The Fiduciary Responsibility Guidelines For Asset Management Companies

~ Deliberations and Findings of the Fiduciary Responsibility Working Group ~

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The Employees' Pension Fund Association "Working Group on Fiduciary Responsibility of Asset Management Companies" (Fiduciary Responsibility Working Group) published guidelines for fund directors in 1998, followed by a "Fiduciary Responsibility Handbook" for asset management companies on 17 April 2000.

The handbook represents the first detailed codifying of the fiduciary responsibilities of Japan's asset management companies. It sets out the duties of companies acting in an asset or investment administration capacity and of financial services providers as defined under the Financial Products Sales Law. As such it is likely to have a significant impact ahead of the scheduled enactment of the defined contribution pension bill sometime during FY2000.

1. Background

Reform of Japan's pension management industry is proceeding at a rapid pace. The "Big Bang" program of financial sector deregulation has brought about significant liberalization in trading rules, and consequently a dramatic expansion in asset management business. Now the investment environment surrounding Japan's pension funds enables money managers much more discretion in applying more effective and advanced investment methods. However the development of rules to clarify the responsibilities of asset mangers in this more open investment environment has lagged far behind the pace of market reform.

1) Deregulation of Pension Investment

The strict regulations governing the way in which Japan's pension fund assets may be invested, starting with the "5-3-3-2" asset allocation ratio, have gradually started to be rolled back due to the restrictions they place on money managers in making use of more advanced and effective investment methods (Table 1).

Moreover the Pension Reform Law promulgated on 31 March 2000 practically removed all remaining restrictions on employee pension fund investment. This piece of legislation brought in the following reforms: (1) it allowed the transfer of trust assets in securities form in addition to monetary form (Employee Pension Insurance Law Article 130-2; (2) it abolished

the minimum required size of assets under management[1] for funds to be able to manage investment in-house (Article 130-2-3 and 4 of the old law removed); (3) removal of the restriction on only cash contributions to pension plans, allowing listed equities also to be contributed[2] (Article 139-4 of the new law); (4) allowed master trust contracts; (5) abolished the registration (approval) system for pension reserve management and investment.

All the above reforms were to become effective within 3 months following the date the act was promulgated (scheduled for 1 June), except for (4) which came into force on 1 April 2000.

Table 1 History of Pension Asset Investment Deregulation Measures

Date	Deregulation Measure
Apr-90	• Companies allowed to entrust investment of a portion of pension fund (1/3 of total assets) to outside investment advisory company • Rules introduced requiring investment of new funds according to the "5-3-3-2" asset allocation ratio, and requiring at least 50% of funds with each asset management company to be invested in low-risk assets • In-house investment permitted (for funds with assets under management of ¥50 billion or more, investment targets bonds and deposits only)
July-93	• Minimum amount that can be entrusted to an investment advisory company lowered to ¥100 million
Nov-94	• Distinction between "additional funds" and "present funds" abolished (proportion of funds that can be marked for deregulated investment funds to be no more than 1/3 of total assets)
Apr-95	• "5-3-3-2" rule for allocation of deregulated investment funds by each financial institution abolished
Apr-96	• Asset investing requirement for additional funds increased from 1/3 to 1/2 • 5-3-3-2 allocation rule for each investment institution abolished for present funds • "5-3-3-2" rule abolished for the Employee Pension Fund Association and other funds that meet fulfil certain criteria
Dec-97	• "5-3-3-2" rule completely abolished
Jan-98	• Requirement to guarantee uniform investment returns abolished
Mar-98	• Abolition on restrictions on
Apr-98	• Upper limit on in-house investment of Employee Pension Funds abolished
Apr-00	• Prohibition on transfer of physical assets between pension trusts / designated money trusts lifted
Jun-00	• Abolition on restrictions on amount of fund that can be invested in-house • Allow listed equities to be deposited as contribution to pension funds (in addition to trust contributions) • Specialist asset administration trust contracts permitted (in order to allow master-trusts to be established)

Source: NRI

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1 Funds with assets under management of ¥50 billion or more and who had received approval from the Ministry of Health and Welfare regarding asset administration and organizational structure were allowed to conduct in-house investment in a limited range of instruments (*tokkin* money trusts, certain fixed-income products and cash deposits). However only the Federation of Employee Pension Funds was ever actually approved (Employee Pension Fund ordinance 30-6 ~ 30-9, Employee Pension Fund Regulations 39 ~40-3).

