautious stance taken by investors toward equity investments.

A survey of individual investors by Forrester Research, Inc. categorizes investors with such a cautious stance as "validators" who ask for advice from securities firms and/or second opinions from professional financial advisers, in addition to their own research. Based on its surveys for 1999 – 2003, Forrester observes that 61 percent of baby boomers are such validators.[2]

Table 7. Financial Institutions Trading Equities

(Unit: %)

	1999	2002
Full-service brokerages	44	47
Discount brokerages with walk-in offices	20	16
Discount brokerages only available online	9	17
Direct from company issuing individual stock	23	32
Independent financial planning firm	11	13
Banks	7	10
Insurance agencies	2	3

Note: Includes multiple responses.
Source: Investment Company Institute and the Securities Industry Association, "Equity Ownership in America, 2002."

Table 8. Financial Goals for Equity Investments

(Unit: %)

	1999	2002
Retirement	89	87
Emergency	42	33
Minimizing taxes	Not asked	31
Education	32	29
Current income	20	18
Purchase of home or other major item	15	14

Note: Includes multiple responses.
Source: Investment Company Institute and the Securities Industry Association, "Equity Ownership in America, 2002."

Table 9. Views on Equity Investing

(Unit: %)

	1999	2002
I view my equity investments as long-term savings	96	96
I tend to follow a buy-and-hold investment strategy	87	86
I tend to rely on advice from a professional financial adviser	64	58

Note: Includes multiple responses.
Source: Investment Company Institute and the Securities Industry Association, "Equity Ownership in America, 2002."

II Innovations in Retail Sales Operations by Securities Firms

1 Transformed American Securities Industry

Table 10 shows the scale of major American securities firms in terms of the number of registered sales representatives. Wachovia Securities, ranked second, and Smith Barney, ranked third, are bank affiliates; American Express Financial Advisers, ranked fifth, is an affiliate of the credit card firm and ING Network, AIG SunAmerica and MetLife Securities, ranked eighth or below, are affiliates of insurance companies. Following passage of the "Financial Services Modernization Act of 1999," which is also known as the Gramm-Leach-Bliley Act, these new major securities firms have been rapidly expanding.

Wachovia Securities, ranked second, was established in 2003 by the merger of an affiliated securities firm of Wachovia Corporation with headquarters in North Carolina and an affiliated securities firm of Prudential Financial, which is a life insurance company. The predecessor of the affiliated securities firm of Prudential Financial is the long-established Bache Securities. Smith Barney, ranked third, is also a long-standing securities firm. Smith Barney became an affiliated company of Travelers Group, an insurance company, and became a bank-affiliated securities firm by the merger of Travelers Group and Citicorp. Both of these companies are new securities firms that were established for the integration of financial services with the aim of promoting the sales of retail financial products that are

Table 10. Scale of Retail Securities Firms (in terms of number of registered representatives at the end of 2004)

Order	Securities firm	Number of registered representatives (persons)
1	Merrill Lynch*1	15,000
2	Wachovia Securities*2	11,500
3	Smith Barney*2	11,411
4	Morgan Stanley*1	11,086
5	American Express Financial Advisors*4	10,545
6	Edward Jones*3	9,409
7	UBS*4	7,766
8	ING Network	7,534
9	AIG Sun/America*4	7,467
10	Met Life Securities*4	7,433

Notes: *1: Major securities firm with principal office in New York City, *2: Bank-affiliated securities firm, *3: Regional securities firm, *4: Securities firm with principal office in New York City.
Source: Securities Industry Association.

being expanded through deregulation, acquiring channels and strengthening the cross-selling of products of different fields.

2 Major Securities Firms Aiming at Offering Full Financial Services

The retail sales strategies of these major securities firms focus on measures for individual investors who have increased investments in risk assets chiefly consisting of equity investing and the expansion of services particularly for baby boomers nearing retirement.

First, let's look at the product strategies of Merrill Lynch. In 1999, Merrill Lynch started offering a new securities account named "Unlimited Advantage." Under this service, while a fixed commission is charged for the balance of assets in securities account, no commission is paid for each securities transaction. In this sense, Unlimited Advantage is an unprecedented type of securities account. Advice from professional financial advisers such as registered representatives of the securities firm is, of course, available under this service.

There have been more than a few cases where customer interest is not necessarily consistent with that of a securities firm under current securities services that require a commission for each transaction. In its comments in announcing this new service, Merrill Lynch made it clear that Unlimited Advantage is a product that is aimed at offering comprehensive advisory services in relation to financial assets, in addition to providing support for securities trading. This service is designed to meet a wide array of needs related to financial assets including not only building up assets but also effectively utilizing and maintaining assets as we enter the period of baby boomer retirement.

In 1985, prior to the announcement of the new service, Merrill Lynch changed the titles of its sales representatives from "account executives" to "financial consultants." In 2001, the titles were further changed to "financial advisors." These moves reflect the efforts of Merrill Lynch to offer comprehensive financial consulting services, rather than mere brokerage services.

