Developments In The Corporate Pension Business Of The Japanese Asset Management Industry

~ Facing A Period of Dramatic Change ~

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Japan's asset management industry is going through a period of dramatic change prompted by reform of Japan's corporate pension system. This report will examine the issue of corporate pension funds from a broad perspective by touching upon such topics as the introduction of a defined contribution pension system, the advent of master trust services and the discussions on the need for a comprehensive corporate pension law.

1. The Changing Face of Corporate Pension Business in Japan

The asset management industry in Japan is going through an unprecedented shake-up as a series of corporate pension system reforms are introduced. Figure 1 gives a brief overview of the various issues facing the asset management industry in Japan in conducting corporate pension business, with the introduction of defined contribution pension schemes the key change about to occur. This represents a major change to the existing pensions system that limits companies to having only a defined benefit plan. The addition of defined contribution schemes will present the asset management industry with a golden opportunity to offer new services and investment products.

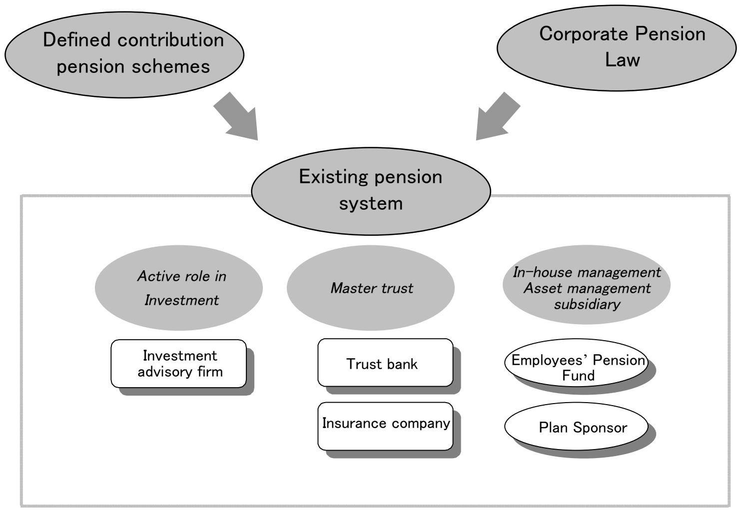
At the same time a succession of major changes are being made to the existing defined benefit system. Originally Japan's pension laws prescribed exactly "how" and "by whom" pension fund assets could be managed: only trust banks and life insurance companies were eligible as money managers, and the 5:3:3:2 rule of asset allocation determined the relative mix of assets they could hold. However, as these regulations were gradually swept away in the 1990s, an environment was established where the various financial institutions allowed to offer asset management services (trust banks, insurance companies and investment advisory firms) competed with each other. Further, the most important recent change to defined benefit plans is the movement towards introduction of master trust services and the changes this will bring about to the asset administration of corporate pension funds.

The need for a Japanese equivalent to the Employment Retirement Income Security Act (ERISA), comprehensive legislation covering the operation of private pension schemes in the US, is considered to be at the center of efforts to reform Japan's corporate pension system. At the heart of this legislative reform is the question of fiduciary responsibility, an issue which has already provoked a great deal of debate.

This report will discuss such recent developments in Japan's asset management industry with the aim of painting a broad overview of the current situation while pointing to further resources that provide a more detailed examination of specific issues. The basic structure of Japan's existing pension schemes, toward which the current reform efforts are targeted, is outlined in Figure 2.

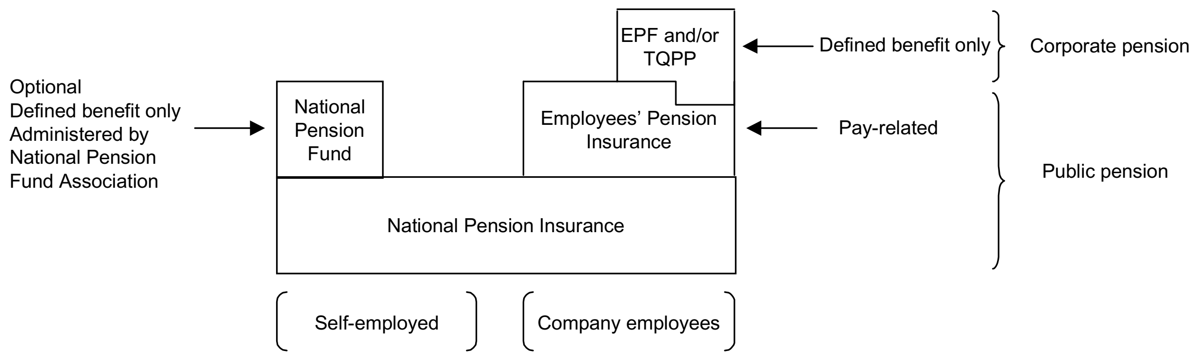
This report will also draw many comparisons with the corporate pension system in the US. Our view is that many of the changes experienced by the US in the 1970s are about to be repeated in Japan, though Japan is having to fit in to the next few years what it took the US over two decades to achieve.

