

## TRUST BANKS AS ACTIVE INVESTORS?

AN ANALYSIS OF JAPAN'S CHANGING SHAREHOLDER  
COMPOSITION AND CORPORATE GOVERNANCE

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## What is “Corporate Governance”?

- The systems and processes by which the management of a company is monitored and guided, so as not to exploit asymmetric information
- A system to ensure the representation of the interest of stakeholders
- Two aspects:
  - Institutional arrangements:
    - Board members, as representatives of shareholder interests
    - Auditors
    - Regulators
    - Laws and regulations
  - Market arrangements:
    - A market for information (disclosure rules; securities analysts; rating agencies)
    - The stock price
    - A market for corporate control (hostile takeovers)

## Investors' Options: Exit – Voice - Loyalty

- Loyalty
  - Wait quietly and trust that management will figure it out
  - Old Japan-style “stable shareholders”
- Voice
  - Become an active shareholder: help management improve
  - Offer advice/demands on how to improve the company
  - Get involved, fight, resist, demand, etc.
- Exit
  - Sell off shares of under-performers
  - Do not waste time or energy
  - “Invisible hand of the market”: drop in prices will invite raiders
  - Foreigners are the most active stock traders at the TSE

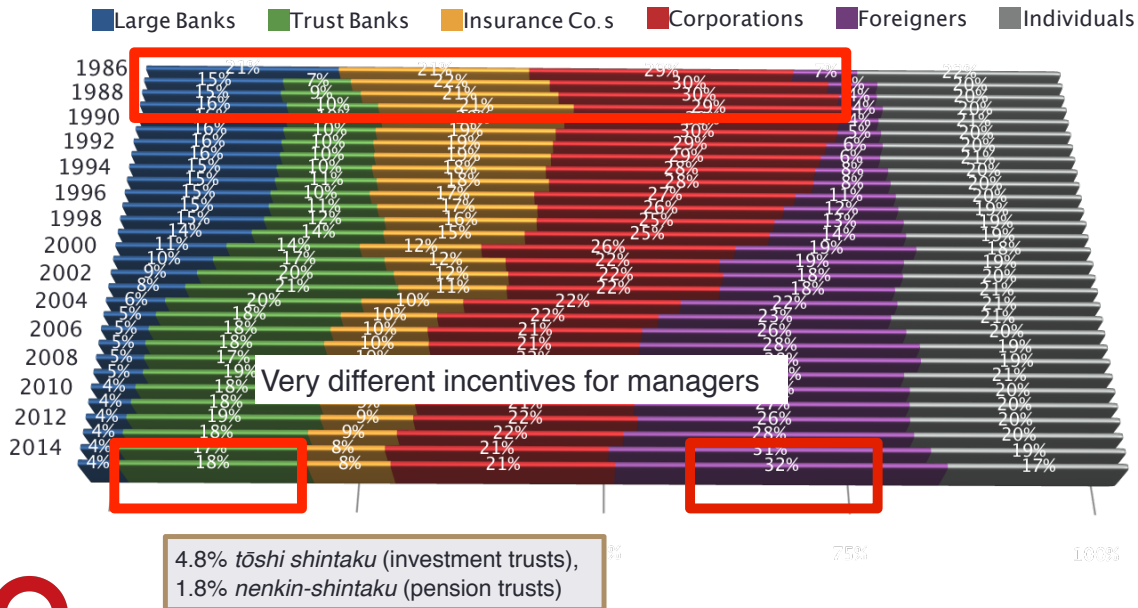


## Relation to Innovation?

- Owners set incentives
  - Acquirers (raiders) will replace managers and board directors.
  - The best protection against the market for corporate control is to run the company such that market cap is too high for raiders.
    - innovation and tech leadership, cost control, etc.
- Protection invites slack (“*keiei ni amaeru*”)
  - Why are some large dinosaurs still not reforming?
  - Sharp case as a warning?