In 2003, Merrill Lynch announced the name of the integrated service as "Total Merrill" by incorporating its "Beyond Banking" service in this account service. The Beyond Banking service consists of cash withdrawals without handling fees at ATMs (automated teller machines), free check issuing services, bank-to-bank remittances, overdrafts, loan services, etc. As part of this announcement, emphasis was placed on the role of this integrated service as a comprehensive account that was designed to meet not only the asset formation needs of about 78 million baby boomers but also their needs for maintaining assets and managing asset liquidity.[3]

Concurrently with this enhancement of an account for products and services, Merrill Lynch also developed a customer needs analysis system that enables registered representatives to offer a variety of services including brokerage and banking services efficiently. First, the system analyzes the "investment purposes and achievement goals" of a client and finds investment products and methods to achieve such goals. Second, it presents a path to the achievement of investment goals based on the scenario of future market trends. Through these functions, the system is designed to enable registered representatives to meet client needs more resourcefully.

A survey of the wealthy class conducted in September 2003 by Smith Barney, which is an affiliated securities firm of Citicorp, revealed that the rate of client defections when a registered representative in charge of a client's account is changed is only 28 percent in the case of Merrill Lynch. This rate increases to 70 percent and 55 percent, respectively, in the case of UBS and Smith Barney.[4] This result represents part of client evaluations regarding the efforts of Merrill Lynch to offer comprehensive financial consulting services.

Figure 4 shows the current securities account framework of Merrill Lynch. Under Total Merrill, which is explained above, the industry's first credit card and check services were linked to MMF within a securities account. A CMA (cash management account), which was introduced in 1977 when automatic fund transfer to MMF became possible, and a general securities trading account are provided. The service incorporated with these accounts is a securities account service involving a fee on the balance of assets. This framework permits clients to select and combine a securities trading account and banking services such as settlement services and loans in accordance with their different fund needs.

Naturally, monthly fees are required if the balance of assets on deposit falls below a certain amount under the CMA and Beyond Banking services. The fee for the Beyond Banking service is 15 dollars if the assets in the account fall below 100,000 dollars.

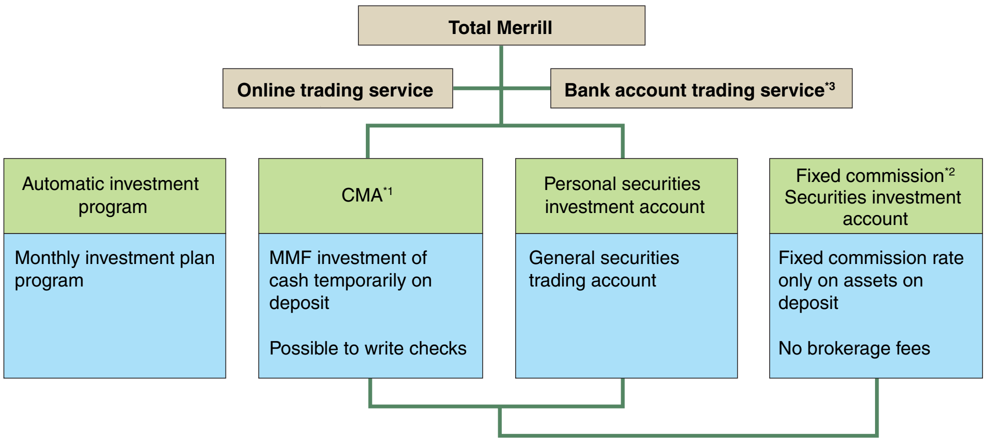
In addition to this securities trading account, a "wrap account" (or SMA: Separately Managed Account), which is the investment discretionary account introduced in April 2004 through an amendment to the Investment Advisory Law in Japan, is available as a primary account for the wealthy class. Details of this account are explained later in this paper.

Next, let's discuss Wachovia Securities as an example of a bank-affiliated securities firm. Table 11 outlines various securities accounts offered by Wachovia Securities. An account product that is considered to be characteristic of a bank-affiliated securities firm is their "Command Asset Program" (integrated banking and securities account). This product combines an ordinary securities trading account with a banking account to offer services such as checks, cash withdrawal at ATMs, credit cards, etc.

Of course, online banking services are also available, such as bank-to-bank remittances, account transfers, transfers between a securities trading account and a deposit account. Another feature is that the minimum amount of assets on deposit to open an account is set lower, at 25,000 dollars, as compared to other major securities firms. This account product also offers "Command Asset Program Premier" (premier integrated account), under which a dedicated advisor is assigned to the account. While the minimum necessary asset level is increased to 250,000 dollars, no fees are required.

Incidentally, under the circumstances where major securities firms including Merrill Lynch have started to offer online trading services since 1999, online trading

Figure 4. Merrill Lynch's Securities Account Framework



Notes: *1: Cash Management Account, *2: Unlimited Advantage Service, *3: Beyond Banking Service (free checking account, free credit card, providing housing loan, etc.; monthly fee of $15 is not required if assets on deposit are $100,000 or more).
Source: Merrill Lynch, May 27, 2005 (press release).

Table 11. Wachovia Securities: Securities Account Framework and Commissions

	Fees	Minimum balance required to waive fees	Minimum deposit required to open account
Full-service brokerage	$50 per year		
Self-directed brokerage	$50 per year	The annual fees will be waived if trading commissions during the previous 12 months exceed $50.	
Command asset program	$125 per year $30 per month	$25,000	$25,000
• Basic brokerage account and online brokerage account service • Banking account service (free checking account, consolidated monthly statements, no ATM fees, no-fee Visa Card, lines of credit up to $25,000 per year)			
Command asset program premier	Free	–	$250,000
• In addition to the integrated banking and securities account service, a dedicated advisor is assigned to the account.			