Figure 1 Overview of Current Developments Concerning The Asset Management Industry and Corporate Pension Management in Japan



Source: Nomura Research Institute

Figure 2 Basic Structure of Japan's Existing Pension Schemes



Note: EPF=Employees' Pension Fund, TQPP= Tax Qualified Pension Plan
Source: NRI

2. Introduction of Defined Contribution Pension Schemes

1) Timetable

After several years contemplating the establishment of a framework for defined contribution pension schemes, Japan's ruling Liberal Democratic Party finally formulated a proposal in December 1999 which outlined the special tax treatment that such schemes would receive. The Defined Contribution Pension Bill was subsequently put before the Diet in March 2000, timetabled for passing during the regular session and enactment in January 2001. However the resignation of the Obuchi cabinet in April 2000 and its replacement by the Mori administration, followed by the June 2000 lower-house election, resulted in the adjournment of the session before the bill had a chance to be debated.

A narrow LDP election victory resulted in the second Mori cabinet taking up its position in July, and if all goes as planned the bill will be resubmitted and debated in the autumn extraordinary Diet session. If the bill is passed in the session then the related government ordinances would be adopted by end 2000 and the law should be in place on schedule in January 2001.[1]

2) Defined contribution pension system tax incentives

This section will introduce those tax incentives envisaged in the draft legislation and highlight surrounding issues.

(1) Tax on contributions

The new system envisages two types of defined contribution pension funds: "corporate type" schemes set up and paid into by an employer, and "individual type" schemes set up under the auspices of the National Pension Fund Association and paid into by the participants themselves. Table 1 details the various tax incentives available at the contribution stage for employees of companies that have an existing corporate pension scheme (Employees' Pension Funds and Tax-Qualified Pension Plans), employees at companies without such schemes and for the self-employed.

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1 The Japanese press has pointed to the possibility that debate of the defined contribution scheme bill in the extraordinary session may be delayed until the ordinary session starting in January 2001 (*Nihon Keizai Shimbun*, 8 June 2000).

Table 1 Tax Deductible Amounts For Defined Contribution Pension Plans According To The Draft Bill

With existing corporate pension plan
– Can set up "corporate type" scheme where employer contributes
– Upper limit on per-employee contributions of ¥216,000 / year
– Employee may not make additional contributions
No existing corporate pension plan
– Can set up "corporate type" scheme where employer contributes
– Upper limit on per-employee contributions of ¥432,000 / year
– Employee may not make additional contributions if company pays contributions
– Where company does not pay contributions (no defined contribution pension scheme to be set up), employee may participate in an "individual type" scheme. In which case the upper limit on contributions is ¥180,000 / year
Self-employed
– Can participate in an "individual type" scheme. Upper limit on contributions of ¥816,000 to include National Pension Fund contribution.

Source: NRI

Employees of firms with existing corporate pension schemes and choosing to initiate corporate type defined contribution plans would become participants. (Basically all employees will be covered, unlike the US 401(k) plans where the employee can decide whether to join or not.) Companies would pay the contributions with an upper limit on contributions per-employee of ¥216,000 per year which is tax deductible. For companies that do not introduce defined contribution schemes, employees may not become members of an individual-type scheme, and would continue to be members of the existing defined benefit scheme only.

Employees of companies without existing pension schemes would become members of a company-type scheme if the company were to set one up. The difference with companies with existing pension schemes is in the upper limit on contributions of ¥432,000. In this case if the company decides not to set up a corporate-type scheme, individual employees may join an individual scheme, in which case the upper limit on contributions is ¥180,000 per year.

Finally, the self-employed may enter into individual-type schemes on the condition that they are paying National Insurance. If a self-employed individual has also joined the National Pension Fund, then the combined (National Pension Fund plus individual scheme) upper-limit on contributions that may be deducted from annual income is then ¥816,000.