# Tokyo Stock Exchange Survey 株式分布状況調査 (as of March each year)



## Literature

- On board structure and laws
  - Big literature, e.g., Ahmadjian (2003), Schaede (2008), Hanazaki (2010), many others
  - FSA (2009) on voting behavior
- On impact of foreign shareholders on employment
  - Ahmadjian/Robinson (2001), Vogel (2006), Hoshi/Diamond (2010, 2012), many others
- Little research yet on the growth of the trust investments
  - Zhai (2010), Ema (2011) on institutional investors
  - Uemura (1998) and banking system change



## Foreign Investors: The Standard Image

- Who/What is the “foreign” category?
  - Global portfolio investors
  - Private equity funds/hedge funds
  - Japanese money invested through Wall Street “street names”
- What do “foreigners” want?
  - Return on investment very important
  - Some confusion in literature regarding causality
  - Either direction, foreigners are said to invest in more profitable firms
    - Not patient investors, will not practice “loyalty”
    - May engage in “voice” (activist funds, ハゲタカ)
  - Will practice “exit”
    - Will sell poorly performing stocks in their portfolios
    - Will acquire undervalued stocks (raiders)



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## Research Question: How about the trust banks?

- Claim: trust banks are just a continuation of “Old Japan”
  - Risk averse, not driven by return on investment
    - Indexed investments
  - Long-term holdings, continuation of stable shareholdings system
  - Similar to banks, insurance companies, or corporations
- Or, are they more like the foreigners?
  - Competition for clients with foreign trust funds managers in Japan (esp. GPIF)
  - Global competition, consolidation
  - Must differentiate to survive
- Is there a pattern in trust investments, in particular in 投資信託?
  - How are investment decisions made? How do trust banks compete with each other?
    - Along keiretsu-lines, etc.?
    - According to returns on investment?



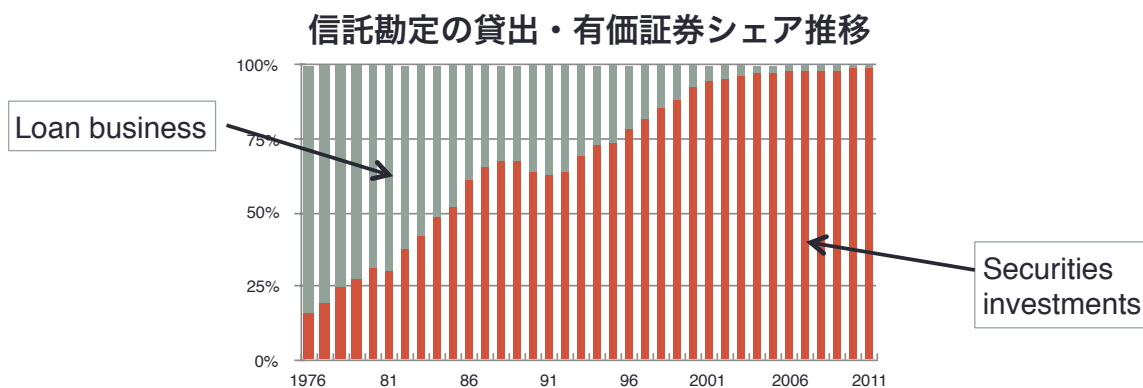
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# The Trust Bank Industry

- Trust Banks 信託銀行
  - Administer financial assets on behalf of another
  - Pool investments and invest based on their own financial strategy
  - Trust Companies Association 信託協会 (50 members)
  - Investment Trusts Association 投資信託協会 (149 members)
- History
  - Developed post-WWII as a special category to straddle commercial banking (lending) and investment banking (trust investments)
  - Some scandals during bubble period (“tobashi”, “tokkin”)
  - Some merged into large financial groups around 2000
- Funds under management:
  - Private investments (“mutual funds”)
  - Pension funds and other corporate reserves; funds entrusted by corporations and insurance companies
  - Funds that companies/banks/insurers want to invest anonymously?



# Changes in Trust Bank Business



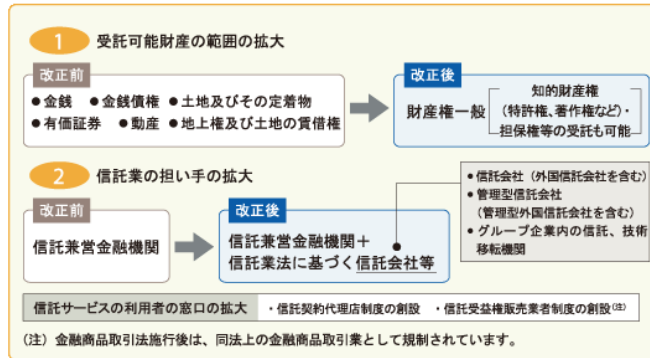
## Several legal reforms (2004, 2006, ...)