Note: ATM = automated teller machine.
Source: Complied based on the website of Wachovia Securities, June 13, 2005.

securities firms have been forced to compete in commission reduction. Table 12, which outlines the commission framework of each online trading securities firm, indicates that the commission differential at the introductory level exceeds 12 dollars per one trade. As measures of differentiation other than commissions are not available from the beginning for this type of service, extremely intense competition is widespread.

Under such circumstances, services that have become especially conspicuous are preferential measures for large-scale clients in terms of asset amounts and clients who conduct a large number of trades. In the case of Charles Schwab and Fidelity Investments, if the amount of assets in account is one million dollars or more and/or if the number of annual trades is 120 or more, the commission per trade is reduced by as much as 10 dollars or even more.

Table 13 uses Charles Schwab as an example to show the securities account framework and commissions of online trading securities firms. It is clear from this table that Charles Schwab is giving preferential treatment to large-scale clients in terms of assets in account and clients with a large number of quarterly trades. However, as I explain later in this paper, these measures are not necessarily considered as exactly meeting the investment needs of aging baby boomers. Accordingly, competition among companies to survive has become increasingly more intense.

3 Sales Activities of Securities Firms with Fee-based Account and SMAs

Table 14 summarizes responses to individual clients by major securities firms. Each firm uses the amount of deposited assets as the basis for service categorization. The services of each firm vary respectively for each balance amount of 100,000 dollars, 250,000 dollars and 500,000 dollars. Starting from the level of clients with assets of 500,000 dollars or more, a dedicated representative is appointed and preferential treatment in terms of handling fees is given. If the deposited assets exceed one million dollars, a discretionary management account such as an SMA (separately managed account) is offered.

The following section examines an SMA, which is a service for large-scale clients. While a securities firm conducts account management for an SMA, the client leaves investment management entirely to a professional investment advisor employed by an investment advisory firm, etc. The advisor makes investments according to

Table 12. Commission Reduction Competition among Online Trading Securities Firms

Online securities firm	Introductory-level commission	Clients subject to conditions in column at left	Most preferential commission	Clients subject to conditions in column at left
Ameritrade	$10.99	All clients	$10.99	All clients
Charles Schwab	$19.95 (up to 1,000 shares)	Clients with low trading frequency; clients with less than $1 million of assets on deposit	$9.95	Clients with 30 trades or more per quarter; clients with 120 trades or more per year; clients with $1 million or more of assets on deposit
E*TRADE FINANCIAL	$19.99 plus $3 (handling fee; up to 5,000 shares)	Clients with fewer than 9 trades per quarter; clients with $50,000 or less of assets on deposit	$9.99	Clients with 27 trades or more per quarter
Fidelity Investments	$19.95 (up to 1,000 shares)	Clients with $30,000 or less of assets on deposit and fewer than 36 trades per year; clients with $100,000 or less of assets on deposit and fewer than 72 trades per year	$8	Clients with 120 trades or more per year and $30,000 or more of assets on deposit; clients with $1 million or more of assets on deposit
Scottrade	$7 (market order without limit)	All clients	$7 (market order without limit)	All clients
TD Waterhouse	$17.95 (market order without limit; up to 2,500 shares)	Clients with fewer than 18 trades per quarter and $250,000 or less of assets on deposit	$9.95	Clients with 30 trades or more in the previous 90 days; clients with $500,000 or more of assets on deposit

Source: Compiled based on materials of each company.

Table 13. Charles Schwab: Securities Account Framework and Commissions

<table>
<tr><td rowspan="2">Number of household trades per quarter</td><td colspan="6">Household deposited asset balance (quarterly average)</td></tr>
<tr><td>$1,000,000 or more</td><td>$100,000 to $999,999</td><td>$50,000 to $99,999</td><td>$25,000 to $49,999</td><td>$10,000 to $24,999</td><td>Less than $10,000</td></tr>
<tr><td>30 or more</td><td rowspan="3">$9.95 per trade</td><td colspan="5"></td></tr>
<tr><td>9 to 29</td><td colspan="5">$12.95 per trade (up to initial 1,000 shares; $0.015 for each additional share beyond 1,000 shares)</td></tr>
<tr><td>0 to 8</td><td colspan="2"></td><td colspan="3">$19.95 per trade (same as above)</td></tr>
<tr><td>Fees</td><td colspan="4">Free</td><td>$30 per quarter</td><td>$45 per quarter</td></tr>
</table>

Source: Charles Schwab, April 20, 2005.

Table 14. Service Categories of Major Brokerages Based on Client Asset Balance

	Asset balance in account				
	$100,000 or less	**$250,000 or less**	**$500,000 or more**	**$1 million or $2 million**	**$10 million or more**
American Express Financial Advisors	Handled by any available representative		Dedicated representative and preferential treatment in terms of interest rates and handling fees		
Smith Barney	Handled by any available representative		Handled at a dedicated center and no handling fees		
Merrill Lynch	Directed to the Financial Consulting Call Center	CMA, etc.			Investment management by trust managers for individuals
Morgan Stanley		Handled by any available representative; the maximum commission is $250 per year		No annual fees (balance of $1 million – $10 million)	
UBS				Handled by any available representative (balance of $2 million or less)	Fund management by a dedicated team
Wachovia		Handled by any available representative	Fund management by a dedicated team available representative	An investment, inheritance and tax consulting team participates (balance of $2 million or more)	

Source: *Wall Street Journal,* February 17, 2005.

the investment goals and risk tolerance designated by the client.