In the US, defined contribution schemes contributed to by employers had existed for a considerable time prior to the passing of the ERISA in 1974, which introduced IRAs (Individual Retirement Accounts) for self-employed persons and employees of companies without pension schemes. The retirement system was further modified by the introduction of Internal Revenue Code (IRC) section 401(k) in 1978 which explicitly allowed employee's contributions to defined contribution plans to be tax deductible. With corporate-type defined contribution schemes, Japan, in terms of the evolution of US pension system, would be equivalent to the state the US was at pre-1978 when companies were the sole contributors with tax incentives, while individual-type schemes approximate to the IRA system introduced in 1974. In other words, if Japan goes ahead with the current defined contribution schemes it will have a system similar to the US in the latter 1970s, when the IRA had been introduced but before employee contributions were tax-deductible.

(2) Tax on investments – 1.173% tax still to apply

While pension fund investment in Japan does receive tax incentives, its beneficial treatment is not complete. The investment of Employees' Pension Funds are in substance completely tax-deductible, but Tax Qualified Pension Plans are subject to a taxation of 1.173% of asset value. There have been strong demands for this tax to be abolished, though this has not been included as part of the legislation for defined contribution schemes. Accordingly, defined contribution plans will be subject to the same 1.173% taxation on outstanding asset balance as per Tax Qualified Pension Plans.

In the past, participants in defined benefit pension plans have rarely, if ever, been aware of this tax levied on their investments. With defined contribution plans, however, this tax will become much more visible as the plans are handled on an individual account basis. The 1.173% tax has been frozen for FY99 and FY2000 but the freeze could be lifted in the future.

The issue of this 1.173% taxation on pension assets remains as a problem that needs to be resolved for the benefit of the Japanese retirement system as a whole.

3) Corporations prepare ahead of the introduction of defined contribution pension scheme

Here we will review some of the reactions of Japanese companies to the imminent arrival of the defined contribution pension system as reported in the Japanese press.

The reaction among large corporations is reported to be rather muted due to the tax breaks offered not being up to expectations[2], coupled with uncertainty over the timing of the legislation. Ricoh and Hitachi have announced plans to work towards adopting defined contribution pension schemes, while Tanabe Seiyaku, Kao and others are reported to be "considering" a move (Table 2).

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2 The tax incentives were reported as being more limited for companies with existing pension schemes, which tend to be found in larger companies. An added problem, according to the *Nikkei Kinyu Shimbun*, is that when companies transfer from existing defined benefit schemes to the new defined contribution schemes, given the upper limit on contributions to the plan it would be difficult for them to offer similar retirement benefit levels.

Table 2 Initiatives taken by Japanese corporates to date to set up defined contribution pension schemes

Planning a defined contribution pension scheme	
Ricoh	- Plans to abolish current lump-sum program in April 2001, and employees will be able to choose either pre-payment of the lump-sum as an addition to their salary or participation in the defined contribution pension plan. - Only the lump-sum portion will be transferred. - Employees will be offered three pension payments methods: Employees' Pension Fund (defined benefit), defined contribution and pre-payment of the lump-sum retirement allowance (Nihon Keizai Shimbun, 7 April 2000)
Hitachi	- Plans to implement changes as soon as the new legislation is in place. The entire workforce of 60,000 will have a portion of their lump-sum payment transferred to a defined contribution pension scheme which will coexist with a defined benefit scheme. During the time the employee remains at the company, the company will pay a regular amount each month into a defined contribution pension individual account. - Discussions will be held with workers unions as soon as the bill is passed and details of the system have been clarified (*Asahi Shimbun*, 23 May 2000). - Discussions with workers unions cannot be started if timing of the bill's passing becomes uncertain (*Nihon Keizai Shimbun*, 8 June 2000)
Considering	
Tanabe Seiyaku	- Given the current more liquid labour market , Tanabe has recognized the need to be offering more than the traditional pension benefits in order to attract and keep quality staff. - Considering both pre-payment of retirement lump-sum and a defined contribution pension scheme. Wants to make decision in around 2 years time. (Nihon Keizai Shimbun, 28 December 1999)
Kao	- Considering modifying the retirement benefit package and adopting defined contribution pension scheme in some form or other (Nihon Sangyo Shimbun, 5 August 1999) - No longer able to decide on timing of changes if timing of the bill's passing becomes uncertain (Nihon Keizai Shimbun, 8 June 2000)
Sumitomo Corp.	- Considering introduction of defined contribution pension scheme sometime in future. This will give fairer treatment to employees changing jobs in mid-career, as we expect to see greater worker mobility in the industry. Does not wish to shift entire investment risk on to employees at once so the defined contribution scheme will only be a part of the entire retirement benefit package (Nihon Keizai Shimbun, 15 December 1999) - Will have to postpone consideration if timing of the bill's passing becomes uncertain (Nihon Keizai Shimbun, 8 June 2000)
Considered but decided against	
Welfide	- Labor and management reached agreement in 1999 on general terms for replacing Employees' Pension Fund and Tax Qualified Plan with a defined contribution pension scheme. - Judged there was little merit in making the transition owing to the upper limit on defined contributions for corporate type schemes in the bill presented to the Diet being too low. (*Nihon Kinyu Shimbun, 24 March 2000)*
Pre-payment of Retirement Lump Sum	
Matsushita Electric	- Optional scheme of lump-sum pre-payment introduced in April 1998 for new employees. 40% opted for the pre-payment. - Drew attention for being front-runner among major Japanese corporations.
Rockfield	- Major ready-made meals company, abolished lump-sum retirement payment system and shifted to pre-payment system in July 1999. - Drew attention for applying the scheme to its entire workforce as opposed to its being optional.