2 Allowed contribution of listed equities to pension funds provided the following conditions were met: (1) it is specifically stated to that effect in the fund agreement; (2) the equities are valued according to the market price-based calculation formula of the Ministry of Health & Welfare; (3) the combined total of equities held by the fund does not thereby exceed 5% of total assets under management; (4) the combined total of any single equity holding does not exceed 5% of the total share issuance of a company (Employee Pension Insurance Law Enforcement Ordinance 34-2, Employee Pension Fund Regulation 32-3-2~5)

2) Growth In Japan's Asset Management Business

The Financial System Reform Law that formed the basis of Japan's "Big Bang" program of financial sector deregulation brought about large-scale deregulation of Japan's asset management business, and by so doing broadened and strengthened the roles of Japan's financial institutions, brokerages and insurance companies.

The introduction of private and company type investment trusts and proliferation of legally recognized investment methods is probably a step towards recognizing investment in higher-risk financial products such as derivatives or other alternative investment methods.

It has further become possible for investment advisory companies to employ the services of more specialized investment trusts or advisory companies to take advantage of their more specialized expertise or trading methodologies, and thereby increase their operating efficiency. Techniques such as block trades combined same securities order of some clients' funds with set allocation rules have also become available. Further, the October 1999 complete liberalization of trading commission and allowance of off-exchange trading has opened the way for real investor savings as securities brokerages make drastic cuts in their trading commissions, are able to choose the best exchange to trade on or even cross-trade customer orders themselves.

The success of the deregulated environment however depends to a large extent on how far Japan's financial institutions are able to specialize and thereby increase their asset investment efficiency. On the other hand however, as the funds are exposed to risk and receive returns, asset management companies have to give due consideration to their responsibility in the investment process, while fund directors must also consider their responsibility as regards monitoring the actions of money managers.

2. Fiduciary Responsibility Regarding Pension Funds

Corporate pension funds[3] consist of a close relationship between four parties: the company that sets up the fund, the directors assigned to manage the fund, the asset management companies who invest the fund's money, and finally the employees who contribute to the fund and eventually claim its benefits when they retire.

The beneficiaries who own title to the assets entrust the management and investment of those assets to market professionals and thereby expect a higher return than they would otherwise get investing the fund assets themselves.[4] Figure 1 shows how the schemes are constructed, with the beneficiaries (employees of the company) receiving the eventual

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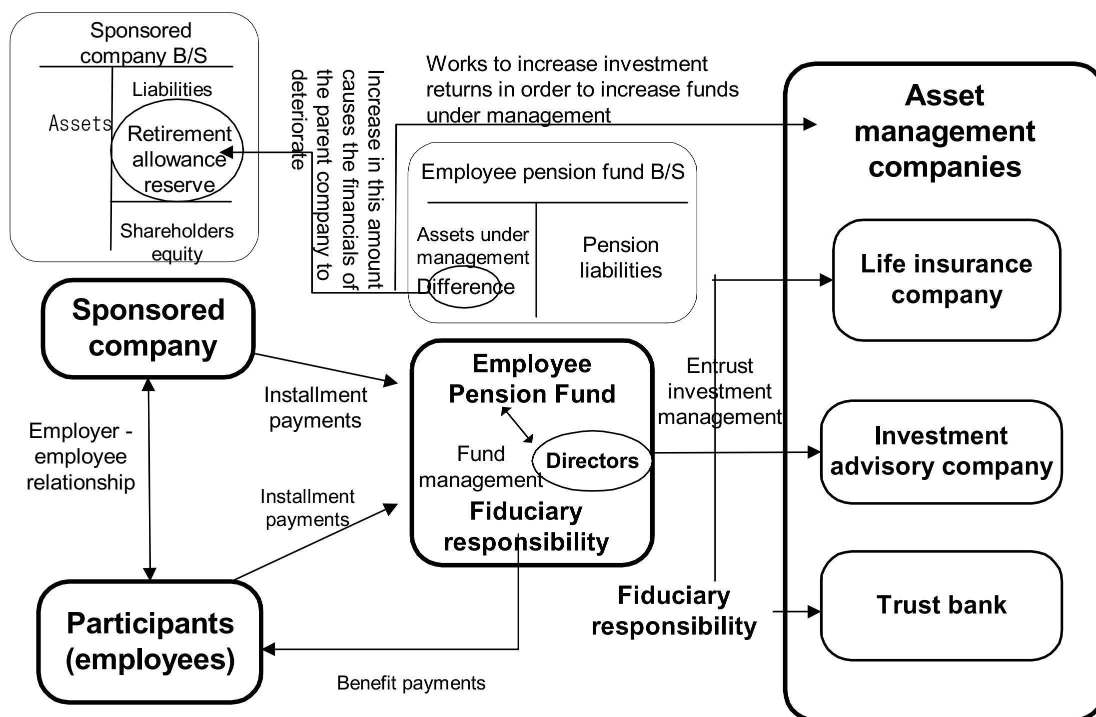
3 Corporate pension funds include both the employee pension funds and tax-qualified pension funds, though we will only deal with the former here. Further, while a bill is currently before the 2000 ordinary session of the Diet to introduce a new defined-contribution pension scheme system, here we will deal only with traditional defined-benefit plans.