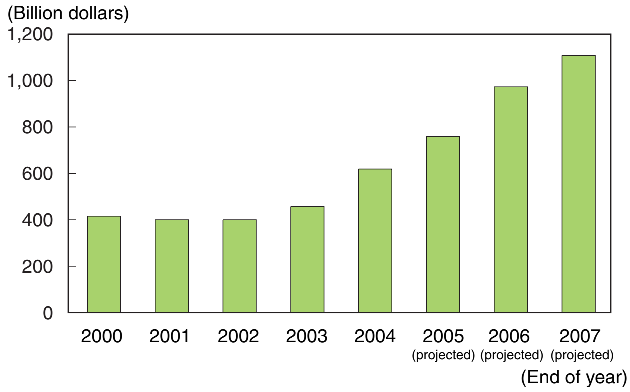
In the United States, only RIAs (registered investment advisors) who have passed Series 66 or Series 65 examinations conducted by the National Association of Securities Dealers (NASD) and are registered with the state authorities and the Securities and Exchange Commission (SEC) pursuant to the "Investment Advisers Act of 1940" (SEC registration is not required for cases where a client's assets in an account do not exceed 25 million dollars), can become investment advisors.

The act stipulates that fixed fees shall be paid to investment advisors as remuneration in accordance with the amount of assets invested, etc. Unlike registered representatives, the act prohibits the receipt of commissions based on the trades of securities. As of the end of 2004, there were about 14,000 RIAs in the United States. Of these, 8,951 were independent advisors who were not employed by securities firms.

A typical example of an SMA as seen at Merrill Lynch is the following: the minimum amount of deposited funds begins with 100,000 dollars (investments in stocks only) or 250,000 dollars (investments in stocks and other securities). The annual fee is 1 – 2 percent of the average balance of the assets in account.

Because an SMA is discretionary account service, investment advisors are required to assume "fiduciary duty" and "responsibility to disclose information" for their clients under the Investment Advisers Act of 1940. The so-called "Prudent Man Rule" that was specified in the Employee Retirement Income Security Act of 1974 (ERISA) serves as the standard of this fiduciary responsibility. This act defines responsibilities of those who engage in management and investment of corporate pensions, etc., and requires them to act with prudence,

Figure 5. Change in Balance of Assets in SMAs (Separately Managed Accounts)



Source: SEI Investments and Cerulli Associates.

discretion, intelligence and regard for the sake of beneficiaries.

Figure 5 shows the balance of assets in SMAs. It is estimated that the balance reached some 600 billion dollars by the end of 2004. The balance is expected to further increase in the future and is projected to exceed 1 trillion dollars by the end of 2007. Recently, chiefly among major brokerages, SMAs and fixed-fee accounts have become popular, and the number of registered representatives who are becoming registered investment advisors has been increasing.

Looking at the situation in each financial institution offering SMAs, we find that major brokerages having their principal offices in New York City account for a 60-percent share or more. The share of bank-affiliated brokerages and discount brokerages offering SMAs is low (Table 15).

Figure 6 shows the amounts of deposited assets in SMAs in each major brokerage. As of the end of March

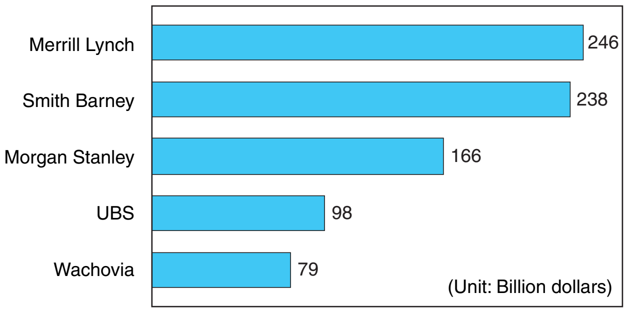
Table 15. Share of Separate Account Assets (End of year)

(Unit: %)

	2000	2001	2002	2003	2004 (estimated)
Wire house	72.4	70.0	67.6	68.3	65.9
Regional brokerage	9.2	10.3	11.4	9.0	8.2
Broker/dealer	8.1	8.2	8.2	8.3	9.1
Third-party vendors	7.1	7.8	8.5	10.0	11.7
Discount brokerages	2.0	2.5	3.1	2.6	2.6
Bank-affiliated brokerages	1.2	1.3	1.3	1.8	2.5
Total balance of managed accounts (billion dollars)	417	400	399	459	619

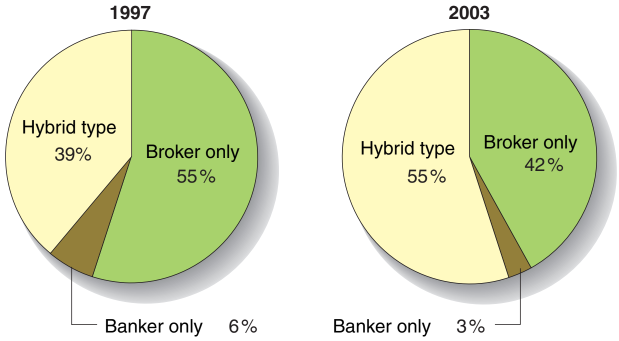
Note: Third-party vendors refer to independent turnkey asset-manager programs (TAMPs).
Source: SEI Investments and Cerulli Associates.