Friendly	- Mid-size family restaurant operator, introduced optional pre-payment system in FY00 to 01. - At first management only will be eligible, then gradually to expand scheme throughout company ranks.

Source: NRI, from newspaper sources Nihon Keizai Shimbun, Nikkei Kinyu Shimbun, Nikkei Sangyo Shimbun, Asahi Shimbun

The issue of pre-payment of a retirement lump-sum does not strictly speaking fall within the subject of pension schemes, but it is worth dealing with here. Retirement lump-sums are usually paid when an employee leaves the company, but pre-payment of these allowances entails payment while still in employment as an extra to monthly salary or bonuses. Matsushita Electric introduced a scheme in April 1998 whereby its new employees could choose whether to receive their lump-sum in pre-paid form or on retirement, which drew much attention for being relatively forward-thinking for a large Japanese corporation. Rockfield, a major Japanese producer of ready-made meals, also made waves by introducing a compulsory pre-paid scheme in July 1999. Other companies are also reported to be introducing pre-payment schemes or are considering.

Retirement lump-sum pre-payment and defined contribution pension schemes are in fact quite similar. The lump-sum pre-payments are without any tax incentives. But if the pre-payment is paid into a special individual account instead of as a cash salary, and under the restriction that the money cannot be withdrawn until the employee retires and the company deducts contributions which are not regarded as an employee's taxable income, then it is in effect the same as a defined contribution pension plan. The introduction of pre-payments indicates that Japanese corporations have started to overhaul their retirement benefit schemes.

4) Planned services to be offered by financial institutions

Japan's financial institutions have been actively preparing for the introduction of defined contribution pension schemes in an attempt to position themselves to advantage in the market for attracting clients. Table 3 outlines the main initiatives reported in the Japanese news media as being taken in the three categories of record-keeping, investment products and consulting.

Table 3 Financial institution moves ahead of defined contribution pension system introduction

Investment products	Company consultation, employee education
Nomura Securities To set up Nomura Fund Research & Technology jointly with Nomura Research Institute to offer "fund of funds." Mizuho Financial Joint plan to establish pension sales company from IBJ, Dia-ichi Kangyo and Fuji banks. The company will support companies introducing pension schemes by offering planning and employee education services, in addition to which they will sell their own packaged investment products. Nippon Life To sell “lifecycle funds” through its investment subsidiary Nissay Asset Management. Special accounts to be transferred to Nissay Asset Management which will expand workforce and assets under management. To market GIC (Guaranteed Investment Contract) type insurance products to group pension schemes. In terms of defined contribution pension schemes, GIC-type products will rival bank deposits as stable value products. Mitsui Sumitomo Plans establishment of Japan Pension Navigator to offer investment product, employee education and plan sponsor consultation. Softbank Plans establishment of Softbank Asset Management offering fund of funds and other products to defined contribution pension funds.	Nomura-IBJ Investment Services (NIIS) Consulting and employee education services for companies introducing defined contribution pension schemes. Japan Pension Planning Joint venture of Sanwa Bank, Daido Mutual Life and Toyo Trust. Consulting service for firms introducing defined contribution pension schemes. Yasuda Kasai Cigna Securities Benefit plan consulting, offering investment products. Sumitomo Trust Online / email-based investment education for employees of companies introducing defined contribution pension schemes Fujitsu Planned September launch of Internet based defined contribution pension scheme education system targeting financial institutions and companies introducing defined contribution pension schemes Pasona Plans Internet site offering defined contribution pension scheme calculation tools run jointly with JustSystem **Recordkeeping systems** Japan Investor Solutions and Technology (JIS&T) Nippon Record Keeping System (NRK System)