- Main points:
- Extension of assets that can be held in trusts
- Extension of companies that may engage in this business
- More competition

### 1. 平成16年の改正

平成18年の改正に先立って、平成16年12月に信託法の抜本改正がされました。この改正によって、新たな信託の担い手が増えることにより競争が一層促進され、信託のすそ野が広がるとともに、知的財産権等信託財産の多様化が図られました。

#### 改正のポイント



[http://www.shintaku-kyokai.or.jp/trust/trust03\\_04.html](http://www.shintaku-kyokai.or.jp/trust/trust03_04.html) 11

## Trust Funds under Management, 3/2015

(Trust Companies Association data)

Classification	機能別分類	Asset Management Trusts 資産運用型信託	Asset Administration Trusts 資産管理型信託	Asset Securitization Trusts 資産流動化型信託	Total (incl. others) 合計
Money trust	金銭信託	30.7	88.6		
Pension trust	年金信託	42	44.9		
Investment trust	投資信託	na	144.7		
Other money trust	金銭信託以外の金銭信託	1.9	17.6		
Re-trust	再信託		32.4		
Securities trust	有価証券の信託	48.6	na		
Monetary claim trust	金銭債権の信託	na	na	31.8	
Real estate trust	不動産の信託	na	na	29.5	
Others	その他	3.5	98		
<b>Total</b>		<b>127</b>	<b>720.4</b>	<b>62.4</b>	<b>933.3</b>

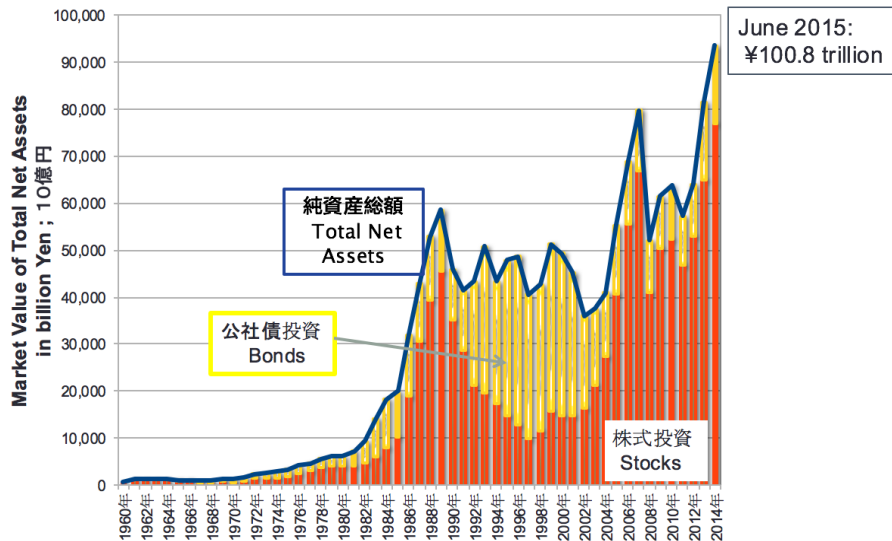
Asset management: trustee manages based on its discretion.  
Asset administration: trustee manages based on directions.

in trillion Yen, 兆円



<http://www.shintaku-kyokai.or.jp/news/news270610.html>  
(別紙) 信託の受託概況 (信託の機能別分類に基づく総数)

## Assets of Publicly Offered Investment Trusts 公募投資信託



Source: Investment Trusts Association 資産運用状況に関する統計  
Data on Asset Allocation, <https://www.toushin.or.jp/statistics/statistics/data/>

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## Big players

- Big players today:
  - 4 trust banks
    - Sumitomo Mitsui Trust Bank
    - Mitsubishi UFJ Trust and Banking Corporation
    - Mizuho Trust & Banking Co.
    - Resona Bank
  - 3 “retrusts” (再信託)
  - Other big players
    - Nomura Trust and Banking, some foreigners, Rakuten, Orix, regional banks
  - 31 large “investment advisory companies” (投資顧問会社)
    - JP Morgan Asset Management, Blackrock, Sompo Japan Nippon Koa, Mizuho Financial Advisory Co., Asahi Life, State Street, Nomura Asset Management, Nikko Asset Management, ...
  - Advisors to the advisors: huge industry of security analysts for trust investors

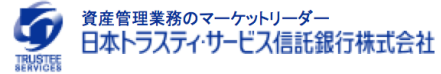


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# The Formation of “Retrusts” 再信託