4 In the US and UK this relationship relies more on the trustee's responsibility than a contractual bond. Japan however does not clearly differentiate between the two types, though this will in our view have to change if the asset management business is to thrive in Japan.

benefits and the fund directors entrusted with the management of the fund and representing those employees' interests.

The final objective of a pension fund is to ensure that the company's employees receive their retirement benefits. It is therefore very important to clarify who will be liable to pay compensation if it so happens that due to bad investment decisions or declining asset prices the fund is not able to pay out the expected retirement benefits. Though responsibility for the results of investments lies with the fund directors, there is also a risk to the company that it may have to make good any unfunded retirement benefit allowances by transferring some of its own assets into the pension reserve fund. Litigation in such a situation may be invoked not only by the company's employees, but also by shareholders of the company who suffer the loss in their capital.

Figure 1 Participating Parties In The Operation Of Employee Pension Funds



Source: NRI

1) Responsibilities Of Employee Pension Funds

In the US the Employee Retirement Income Security Act (ERISA) defines the responsibilities of trustees or fiduciaries (persons who exercise discretionary authority or control over management of a pension plan) as: to act in good faith, to act in accordance with the "prudent man" rule, to diversify the investment portfolio, and to comply with documents and instruments. In order to protect the interests of pension plan participants the ERISA also contains heavy sanctions for any infringement and gives strong rights of recourse for claiming damages to the plan participants. In Japan however, there is no equivalent legislation that clearly defines the fiduciary responsibilities.

In the light of the way fiduciary responsibility is set out in the ERISA, fiduciary responsibility in Japan is likely to be formed from two main elements: the duty to act in "good faith" (to act solely in the interests of the participants and beneficiaries and to not undertake any action which would harm those interests); and the duty to act with the due care and diligence appropriate to be a good manager of those assets entrusted.

Fund directors, according to the Employee Pension Fund Law and Employee Pension Fund Ordinance, have duties to act in good faith and with due care and diligence towards the fund (pension plan participants / beneficiaries), and unconditional responsibility with regard to the investment and administration of the fund assets.

2) Lack Of Uniformity In Fiduciary Responsibility Duties Under Current Legislation

Asset management companies in Japan are governed by something approaching fiduciary responsibility rules according to their separate industry-specific legislation. However these basic industry laws covering operations in terms of the asset management business as a whole do not clearly define duties to act in good faith or duties to act with due care and diligence.

The operation of employee pension funds in Japan gives rise to various contractual arrangements: pension trusts operated by trust banks, *shiteitan* designated money trusts, *tokkin* specified money trusts (with investment management carried out by an investment advisory company), investment consignment contracts of investment advisory companies (for securities custody by a trust bank), general accounts and special accounts operated by life insurance companies (Figure 2). Each of these contract types has its own definition of investor responsibility.

Governing pension investment and asset administration operations of trust banks are due care and diligence duties (Trust Law, Article 20), duties to act in good faith (Trust Law Article 22, Combined Trust Business Law Article 4, Trust Business Law Article 10-2,3), autonomous execution duties (Trust Law Article 26), separate administration duties (Trust Law Article 28), duties to act in cooperation with joint trustees (Trust Law Article 20) and duties regarding availability of documentation and reporting (Trust Law Article 39,40). In addition to these the trust banks are subject to operational guidelines and Trust Association notifications, business method documents and contracts.