Source: NRI, from the Nihon Keizai Shimbun and Nikkei Kinyu Shimbun

A Recordkeeping service involves account management on an individual participant level, and is unique to defined contribution type schemes. In summer 1999 two companies, one established by a group of firms headed by Nomura Securities and IBJ (Japan Investor Solutions & Technologies, JIS&T), the other by firms headed by Bank of Tokyo Mitsubishi and Sumitomo Bank (Nippon Record Keeping Systems, NRK System), launched as providers of recordkeeping services. With both of these companies joint-ventures between a large number of financial institutions, they have more the flavor of “public infrastructure” providers, in contrast to the US where rival individual financial institutions and recordkeepers compete with one another.

In terms of the investment products being offered, a number of companies are marketing themselves as offering services tailored for defined contribution pension schemes. In order to provide these services many institutions have moved quickly to either set up new companies, or used the opportunity to reorganize the way they offer asset management services.

With defined contribution pension plans the employee issues directions as to how their account assets should be invested, thus presenting a challenge to financial institutions to design investment products for those plans. In Japan still over half of personal financial assets are held in the form of bank deposits, and the average Japanese worker is far less familiar with financial investment than in the US. Thus financial institutions need to develop products that constitute a viable alternative to such over-conservative investing practices, and at the same time are appropriate given the age and experience of the employee. As shown in Table 3, this has lead to the offering of "life cycle funds"[3] and products modeled on the GICs (Guaranteed Investment Contracts) found in the US.

Consultant businesses are already in operation that advise companies on setting up defined contribution pension schemes and provide the subsequent education of their workforce. There are also many initiatives to use the Internet for employee education. While in the US 401(k) internet-based services are only the latest trend in the twenty-year history of 401(k) plans, Japan's workers should be able to benefit from the use of this information technology as soon as the new schemes are set up.

3. Fast-Paced Reform Also Underway in Defined Benefit Pension Schemes

Here we will turn to examining developments in the asset management industry where the ongoing schedule of deregulation will have an impact on traditional defined benefit pensions: particularly the introduction of master trusts, the deregulation of in-house management and the establishment of asset management subsidiaries.

1) The Introduction Of Master Trusts[4]

(1) History of master trusts in the US and the current state of pension management in Japan

Master trusts are pension fund management and administration schemes developed in the US. The existence of master trusts is now indispensable to the US pension industry. However, pension fund administration has not always been carried out as now in the US. In the 1960s, for example, money managers also acted as custodians. In the 1970s the ERISA obliged funds to diversify their investments which prompted funds to hire a larger number of managers, while the higher standard of information disclosure required meant the funds had a greater need for unified management of their information. This in turn brought about the creation and spread of master-trusts.

Currently in Japan, pension fund managers such as trust banks and life insurance companies take care of both investment and administration sides. Accordingly if an Employees' Pension Fund hires three money managers, its assets would be administered by three institutions, as was the case in the US in the 1960s. Recently however this system has

3 Life cycle funds are packaged financial products targeted separately at people in their age groups such as 30s, 40s or 50s, composed of a number of investment trusts products where individuals choose an appropriate product for their age group. US 401(k) plans also offer life cycle funds to participants with either not much experience or little interest in investment issues.

4 For further information readers should refer to E. Katayama "New Developments in Institutional Services in Japan," (Capital Research Journal, Spring 2000).

been showing signs of stress as deregulation gives rise to more and more asset management companies specializing in a certain style or asset class offering services to Employees' Pension Funds. It would perhaps be safe to say that Japan is currently where the US was in the 1970s.

(2) The appearance of "master trust banks"

Prompted by a report on asset management deregulation published in November 1998 by the Employees' Pension Fund Association that took up the issue of master trusts, market interest in these schemes has increased considerably. Now little over a year since this report came out a succession of financial institutions have announced plans to set up "master trust banks."