Figure 6. SMA Balance by Broker (End of March 2005)



Source: Complied based on quarterly financial statements issued by each company.

Figure 7. Types of Investment Distribution



Source: "CBA Consumer Investments Study," *ABA Banking Journal,* December 2004.

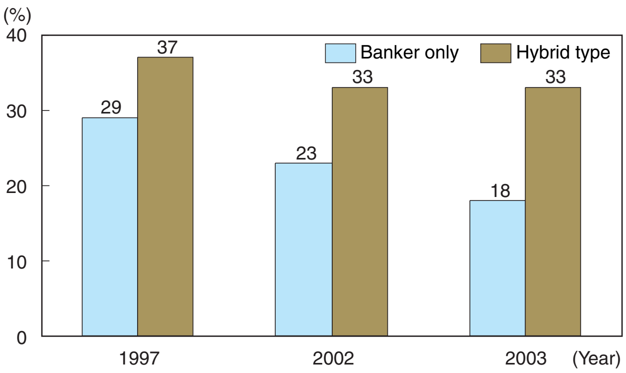
2005, Merrill Lynch ranked first, followed by Smith Barney and Morgan Stanley. While Wachovia Securities, a bank-affiliated brokerage, ranked fifth, the total balance of its deposited assets is about 30 percent of that of Merrill Lynch.

4 Aggressive Moves by Bank-Affiliated Securities Firms and Effective Use of UMAs

In the United States as well as in Japan, banks and bank-affiliated brokerages are providing securities services within bank branches. Under the Gramm-Leach-Bliley Act passed in 1999, each professional bank employee is permitted to acquire the license of a registered representative. Usually, registered representatives working for a bank-affiliated brokerage and bank employees who have been registered as securities sales representatives after passing NASD's Series 7 examination provide securities services.

Figure 7 shows the rate of the composition of the personnel providing securities services at major banks in 1997 and 2003. Around 1997, when securities services started to expand, a strong tendency was seen in which registered representatives of brokerages provided such services. However, in 2003, the general trend shifted to a hybrid-type sales structure in which bank employees having securities sales representative licenses joined this sales force.

Figure 8. Revenue Margin of Bank Inverstment Programs



Source: "Kehrer-Essex Bank Investment Program Benchmarking Study," *ABA Banking Journal,* December 2004.

While approximately 33 percent of the fees received from clients is given to registered representatives as compensation, the rate is about 12 percent in the case of bank employees. Accordingly, as shown in Figure 8, as far as the rate of profit of a bank is concerned, the efficiency of the hybrid-type sales structure is higher by some 15 percent than that of registered representatives.

More than 80 percent of major banks have already been using bank employees who have been registered as securities sales representatives as financial advisors. The total number of such advisors is said to be more than

38,000.[5] In view of the fact that the number of registered investment advisors mentioned above is about 14,000, such bank employees constitute a considerable sales force. However, if compared with the 660,000 registered representatives (as of the end of 2004), this sales force constitutes only slightly more than 5 percent of the total sales force.

While the securities intermediary service system was introduced in April 2004 in Japan and banks were permitted to conduct such agency service to securities companies in December 2004, such services do not exist in the United States. The only securities service that can be provided by bank employees who are not registered as securities sales representatives is "referral."

Under such a sales structure, it appears that SMAs are not novel as providers of asset management services for wealthy clients in many banks that also operate trusts. Table 16 outlines the securities products offered by banks in cooperation with their affiliated brokerages. All major banks provide SMA services.

In addition, because many clients own securities, such as stocks, mutual funds and annuities before they started to invest in SMAs, major brokerages started to offer UMAs (unified managed accounts) in 2000 to jointly manage SMAs and securities trade accounts for single investments. In 2002, Wachovia was the first bank to start offering UMAs.

5 Features of UMAs

There is not much incentive for registered representatives of brokerage firms to direct their clients to SMAs. Shifting assets to SMAs not only makes advice on securities trades unnecessary—a major reason for the existence of registered representatives—but also deprives the representatives of their commissions.

Besides, the registered representatives of brokerage firms who manage securities accounts have the responsibility of monitoring the situation of their clients' assets, and to confirm with clients that appropriate securities investments are made (suitability principle). If much of the clients' assets are shifted to SMAs, concerns might arise that such fundamental management responsibilities cannot be fulfilled.

However, in the case of a UMA, registered representatives of brokerage firms are able to use an SMA on a supplementary basis for the investment areas in which they lack expertise. Further, by doing so, client satisfaction can be increased. As such, a UMA has become the product most suitable for registered representatives of brokerage firms to facilitate responses to the diversified investment needs of baby boomers reaching retirement age.

A major difference from an SMA is the appointment of an OPM (overlay portfolio manager) for a UMA, who supervises registered investment advisors for SMAs and registered representatives responsible for securities investment accounts such as for individual securities, etc. and acts as a comprehensive manager. An OPM plays the four roles listed below.