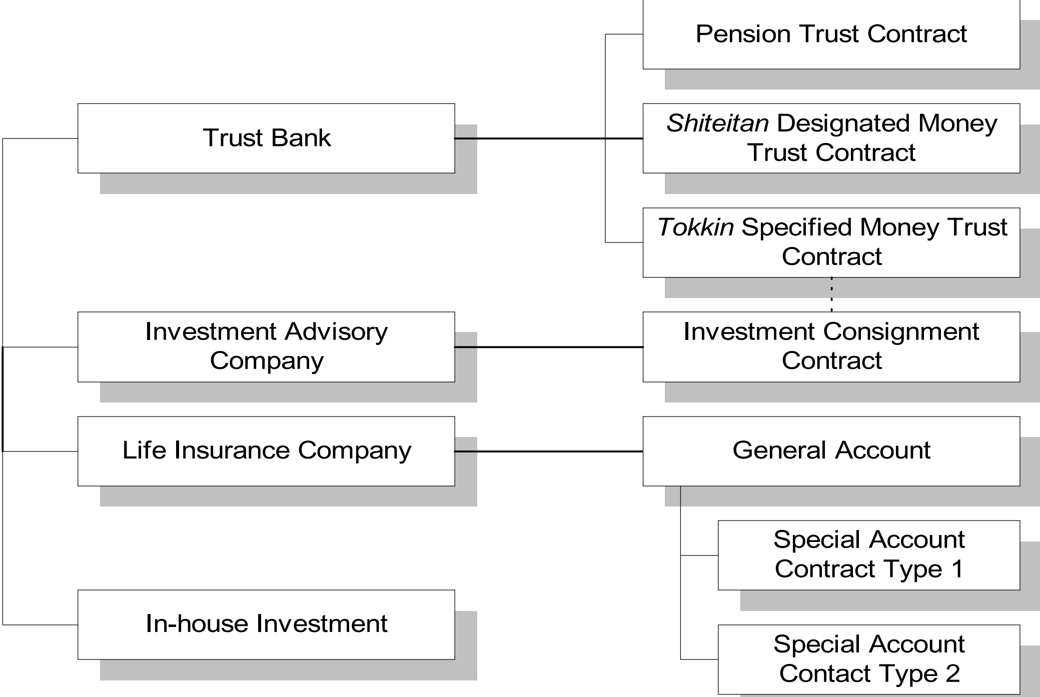
There are no provisions in Japan's insurance legislation regarding fiduciary responsibility for the operation of pension funds by life insurance companies. Life insurers manage their funds under the principle of acting in good faith according to the Civil Code and in accordance with the employee pension fund insurance contract. Further, many point to the fact that since life insurance companies are legally liable to pay back the principal plus guaranteed return on general account pensions, the principle of fiduciary responsibility is superfluous. With special accounts on the other hand, since the pension fund itself bears the investment risk, life insurance companies then do have a duty to act in good faith as trustees. Though not a legal duty, it is clearly stated in the trust agreement as a basic undertaking that the life insurance companies will endeavour to act in good faith and with due care and diligence in the operation of pension fund special accounts.

Investment advisory companies are governed by duties of due care and diligence (Article 644 of the Civil Code) and good faith (Investment Advisory Business Law Article 21:

Investment Advisory Companies, Article 30-2: Approved Investment Advisory Companies), in the operation of pension funds based on an investment consignment contract.

The above shows how the duties of asset management companies are not uniform as they are governed by separate legislation depending on the form of the trust arrangement. Thus it remains unclear how responsibility should be divided between the pension funds who bear the final risk of investment returns and their money managers.

Figure 2 Forms Of Employee Pension Fund Management



Source: NRI

3. Deliberations And Findings Of The Fiduciary Responsibility Working Group

1) Approach To The Problem And Course Of The Debate

Following the Ministry of Health & Welfare's publication of its "Guidelines Regarding the Roles and Responsibilities of Parties Involved in Management of Employee Pension Fund Assets" in 1997, the Federation of Employee Pension Funds put together a "Fiduciary Responsibility Handbook" in 1998 aimed at pension fund directors and setting out concrete examples of fiduciary responsibility based on the Welfare Ministry's guidelines.

The Employees' Pension Fund Association then turned to the clarification of fiduciary responsibility of asset management companies by setting up a new body, the Fiduciary Responsibility Working Group (FRWG), in April 1999. However without similar guidelines to those applying to fund directors, it was unclear as to what fiduciary responsibility asset management companies should have. The group, lacking any established legal precedents and deciding against waiting for legislation, brought together all the existing legal and

contractual rules and regulations regarding responsibilities of asset management companies and interpreted them in the light of fiduciary responsibility, detailing examples for each stage of the asset management process.[5]

The FRWG set up 3 groups consisting of representatives from the fund administrators, investment management companies, think-tanks and investment consulting firms. The various processes involved in asset management and administration were split into 3 and assigned to each working group (A, B and C) to be debated. A list of 43 separate individual items was drawn up, and for each item the basic concept and related legislation were delineated along with examples of "inappropriate conduct" and "actions which an asset management company would be expected to carry out."[6] In addition the working groups drew up recommended checklists, using which funds could monitor the asset management companies acting on their behalf (Table 2).