In November 1999 an announcement by Daiwa Bank and Sumitomo Trust & Banking that they were to set up a joint-venture "Japan Trustee Services Bank" was quickly followed by an announcement by Mitsubishi Trust and Nippon Life that they were to set up the "Master Trust Bank of Japan" in concert with Toyo Trust & Banking, Meiji Life and Deutsche Bank. Then in May 2000 the Mizuho Financial Group consisting of the Industrial Bank of Japan, Dai-ichi Kangyo Bank and Fuji Bank announced they were to ally with Dai-ichi Life, Asahi Life and other insurers in the provision of master-trust services (Table 4).

Table 4 New Master-Trust Banks In Japan

Japan Trustee Services Bank
Equity Investors – Daiwa Bank, Sumitomo Trust & Banking, 50% each Services – Asset administration services for assets entrusted by the clients of each bank (securities administration for commingled accounts and separately managed accounts for pension funds, and investment trusts) – Custody services, management of principal and coupon payments etc. – Master trust services * Scheduled to start operations in October 2000
Master Trust Bank of Japan
Equity investors – Mitsubishi Trust & Banking (43.5%), Nippon Life (33.5%), Toyo Trust & Banking (10.0%), Meiji Life Insurance (10.0%), Deutsche Bank AG (3%) Services (1) Master trust services – Custody, settlement and accounts reporting for assets under management – Efficient management of assets (securities lending, cash management etc.) – Value-added data service provision (performance evaluation, risk management etc.) (2) Asset administration – Administration of life insurers' custodian assets – Asset administration for defined contribution assets for clients of the life insurer shareholders * Started operations on 9 May 2000
Mizuho Financial Group
Joint provision of asset management services by the Mizuho Financial Group members plus 4 life insurers (Asahi, Dai-ichi, Fukoku and Yasuda) Services – Master trusts – Securities administration

Source: NRI, from press releases, etc.

The enactment of the Pension Reform Bill in March 2000, with related government ordinances issued in June, established the legal and regulatory background for master trust services. This abolished the requirement whereby trust fund investments had to be mandated in cash and liquidated into cash for payments, and instead allowed pension asset transfer in the form of securities. It allowed money managers to re-consign their pension asset administration contracts thus enabling centralized asset administration services of master trusts.

The above changes and reforms were particularly of note due to the speed with which they were implemented, coming merely one year after master trusts initially attracted interest in Japan towards the end of 1998.

A further notable feature is that Japan’s major trust banks and life insurers have moved quickly to form mega-alliances to provide master-trust services. In the US many banks started to offer these services separately, after which the market went through a period of consolidation as major players bought out weaker rivals. In our view, the alliance strategies of Japan’s banks show they have learnt from this example. Today’s level of market concentration in the US, achieved through a 20-year ongoing process of weeding out the weaker competitors, has been achieved in a remarkably short space of time in Japan.

Moreover, these reforms now open the way to functional specialization in either asset management or asset administration where before trust banks and life insurers offered as a single integrated service. Both the Japan Trustee Services Bank and Master Trust Bank of Japan will be specializing in asset administration and not offer any investment services. The establishment of these new master trust operations represents a significant step towards the unbundling of financial services in the history of the Japanese financial market.

(3) Pressure to implement securities settlement reform[5]

It is important to also note the issue of Japan's securities settlement reform when we discuss issues in pension management. Already preparations are being made in Japan to move from T+3 (settlement in 3 business days following the trade-date) to T+1. As an urgent issue facing trust banks in particular, presumably this is one motivating factor behind the establishment of the new master trust banks.

Following a report by a committee of the ruling Liberal Democratic Party in August 1999 regarding the move to T+1, concrete steps were taken to examine the issue by the Japan Securities Dealers Association's settlement system reform discussion group and the Ministry of Finance’s working group. These groups’ objective was a move to T+1 sometime during fiscal 2002. A June 2000 report by the Financial System Council’s working group currently forms the basis of government plans to create the legislative infrastructure to support T+1.

The urgent need for settlement system reform in Japan has been provoked by the global trend towards shorter settlement cycles. The US is targeting June 2004 for achieving T+1 settlement, with the Securities Industry Association leading this effort.

5 For further information see “Developments Regarding the Move to T+1 Securities Settlement in the US" by Sanae Mori, Capital Market Quarterly Winter 2000.

T+1 settlement therefore is an issue that Japan's trust banks have no option but to confront. The level of IT investment required to carry this out however may well run into the hundreds of millions of yen, a figure that could easily rise ten-fold if the conversion of global custody operations are also to be taken into account. The trust banks have to decide whether to shoulder this investment burden themselves, or whether to outsource. Quite possibly the issue of settlement system reform is even more pressing for Japan's trust banks than the question of master trust services.