## • 3 “Retrusts”

- Japan Trustee Services Bank
  - Resona, Sumitomo Trust, Mitsui Trust
  - 1,000 employees, ¥184 trillion (\$2 trillion) under investment in 2010
- Trust & Custody Services Bank
  - Mizuho Group, 4 life insurance companies
  - 500 employees, ¥338 trillion (\$4 trillion)
- Master Trust Bank of Japan
  - Mitsubishi UFJ Group, Norin Chukin
  - 685 employees, ¥339 trillion (\$4 trillion)



## • Financial Reform 2000: Asset Administration Processing

- Facilitated by e-trading in “tangen” (単元) units
- Invest and vote only “on proxy” (as told)
- 80% of revenues is fee income; some proprietary trading
- Compete through efficiency (costs), immediacy (reliability), integrity
- “Depository”: hold stock in their names (allow for anonymous trading)
  - By assets, are officially now Japan’s largest “banks”



## Example: Kirin

Most of the investment trust holdings, and some of the foreign holdings, are invested through the master trusts.

Kirin Beer	1995	Kirin Holdings	2010
Meiji Life Insurance	4.9	Japan Trustee Services Bank	4.9
Mitsubishi Bank	4.8	Master Trust Bank of Japan	4.4
Mitsubishi Trust Bank	4.6	Meiji Yasuda Life Insurance	4.4
Isono Shokai	2.1	MUFJ Bank	3.5
Nihon Life	2	Treasury Stock	3.1
Sumitomo Trust Bank	1.8	Isono Shokai	2.3
Daiichi Kangyo Bank	1.7	Japan Trustee Services Bank Fund #4	1.7
Long-Term Credit Bank	1.7	Mellon Bank NA Omnibus Fund	1.3
Toyo Trust Bank	1.4	Nomura Trust Fund	1.1
Mitsui Trust Bank (tokkin)	1.3	Tokyo Marine&Fire Insurance	1.1
Top 10	26.3	Top 10	27.8
foreign	6.5	foreign	21.5
trust	9.1	trust	12.1

Often, companies themselves don't know who the owners are



## Our Study

- The “Null Hypothesis”: Trust funds do not affect corporate governance
  - The growth in trust investments (“street names”) as a large owner group is irrelevant for corporate governance, because
    - a) they are a mere continuation of “Old Japan” practices, as loyal, long-term shareholders
    - b) they invest in “indexed” fashion, i.e., regardless of corporate performance
- Trusts do not compete on ROI performance
  - They do not set new incentives for CEOs
  - Nature of the trust industry, and nature of Japan
- Trust funds are very different from foreign investors, who are more profit-/return-oriented



*Is this true? Or, do trust banks function as a market force?*

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## Research Design

- Qualitative: Interviews
  - Interviews with the largest 3 trust banks, 1 “retrust”, others
    - Sumitomo Trust Bank, MUFJ Trust Bank, Master Trust of Japan
    - Big differences among trust banks
- Quantitative: Data analysis
  - Explore patterns in investment trust holdings
    - Are there any (reject the null hypothesis)?
    - Are these patterns different from foreign holdings?
  - Two steps of analysis
    - T-tests of various accounting data (univariate effects)
    - Regression analysis (multivariate effects)



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## Data

- Nikkei Needs data, FY 1995-2012, all listed companies
- Unconsolidated: ownership data, accounting data
- 2 Caveats
  - Ownership data lump all financial institutions; we can single out only the “investment trusts” (投資信託) portion
    - Mean 1.9%, standard deviation 3.7%
  - Missing data on “investment trusts” holdings replaced with 0
    - Difference between our “total shares” for percentage calculation and “total shares” declared by company: +/- 25% (mostly due to treasury shares)
    - Standard for these kinds of study



## Data analysis....

- Under construction.
- Please understand that we cannot post the data on the internet at this point. If you are interested in the results, please contact [uschaede@ucsd.edu](mailto:uschaede@ucsd.edu)



## Conclusions

- Japan went from (almost) complete transparency of “who owns whom” to a much more “hidden” ownership structure.
  - Nature of the market economy?
  - Or, data collection has not been adjusted to new reality?
  - Uncertainty increases market discipline for corporate management
  - Not so good for research
- Clear signs that market discipline is emerging.
  - The null hypothesis is rejected for the investment trust portion of trust holdings.
  - This portion is invested strategically, based on profitability and efficiency measures.
  - Even more results-driven than foreign investors.
- Not all trust banks are the same. Some are very result-oriented. All appear to vote actively at shareholder meetings.
  - Competition for reputation in the trust industry is rising.