Group C was also responsible for debating what legal status the handbook would assume. This was due to the group's thinking that a simple check-list of required actions (a so-called "inductive approach" to rulemaking) was not sufficient and needed to be supplemented by greater clarity regarding what basic perspective the group was taking towards issues of fiduciary responsibility.[7] The group however looked to the enactment of the Financial Services Law and Corporate Pension Law to resolve the question of the legislative basis for fiduciary responsibility and other legal issues that had loomed large during the course of the debate.

Up to 10 February 2000 the FRWG took on board wider reactions to its interim report and published its final findings on 17 April. This took the form of the handbook on the "Fiduciary Responsibility for Asset Management Companies," setting out the group's thinking on fiduciary responsibility in terms of a "deductive approach" by a combined listing of the laws and industry self-regulatory rules relating to each operational process involved in the conduct of asset management / administration business.

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5 Though the author is a member of the Fiduciary Responsibility Working Group the opinions expressed here are her own.

6 These examples were either actual previous occurrences, or events that were thought likely to occur.

7 The following legal issues were raised: (1) legal principles concerning trusts and contracts; (2) duty of loyalty and duty of care; (3) fiduciary responsibility under ERISA; (4) fiduciary responsibility under Japan's law; (5) life insurance companies and fiduciary responsibility; (6) establishment of legislation governing fiduciary responsibility of asset management companies. The life insurance companies took the position that fiduciary responsibility rules were not relevant to them as life insurance policies constitute a promise to pay out a certain amount of money, in consideration for which a premium payment is received which becomes part of the life insurance company's own pool of assets. Against which the group decided to approach the issue focusing on how the funds are actually invested, and though it recognized that while pension funds should bear the investment risk on special accounts, on ordinary accounts where the principal plus return are guaranteed they were not able to reach agreement.

Table 2 Fiduciary Responsibility Issues Concerning Asset Management & Administration Processes

I. Evaluation and Selection of Money Manager and Entering into Contract	II. Basic Investment Stance	III. Selection of Investment Targets
1. Explanation of important issues 2. Disclosure of past investment performance 3. Investment process 4. Organizational structure 5. Selection and management of companies acting on behalf of the momey manager 6. Confirmation of fund instruction contents 7. Outside intervention by parent company in selection of asset manager and entering into contract	8. Adherence to basic investment policy and investment guidelines 9. Accurate risk management 10. Pursuit of mid- to long-term total return **V. Reporting** 30. Reporting investment results 31. Changes in investment style etc. 32. Reporting violations of laws / contract	11. Asset allocation 12. Cash management 13. Portfolio diversification 14. New investment 15. Derivative trading 16. Acquisition of own shares, related company shares or bonds or investment trusts etc. 17. Political investment 18. Unfair treatment 19. Trading between clients 20. Investment selection models

IV. Trade Orders & Confirmations	VI. Other Management Issues	VIII. Investment Consulting
21. Selection of securities broker to take fund orders 22. Conflicts of interest 23. Trade order confirmations 24. Trade execution cost 25. Softdollar services 26. Short-term trades – re-sales 27. Yen conversion, holding of assets in foreign currency 28. Bank A/C lending 29. Own forex trading	33. Shareholder voting rights exercise 34. Shareholder benefits **VII. Asset Administration** 35. Installment of an asset administration organizational structure 36. Separate administration of assets 37. Confirmation matching / delivery and settlement 38. Corporate actions 39. Selection and management of custodian and safekeeping custodian	40. Assessment of fund status and advice 41. Contents of advice 42. Evaluation of asset management company 43. Evaluation of asset management companies employed by affiliates

Note: Responsibilities of each working group: A (I. Evaluation and Selection of Money Manager and Entering into Contract, II. Basic Investment Stance, VIII. Investment Consulting; B (III. Selection of Investment Targets, IV. Trade Orders & Confirmations); C (V. Reporting, VII.Asset Administration).

Source: NRI

2) Remaining Issues

The FRWG has outlined 4 specific areas which remain to be examined, on top of a number of problems related to the wider investment environment as it passes through its current transition phase.[8]

(1) Best execution and soft-dollar services

"Best execution" refers to the presumed responsibility of investment management companies to achieve the lowest possible total cost on trades, taking into account not only trading commission and tax but also more difficult to measure items such as the cost of market impact. In fact however it is extremely difficult to examine whether best execution is being achieved, and all that can really be done is to wait for a reasonable cost IT solution to the problem.