The first role is to monitor daily transactions through SMAs and securities accounts, and to prevent securities trades that do not profit the client such as wash-trades in which the same securities are traded between accounts within a UMA.

The second role is related to tax savings in terms of the taxation of securities investments. In the United States, profits from selling securities are classified into profits from short-term sales (less than one year of ownership) and long-term sales (one year or more of ownership) according to the period the securities are held. The tax rate for the profits from short-term sales is higher than that from long-term sales. Accordingly, an OPM strives to save taxes by providing guidance to minimize the generation of short-term profits by learning in advance the intention of selling securities from registered investment advisors and registered representatives.

The third role is to provide coordination for securities trades conducted by registered investment advisors through SMAs and for advice provided by registered representatives for securities trades in accordance with the client's investment goals, such as cash flow and price fluctuation risks. The purpose of this role is to ensure that the investment goals of a client are optimally achieved

Table 16. Securities Products of Major Banks

(Unit: Billion dollars)

	Total managed assets	Annuities	Mutual funds	SMAs	UMAs	Mutual funds in foreign currency
JP Morgan Chase	770	Other companies' products	Both	Both	Both	Other companies' products
Mellon Financial	670	Other companies' products	Both	Own company products	–	–
Wachovia	247	Both	Both	Both	Other companies' products	Both
Wells Fargo	183	Both	Both	Both	Other companies' products	Other companies' products
Bank of America	133	Both	Both	Both	–	Other companies' products

Note: UMA = unified managed account.
Source: *American Banker,* January 26, 2005.

by coordinating the decisions of each investment advisor under fluctuating market conditions.

The fourth role concerns risk management. As with the roles of tax savings and coordination among various trades, an OPM monitors trades on a daily basis so that they do not deviate from the risk tolerance level designated by the client based on changing market conditions.

As such, a UMA is designed to become a comprehensive account to support products meeting diversified asset management needs. The emergence and popularization of UMAs that meet the needs of registered representatives who provide advice directly to clients is partly attributable to the smooth increases in the amounts of assets deposited in SMAs since 2003.

6 Changed Revenue Structure of Brokerage Firms

The savings and investment needs of a large number of baby boomers reaching retirement age have become more complicated in accordance with individual income and expenditure situations, rather than simply building up assets. In response to this diversification of savings needs, as so far discussed, it appears that both banks and brokerage firms have changed their securities and/or savings products. Measures established by banks and brokerage firms to cope with decreased revenues include: (1) the consolidation of securities accounts and bank settlement services focusing on the liquidity of assets; (2) securities trade accounts for which fees are based on the balance of assets in account, which facilitates planning fund management costs; (3) advice on diverse methods of asset succession such as inheritance and tax savings; and (4) SMAs and UMAs meeting varied asset management needs.

These changes in retail securities services have altered the impressions of individual clients regarding brokerage firms. The results of a survey conducted by Bain & Company, a consulting firm, in the middle of 2005 endorsed such changes. The survey of individuals aged 55 to 70 and having funds worth at least 100,000 dollars that could be invested revealed that over 95 percent of respondents consult "brokerage firms and independent financial advisors" regarding asset management. Less than 5 percent of respondents selected "banks" to rely on.[6] These responses support our assumption that the retail securities sales activities of brokerage firms and banks have shifted their focus to advice concerning assets by targeting baby boomers.

Table 17 indicates the percentage of assets in accounts for which fees are applied based on the balance of assets with respect to three major brokerage firms and one second-tier brokerage firm (AG Edwards). The larger the firm, the more is the focus placed on securities services pursuing revenues from prescribed fee-based accounts than commissions based on securities trades in securities trade accounts. The share of fee-based accounts has been steadily increasing even after the September 11 terrorist attacks in 2001, which has exerted a major impact on the revenue structure of brokerage firms.

Table 18 shows the rate of turnover of the securities accounts of brokerage firms and the rate of revenues from fee-based accounts as classified by the number of registered representatives. In major brokerage firms with 700 or more registered representatives, the rate of turnover is somewhat low and the rate of revenues from fee-based accounts is high at more than 30 percent. In contrast, in second-tier brokerage firms with 100 to less than 700 registered representatives, the rate of turnover is high and the rate of revenues from fee-based accounts is less than 20 percent, indicating a high dependence on

Table 17. Percentage of Client Assets in Fee-based Accounts

(Unit: %)

	2001	2002	2003	2004
Morgan Stanley	19.0	21.0	23.0	26.0
Smith Barney	21.8	20.7	22.9	24.5
Merrill Lynch	15.5	16.4	17.9	18.9
AG Edwards	N.A.	N.A.	9.1	9.6

Note: Figures for three major brokerage firms are as of the end of each year; figures for AG Edwards represent those at account closing in February (the figure for 2004 is that at the end of February 2005).
Source: Complied based on annual reports issued by each firm.

