
New Developments in Institutional Services in Japan

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On 9 November 1999 Daiwa Bank and Sumitomo Trust & Banking Co. announced they were jointly setting up a new trust banking operation. This was followed, on 29 November, by an announcement by Nippon Life Insurance Co. and Mitsubishi Trust and Banking that they also planned to set up a new trust bank in concert with Toyo Trust & Banking, Meiji Life and Deutsche Bank AG. These new trust banks are aimed at providing master trust services, a new concept in Japan. They would cover all types of services for institutional investors, in effect acting more like a trust company than a trust bank. In effect, these new plans represent a significant step away from standard packaging of custody, investment management and actuarial services and towards functional specialization along U.S.–European lines.

1. Establishment Of New Trust Banks (Trust Companies)

In November 1999 there were two significant announcements made by Japanese, trust bank and life insurance company alliances to develop new areas of business. On 9 November Daiwa Bank and Sumitomo Trust & Banking Co. (the Daiwa – Sumitomo group) announced they were planning to establish a trust banking operation. This was followed, on 29 November, by an announcement by Nippon Life Insurance Co. and Mitsubishi Trust and Banking (the Mitsubishi – Nissei group) that they also planned to set up a new trust bank in concert with Toyo Trust & Banking, Meiji Life and Deutsche Bank AG (Table 1).¹

The Daiwa – Sumitomo group plans envisage a 50/50 joint venture capitalized at ¥50 billion, which would be entrusted with the management of the pension trust assets held on behalf of the customers of both institutions. The Mitsubishi– Nissei group plans equity investment in the following proportions: Mitsubishi Trust 43.5%, Nippon Life 33.5%, Toyo Trust and Meiji Life 10%, and Deutsche Bank AG 3%, for total equity capital of ¥10 billion. The new trust bank would take over the management of various assets held by each institution.

Both of the plans for new trust banks have in common as their primary aim the provision of services to institutional investors such as custody, daily pricing and information services,

1 Following these announcements newspapers reported in December 1999 that Chuo Trust & Banking and Mitsui Trust & Banking were also considering investing in the new Daiwa – Sumitomo Trust group's trust banking venture, while in January 2000 the press further reported that the Mizuho Financial Group was mulling a new trust bank venture in concert with a life insurance company. However, since there have not been any official announcements by the institutions themselves we have limited ourselves in this report to an examination of the plans of the Daiwa – Sumitomo and the Mitsubishi – Nissei groups.

which would in effect mean the new companies are acting more in the capacity of trust companies than trust banks. Assuming that the proposed new trust units are approved by the regulatory authorities, the Mitsubishi – Nissei group venture is set to start operations from April 2000, and the Daiwa-Sumitomo group venture in October later that year. In December media reports also indicated that the Chuo Trust & Banking and Mitsui Trust & Banking alliance is considering investing in the Daiwa – Sumitomo group unit.

Table 1 Overview Of Plans For Establishment Of The New Trust Banks

Daiwa Bank – Sumitomo Trust & Banking Co. (1)		Mitsubishi Trust & Banking – Nippon Life Insurance Co.
¥50 billion	Capital	¥10 billion (initially)
50/50 initial equity investment	Ownership	Mitsubishi Trust & Banking 43.5%, Nippon Life 33.5%, Toyo Trust & Banking 10%, Meiji Life Insurance 10%, Deutsche Bank AG 3%
<ul style="list-style-type: none"> • Asset administration services for assets entrusted by the clients of each bank (asset administration of pension funds, discretionary money trusts, <i>tokkin</i> special money trusts, and investment trusts). • Custody services, management of principal and coupon payments etc. • Master trust services 	Operations	(1) Master trust services <ul style="list-style-type: none"> • Custody, settlement and accounts reporting for assets under management • Efficient management of assets (securities lending, cash management etc.) • Value-added data services (performance evaluation, risk management etc.) (2) Asset administration <ul style="list-style-type: none"> • Administration of life insurance securities assets etc.
Estimated ¥4.76 trillion in assets in trust (valued as at end March 1999)	Size	¥5.21 trillion in assets in trust (valued as at end September 1999)
October 2000	Begin operations (2)	April 2000

Notes (1) Reports have appeared in the Japanese press that Mitsui Trust and Chuo Trust are also negotiating to join (Nikkei Shinbun, 12 October 1999)

(2) Assuming the regulatory authorities give their approval

Source: NRI, from press releases etc.