Soft-dollar services are also related to trading costs. This practice, common in the US, is for securities brokers to offer asset management companies a contract whereby they will provide free non-execution related services if the asset manager places a certain number of orders with that broker. There are also cases where soft-dollar services are provided at a relatively expensive rate. It has been brought up as an issue since it may give rise to conflicts of interest between the asset manager and the broker, and the FRWG is aiming at preventing soft-dollar services becoming common practice.

Similar to the provision of information through soft-dollar services is the practice of securities brokers providing their analyst reports free to asset management institutions, though attitudes to this practice are more mixed. Provision of analyst reports is not so easily classified as a soft-dollar service as the reports are a valuable source of information for improving fund performance, while there is no wide consensus on how much this information is actually worth. The problem of information provision and its monetary value is perhaps best treated as part of the fund's duty to achieve best execution in selection of a securities broker with which to place orders.

(2) Separation of asset investment management and asset administration services

As shown in the asset management operation "check-list," while trust banks and life insurance companies are permitted to engage in both investment and administration services, investment advisory companies are prohibited from offering asset administration services and so the issue of separation does not apply to them (Figure 3).

The conduct of asset administration services that include obtaining daily information on trading activity and evaluation of investment performance, in addition to investment management services, would put asset management companies in an unfair position with regard to competitor funds if they also held such information on them. However the separation of these two services according to company internal regulations and establishment of a firewall would not, in our view, be sufficient. There needs to be a clear separation in law of these two activities, and this legislative framework also needs to take into account the

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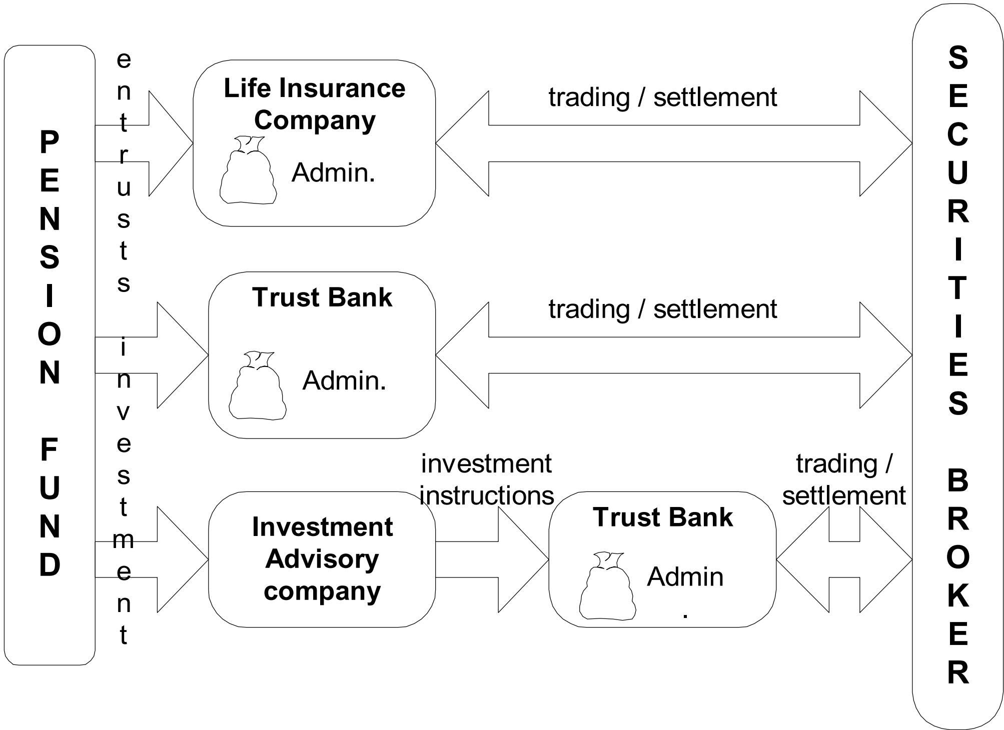
8 Mentioned here are issues such as soft-dollar services, securities lending and settlement of foreign securities with particular regard to the event of default.

preferred shape of master-trust based specialist asset administration services that look set to take off in Japan in the near future.[9]

Figure 3 Structure Of Securities Trading, Settlement and Custody In Pension Fund Investment



Source: NRI

(3) Shareholder voting rights (on takeover bids etc.)