Table 18. Turnover Rate and Rate of Revenues from Fees Based on the Balances of Assets in Accounts as Classified by the Number of Registered Representatives in 2003

(Unit: %)

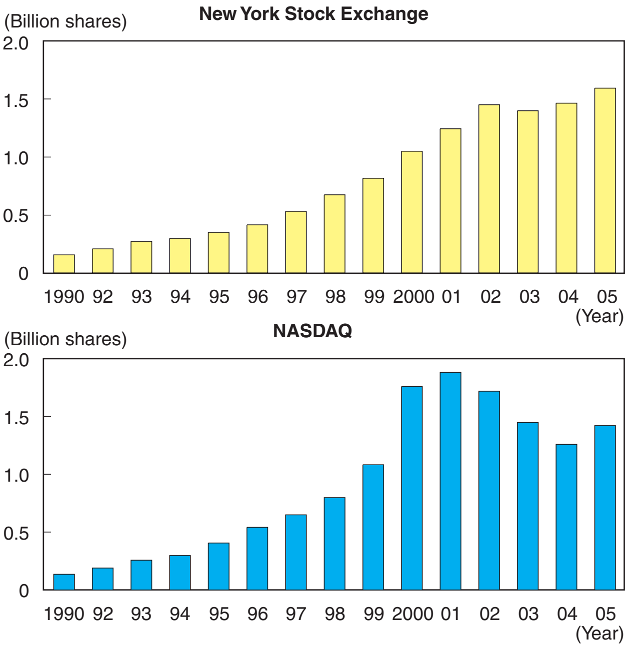
Number of registered representatives (persons)	Rate of turnover	Rate of revenues from balance-based fees
Less than 100	18.8	12.1
100 to 699	29.9	18.7
700 or more	18.1	32.2
Industry average	19.3	31.0

Source: Securities Industry Association.

revenues from commissions on securities trades. At Merrill Lynch, the rate of revenues from fee-based accounts (including fees for mutual funds) to total revenues in the retail field at the time of account closing for 2004 was 49 percent.

Figure 9 indicates the average trading volume per day on the New York Stock Exchange and NASDAQ. Since the collapse of the IT bubble and the September 11 terrorist attacks, the tendency of an increase in trading volume is no longer seen. In particular, NASDAQ, on which many IT-related issues are listed, has been experiencing severe sluggishness.

Figure 9. Average Trading Volume per Day on the New York Stock Exchange and NASDAQ



Source: The New York Stock Exchange and NASDAQ.

Under such stock market conditions, as shown in Figure 10, revenues from the brokerage commissions of securities firms (members of the New York Stock Exchange) have dropped sharply after reaching a peak in 2000. Compared to the peak time, while brokerage commissions dropped sharply by about 7 billion dollars in 2004, revenues from service fees and asset management fees have remained relatively steady, and the fall of such revenues was limited to about 2 billion dollars during the same year. In other words, the ratio of "service fees and asset management fees" to the "total amount of service fees and asset management fees, brokerage commissions and mutual fund sales commissions," which was around 20 percent during the first half of the 1990s, increased to nearly 30 percent in 2004.

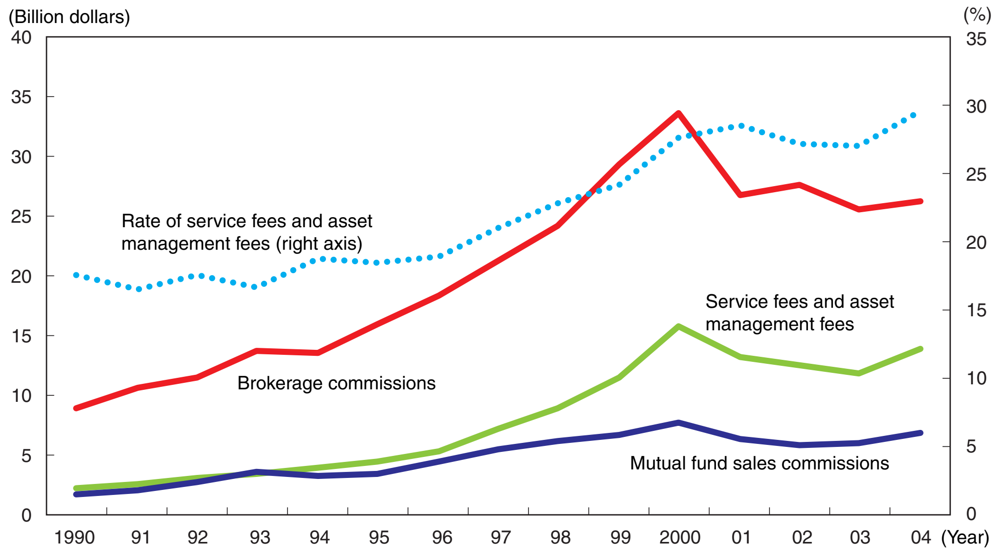
It would be reasonable to consider that these efforts to focus on fee-based account securities account services have resulted in the stable performance of the retail sales operations of major securities firms.

The online securities firms that were discount brokerages in the past have been most severely affected by the low volume in stock trades. Figure 11 shows the revenue sources of Charles Schwab, a major online securities firm. Brokerage commissions that exceeded 40 percent at their peak during the IT bubble dropped to about 20 percent at the account closing for 2004. Compared to 2000, total revenues declined by about 30 percent.

In 2005, Ameritrade Holding Corporation purchased TD Waterhouse from TD Bank Financial Group, and E*trade Financial also acquired Harris Direct from BMO Financial Group. As such, the industrial reorganization has been accelerated against the background of the stock market trading volume remaining low.