2) Increasing use of in-house management and establishment of asset management subsidiaries[6]

Until recently the in-house management of pension funds in Japan has been limited to funds with assets of ¥50 billion or more, with investment targets limited to deposits and a small number of fixed income instruments such as government bonds. This has resulted in no Employees' Pension Funds other than the Employee's Pension Fund Association carrying out in-house management. With the passing of the Pension Reform Law in March 2000 and subsequent government ordinances in June however, the ¥50 billion rule was scrapped and rules regarding the establishment of in-house management operations were clarified. On meeting those requirements the range of permitted investment activities were increased considerably to cover securities trading in government bonds, municipal bonds, CP, foreign bonds, investment in equity indexes etc. We are eager to see whether this relaxation of regulations will cause larger funds to transfer their investment operations in-house.

In August 1999 Hitachi established Hitachi Investment Management, as offering pension fund management services to Hitachi Group companies. This marked the advent of an asset management subsidiary established by a plan sponsor. It is possible that some large companies will follow Hitachi's lead.

4. Towards A Corporate Pension Law[7]

One further important topic regarding Japan's pension fund system is that of a corporate pension law, what could be termed Japan's equivalent to the US ERISA. The framing of such legislation means the establishment of rules by which the asset management industry must conduct corporate pension business, and thus is of vital importance for the industry. Among major debate issues surrounding the introduction of corporate pension legislation are fiduciary responsibility, and whether Japan requires a benefit guarantee system.

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6 For further discussion see "In-house Management and Asset Management Subsidiaries in the US" by Masahiko Igata and Eiji Katayama, Capital Market Quarterly Summer 2000.

7 For further discussion, see "The Fiduciary Responsibility Guidelines For Asset Management Companies~ Deliberations and Findings of the Fiduciary Responsibility Working Group ~" by Motomi Hashimoto, Capital Research Journal Fall 2000.

1) The Growing Importance Of Fiduciary Responsibility

With the deregulation of the pension asset management since the early 1990s, the issue of fiduciary responsibility is now emerging as a major concern among those involved in the fund management business. Here we will outline the background to this issue in Japan.

Firstly, in Japan there is no equivalent to the comprehensive fiduciary responsibility regulations contained in the ERISA, which serve as the basis for all activities relating to the management of corporate pensions in the US. In Japan governing legislation is fractured, with trust banks and investment advisory firms for instance operating under completely separate industry legislation with different definitions of fiduciary responsibility, while for the general accounts of life insurance companies there are no such regulations at all.

Despite the absence of an ERISA type law, Japan has made some efforts as regards delineating fiduciary responsibility for the Employees' Pension Fund. In April 1997 the Ministry of Health & Welfare published guidelines concerning fiduciary responsibility in the operation of the Employees' Pension Fund. The Employees' Pension Fund Association then made it more understandable by publishing a fiduciary responsibility handbook for fund directors in March 1998 consisting of sets of examples based on the government's guidelines. The Association followed this with another handbook in April 2000 detailing the fiduciary responsibilities of money managers, which it is hoped, despite not being legally enforceable, will be followed by the asset management community insofar as it represents the first comprehensive setting out of concrete rules of conduct and policies regarding fiduciary responsibility covering all financial institutions engaged in asset management activities for Employees' Pension Funds.

In actual fact the Defined Contribution Pension Bill obliges employers, Plan Administrators and Asset Administrators to act in good faith, and contains regulations regarding due diligence that approximate to the "prudent person rule" of the ERISA (Table 5). For this reason the Bill is seen by some as a precursor to a corporate pension law.

If this bill is enacted, the fiduciary responsibility regulations will apply across the board to all financial institutions acting as Plan Administrators and Asset Administrators for defined contribution pension plans. Though it applies only to these plans, its comprehensiveness represents a major step forward. Further, financial institutions involved in defined contribution pension schemes will be obliged to pay due attention to conflict of interest issues.