The hostile takeover bids launched for IDC, SSP and Shoei during FY99 are evidence that Japan's management, long protected from such concerns, are now increasingly at the mercy of the markets. Even in the US the actions taken by shareholders in response to such takeover bids is being debated in terms of fiduciary responsibility. To sell out to a hostile takeover bid generally achieves a higher premium and profit than selling the stock on the market. If the hostile bid succeeds then the shareholders who did not sell out remain as holders of minority interests, decreasing the value of their investment substantially. If the bid fails however the share price generally falls back, giving the opportunity to shareholders who sold off to the bidder initially, where the takeover target exhibits potential to improve shareholder value, to improve the value of their investment by buying back in at the lower price. Investment management companies are likely to face increasingly difficult choices with regard to how to react to takeover bids in terms of their fiduciary responsibility.

Further, there are cases where investment management companies are invited to join in class actions against a company in the US. For US institutional investors it is not at all rare to participate in a class action suit against management, but for a Japanese firm to participate

9 Regarding the development of asset administration services and moves towards functional specialization by Japan's trust banks readers should refer to E. Katayama "New Developments in Institutional Services in Japan," (Capital Research Journal, Spring 2000).

in an overseas suit is likely to incur significant costs and labour. Further, while winning the action will result in the shareholders being rewarded in monetary terms, it would also be important to assess each case in and of itself as regards the cost -benefit to the fund itself.

While the FRWG's handbook calls for voting rights to be exercised with a view to increasing the profits of the fund, as companies continue to unwind their cross-shareholdings, the possibility of the fund being solicited to sell to a takeover bid or being solicited by other shareholders is likely to increase. Therefore the actions of investment institutions in terms of corporate governance need to pay even closer heed to the profit interests of the fund itself.

(4) Fiduciary responsibility and investment trusts

This issues arises as funds with discretionary investment contracts have recently been investing in privately placed investment trusts, and in future we can also expect to see funds managing their investments in-house putting money into regular investment trusts.

However the investment trust business has attracted concern from the perspective of pension fund fiduciary responsibility as they are liable to changes in investment style without due consultation or, if one fund is performing badly, another similar one may be set up and investors encouraged to shift their funds. The FRWG therefore discussed how this problem could be tackled.

The revised Investment Trust Law (Article 14) enacted on 23 May 2000 gave legislative form to the deliberations of the Financial System Council and is forming the core of the debate over investment trust fiduciary responsibility. Previous legislation had introduced the duty for companies engaged in the creation and selling of investment trusts to act in good faith; the new law built on this by setting out clear regulations governing duties of due care and diligence and codes of conduct to be followed.

4. The Debate Over Fiduciary Responsibility Is Set To Intensify

1) Establishment Common Rules Between Pension Funds And Asset Management Companies

The FRWG's "Fiduciary Responsibility of Asset Management Companies" handbook, as the first product of the group's comprehensive examination of the issue of fiduciary responsibility, can be seen as a pioneer in defining a real code of conduct for the changing pension fund asset management industry. As funds and asset management companies now have much greater discretion on how to invest pension fund assets entrusted to them, the handbook's setting out rules for conduct in fiduciary responsibility terms in both individual examples and for each stage of the asset management process, while also paying attention to the relationship of "strained cooperation" between the funds and their investment institutions, has great significance in that it clarifies and sets common parameters for those issues fiduciaries (trustees) must pay attention to in the conduct of their business. The FRWG is hoping to see the points it has raised in the handbook fully reflected in the day-to-day operations of Japan's asset management companies.

What action do money managers and funds now need to take in the light of the FRWG's operational handbook? The handbook is not aiming at putting the entire heavy weight of responsibility on asset management companies. Even after the fund has devised the investment policy, decided on the composition of money managers for the fund and entirely handed over the job of investment decisions, the FRWG suggests that pension funds need to be much more active in monitoring the performance of their funds than before. Further, the execution of the monitoring function needs to be first based on a clear understanding of the salient points that require supervision. In preparation for which Japan's asset management companies need to undertake a thorough review of their internal rules and management structures as regards each asset management process.

In addition to closer monitoring of the asset management companies it entrusts investment to, pension funds also need to improve their own investment knowledge. Further they need to be fully aware that according to current legislation, responsibility for management of the pension fund lies solely with the fund directors themselves. For example, if the asset manager believes they have received inappropriate instructions from the fund, the asset manager should not simply follow the instructions but advise the fund that it believes the instructions to be inappropriate. If the instructions are then changed on the grounds of this advice but the resulting investment performs badly, responsibility for the results do not rest with the asset management company.