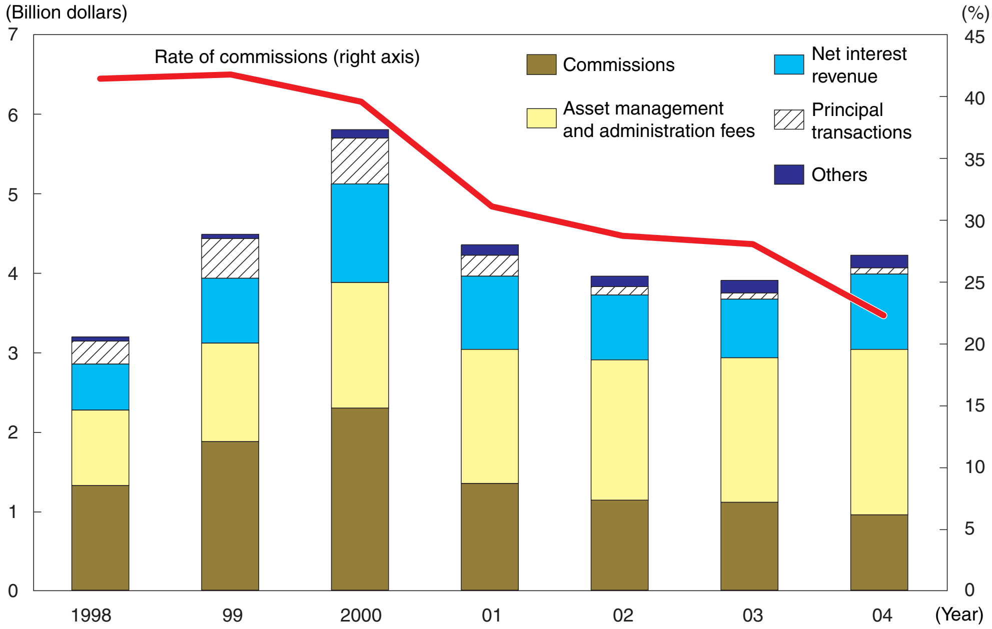
Rather than simply improving the economies of scale, the enhancement of office and advisor networks has been cited as the primary reason in both of these mergers for the

Figure 10. Change in Structure of Revenues from Brokerage Commissions in Securities Firms



Notes: (1) Total figures of NYSE member securities firms. (2) Rate of service fees and asset management fees = Service fees and asset management fees / ("brokerage commissions + service fees" and "asset management fees + mutual fund sales commissions").
Source: Securities Industry Association.

Figure 11. Change in Revenue Sources of Charles Schwab



Source: Annual report issued by Charles Schwab.

purpose of meeting diversified asset management needs, in particular, responding to changes in asset management needs involving the retirement of baby boomers. For example, in the case of Ameritrade, the sales force before the merger consisted of 4 offices and 1,400 advisors. After the merger, the sales force of TD Ameritrade sharply increased to 143 offices and 2,600 advisors. In terms of the number of offices alone, TD Ameritrade is closing in on Charles Schwab, which ranks first in the industry with 282 offices (at the end of 2004).

Amid such a storm of reorganization within the online securities industry, Charles Schwab inaugurated its “Talk to Chuck (nickname for Charles)” campaign on September 29, 2005.[7] During this campaign, no-fee consultation is offered on stock and mutual fund investments by registered representatives in company offices and through call centers.

Furthermore, starting on October 1, 2005, 30 dollars per every three months that were charged as an account management fee for accounts with assets in accounts totaling 10,000 dollars or more and less than 25,000 dollars, as shown in Table 13, have no longer been required. In addition, the account management fee has been waived with respect to accounts with more than eight trades annually regardless of the amount of assets in the account. The competition in fee reduction in the online securities industry that is betting on the survival of a company appears to be entering its final phase.

The accelerated trend towards an aging society and the rise in asset management needs that shifted from an increase in assets to the utilization and maintenance of assets are expected to further promote the popularization of fee-based securities accounts and discretionary investment accounts such as SMAs and UMAs. At the same time, these trends are likely to facilitate the makeover of registered representatives who were merely securities traders into financial advisors.

These changes in securities services are likely to shift the securities industry, where currently discount brokerages and securities firms with varying sizes exist, into an industry chiefly consisting of the provision of financial advisory services, although how much time is required for this shift cannot be projected.

Notes

(1) *Wall Street Journal*, May 5, 2005.
(2) *Registered Representative*, January 2005.
(3) “Merrill Lynch & Co. Inc. News,” January 8, 2003.
(4) *Registered Representative*, May 2004.
(5) “Banks rethink sales structures,” *ABA Banking Journal*, December 2004.
(6) “Why Banks Are Missing the Retirement Boom,” *ABA Banking Journal*, August 2005.
(7) *Wall Street Journal*, September 29, 2005.

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1. Federal Reserve Board, “Recent Changes in U.S. Family Finance: Evidence from the 1998 and 2001 Survey of Consumer Finances.”
2. “Equity Ownership in America, 2002,” Investment Company Institute and the Securities Industry Association.
3. George R. Monahan, “Online Trading Goes Offline,” *SIA Research Report*, October 25, 2002.

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