Table 5 Fiduciary Responsibility As Envisaged In The Defined Contribution Pension Plan Bill

Employer's Code of Conduct (Article 43) Employers must comply with the relevant laws and ordinances, Health & Welfare and Labor Ministry dispositions and corporate type pension rules that are based on those laws and ordinances, and act in good faith in the interests of the participants in their corporate type pension plans (omitted) 3 Employers may not: – Conclude contracts consigning Plan Administration or Asset Administration with the aim of benefiting themselves or third parties who are not participants of the company's corporate type plans (omitted) 4 Employers (where asset management operations are conducted by themselves) may not: – Pursue an investment policy with the aim of benefiting themselves or third parties who are not participants in the company's corporate type plans

Asset Administrator's Code of Conduct (Article 44)
Asset administrators must comply with the relevant laws and ordinances and the asset administration contract, and act in good faith in the interests of the participants to the corporate type scheme
Pension Administrators (Article 99)
Pension Administrators must comply with the relevant laws and ordinances, competent Ministry dispositions and pension administration contracts based on those laws and ordinances, and act in good faith in the interests of the plan participants
Investment strategy and disclosure (Article 23)
In selecting investment policies to be followed, Pension Administrators engaged in pension management of corporate type plan assets must base these investment decisions on professional market expertise

Source: NRI, from Defined Contribution Bill as introduced

2) Debate regarding the benefit guarantee system

Anticipating that whether to establish a Japanese version of the US benefit guarantee system would become a contentious issue, the *Keidanren* (Japan Federation of Economic Organizations) industry association has already outlined its objections to such a system as regards corporate pension funds (Table 6).

Table 6 Japanese Industry's Objections To a Benefit Guarantee System

Why Japan does not need a benefit guarantee system
It is argued by some that corporate pension plans should be obliged to subscribe to a benefit guarantee system in order to secure benefit rights for plan members. However even in the case of the current voluntary guarantee system run by the Employees' Pension Fund Association, the amount subject to guarantee is limited to the additional benefit portion and capped at a certain amount, while in the case of Tax Qualified Pension Plans there is no existing benefit guarantee system. Corporate pensions are basically private pensions, and in our view it is vital that they be based wholly on the principle of self-responsibility. If a benefit guarantee system is made obligatory then problems such as moral hazard and the unreasonable income transfer between companies will undoubtedly arise. Accordingly, we believe that a benefit guarantee system is unnecessary. Instead of such a system in our opinion the company running the pension scheme should be obliged to make best efforts to maintain the soundness of the pension plan and be thorough in its disclosure of information pertaining to the plan to both employees and investors.

Source: Japan Federation of Economic Organizations (Keidanren) "Seeking a Fundamental Reform of the Corporate Pension System ~ To Provide Freedom of Life Planning and Comfortable Post-Retirement Life," December 1997)

It has been reported in the Japanese press that as of June 2000 the Ministry of Health & Welfare was not planning to include a benefit guarantee system in the pension bill to be submitted at the 2001 Diet ordinary session[8], and so how this issue is to be handled from now on has become somewhat uncertain. However the PBGC (Pension Benefit Guarantee Corporation) established in the US by the 1974 ERISA is a prior example that Japan should look to. The experience of the PBGC that Japan should learn from includes (1) establishment of strict criteria for plan termination and benefit guarantees, (2) collection of a

8 Nihon Keizai Shimbun, 4 June 2000

variable premium from companies in proportion to the amount of their underfunding, and (3) activities to prevent plan termination. In our view, Japan's government should examine carefully the advantages and disadvantages of such a system.

5. Year 2000 Japan and 1970s US

This report has given a broad-based overview of the pension asset management business in Japan, and what is immediately striking is that Japan's current state has many overlaps with that of the US in the 1970s. Table 7 compares the state of Japan now and the US in the 1970s, showing that the issues Japan is currently facing (introduction of defined contribution pension schemes, advent of master trust services, the framing of a pension law) have almost direct parallels with those the US confronted in the 1970s (introduction of IRA and 401(k) plans, master trust services and the ERISA).

However, the truth of the situation is that the rest of the world has moved on since the 1970s. Japan's financial institutions have the same IT available as US counterparts. Having the US as a precedent, Japan has to strive to catch up with the US in only a few years. We are hoping that the Japanese asset management industry can overcome this period of dramatic change and thereby set in train the future development of its corporate pension business.

Table 7 Japan's Current Pension Asset Management Business and 1970s US

Japan in 2000s		US in 1970s	
Legal framework	Pension Business	Legal framework	Pension Business
2000 Pension Reform Law	First master trusts appear	1974 ERISA (fiduciary responsibility, benefit guarantees, IRA)	
2001(Planned) Defined Contribution Pension law	First defined contribution pension plans appear		First master-trusts
2002(?) Corporate Pension Law (fiduciary responsibility)		1978 IRC section 401(k)	First IRAs First 401(k) plans

Source: NRI