The process of monitoring and checking that investment guidelines are being followed is likely to incur considerable extra costs. Particularly the hiring of outside auditors to check that trades are fair and proper, and the introduction of a system to confirm that trades are executed at as low a cost as possible would be costly. Legal risk management will also become necessary, to check that legislation is being properly observed and to develop company internal procedures. Whether the funds themselves or money managers should shoulder this bill, and how the division of costs will affect their responsibilities is something that needs to be worked out through discussion.

The individual action guidelines set out in the handbook seem to have been taken on board by all concerned as fair and proper, though it remains to be seen how far they will be followed in practice. Despite the title of "Fiduciary Responsibility for Asset Management Companies," the FRWG does not have the authority to legally enforce compliance to its rules. There are therefore calls for a scheme to be established to enforce compliance by asset management institutions. While asset management companies already have internal business procedures and rules which they appear to observe, it is also desirable for rules for fiduciary responsibility applicable across the industry to be drawn up, and for each company to observe and put these rules into practice.

It is further important to note that compliance with the handbook rules definitely does not constitute safe harbor. Compliance will not necessarily mean that an asset management company has not acted inappropriately in terms of fiduciary responsibility. It may well happen that changes in the investment environment will bring about conditions where issues of fiduciary responsibility not yet codified in the handbook may be brought to bear.

Furthermore, the handbook is not complete as it stands at the moment. During the course of its application in a wide variety of situations it is to be hoped that superfluous rules will be removed and further required rules included through a constant process of review and revision.

It is to be hoped however that asset management industry will develop greater sensitivity to issues of fiduciary responsibility.

2) Connection With Future Asset Management Legislation

It appears that the issue of more strict definitions of contractual responsibility for fiduciaries will be a focus of the debate on future asset management legislation. As Japan's asset management industry develops, legislation needs to be adopted based on the principle of fiduciary responsibility, with a clear separation made between responsibilities based on contract and responsibilities of trusts.

The deliberations of the Financial System Council concerning the Financial Services Law (provisional title) affirmed the view that financial services providers operating collective investment schemes should bear responsibilities to a certain extent equivalent to those of a trustee, and further modifies the Investment Trust Law to include duties of due care and diligence in addition to acting in good faith.[10] Further, the Corporate Pension Law (provisional title), basing its concept on that of the ERISA of the US, is likely to include a clarification of pension benefit rights as well as the fiduciary responsibility regulations that guarantee those rights.

Under the Defined Contribution Pension Bill recently submitted to the Diet companies entrusted with asset investment and administration by pension funds will have a duty to act in good faith towards both the direct counterparty (business running the fund) of the contract and the subscribers to the pension plan. They will also have a duty to act in accordance with a "prudent man rule" based on professional expertise rather than a simple due care and diligence rule, which is evidence of the influence of fiduciary responsibility concepts contained in the ERISA. It will be interesting to see how far this bill also takes into account the findings of the Fiduciary Responsibility Working Group.

3) Sudden Rise In Risk Of Legal Action

Simply put, if recourse to court proceedings is made easier then the risk of litigation will become more of a deterrent. While the FRWG has not itself commented on the subject of litigation, legal recourse is anyway being made much easier in Japan with a number of legislative revisions that will for example reduce the cost of legal proceedings, increase the number of lawyers in Japan and introduce a collective litigation system that will allow several parties with shared interests to participate together in class actions. Under Japan's civil litigation procedures it is much easier to bring an action as a representative of a company's shareholders, and there have been a number of recent cases taking advantage of the reduction of litigation fees to ¥8,200. Further, the new Consumer Contract and Financial Product Sales laws are strengthening both consumer and investor protection, making the risk of negligent parties being targets of litigation procedures substantially greater.

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10 The Investment Trust Law (the "Law on Securities Investment Trusts and Securities Investment Corporations") regarding collective investment schemes and the "Financial Products Sales Law" that introduces stricter information disclosure requirements on financial service providers were both submitted to the current ordinary session of the Diet.

With asset management companies being given much greater discretion over investment decisions in order to achieve greater long-term investment returns, fund directors and money managers are now having to fully grasp the implications in terms of the nature and division of their respective responsibilities. It would be good for Japan if these changes accompany a healthy development of the domestic asset management business. In order for this to happen the risks and responsibilities associated with investment contracts, including litigation, need to be fully clarified.