2. Background To The New Trust Bank Ventures

The following three factors appeared to play a major role in the decisions to set up the new trust bank (trust company) ventures:

(1) Lessons from the U.S. market

Currently providers of master trust services in the U.S. find that their mainstay business, the centralized management and administration of pension fund assets, produces very little in the way of profits despite requiring a large and ongoing investment in IT systems. Revenues from securities lending, shared with the pension funds, is barely enough to cover these large administrative costs. Consequently many major banks have started up master trust operations only to sell them off to rivals when the units have turned out to be loss-makers. As a result, the market has become extremely concentrated with nearly 80% of all master trust administered assets being held in the top 5 institutions (Table 2).

Table 2 Assets Held in Trust By The Leading U.S. Master Trustees

(Units: US\$ million; %)

	Bank	Total Assets In Trust	Share (%)
1	State Street Bank & Trust	1,099,700	22.1
2	Mellon Trust	896,807	18.0
3	Bank of New York	629,295	12.6
4	Northern Trust	617,600	12.4
5	Bankers Trust	577,828	11.6
6	Chase	364,000	7.3
7	Citibank	247,502	5.0
8	Norwest	100,000	2.0
9	Bank One	82,000	1.6
10	Wachovia	72,435	1.5
	Other	372,688	7.5
TOTAL		4,987,420	100
* Total of Top 5 Master Trust Units		3,821,230	76.6

Source: Pensions & Investments, 31 October 1997

Apparently, observing the history of acquisitions and market withdrawal that has occurred in the U.S., the Japanese banks have decided to form alliances from the outset.

(2) High priority accorded settlement system reform

The second factor is settlement system reform. Japan's financial institutions are being pressed to prepare for T+1 settlement (settlement the business day following the trade date), that the ruling Liberal Democratic Party is aiming to have in place by 2002. Such a change will have a particularly large impact on trust banks that are engaged in securities administration, and is according to some reports being seen as an even higher priority than the development of master trust services themselves. The systems investment required to prepare for this is reported to be in the region of several hundreds of million yen, climbing into the several billion if global custody operations are included. Therefore it appears that the trust banks and life insurers decided to spread the costs between themselves by preparing joint operations.

(3) The highly concentrated corporate pension fund market

Thirdly, the Japanese corporate pension fund market has an inherent tendency to become highly concentrated. Looking only at Employee Pension funds (due to the difficulty in obtaining other data), nearly 10% of funds are of asset size ¥100 billion or more, while 50% of funds are over ¥10 billion (Table 3). Therefore, assuming that the assets will be centrally administered, the institutions that can grab the largest funds first will most likely emerge as the winners, and the market tend towards concentration in the hands of a few major players.

Table 3 Employee Pension Funds According To Value Of Assets Under Management

Size	No. of funds	Cumulative share (%)
¥100 billion or over	75	4.0
¥50 ~ ¥100 billion	109	9.8
¥10 ~ ¥50 billion	735	49.0
¥5 ~ ¥10 billion	428	71.9
¥1 ~ ¥5 billion	498	98.5
under ¥1 billion	29	100.0
TOTAL	1,874	

Note: Market value basis, as at end FY97

Source: Pension Fund Association

3. Major Step Towards Functional Specialization

Up to now Japan's trust banks have all offered a package of services that included custody, management and actuarial consulting. The establishment of the new trust bank (trust company) units specializing in securities administration services represents, in our view, a significant step towards functional specialization along the lines of the U.S. – European model.