Hastings International and Comparative Law Review

Volume 16
Number 2 *Winter 1993*

Article 8

1-1-1993

Institutional Investors: Global Scale Securities Markets and Insurance, Trust, and Annuity Groups

Yoshitaka Kurosawa

Institutional Investors: Global Scale Securities Markets and Insurance, Trust, and Annuity Groups

By YOSHITAKA KUROSAWA*

I. INTRODUCTION

Japan's annuity assets rapidly expanded at the beginning of the 1980s. At the end of March 1991, Japan's annuity assets amounted to ¥150 trillion, 42% of its GNP and 17% of its financial assets. Japan's annuities are divided into public annuities and private annuities. Public annuities consist of pension insurance, mutual annuities, and national annuities. Private annuities consist of welfare pension funds and qualified annuities. Public annuity funds are deposited in the Capital Investment Section of the Ministry of Finance, are invested in treasury investments and loans, and are used to encourage industry. Reserve funds of private annuities are invested in either trust banks or life insurance companies and are used in the private market.

The investment balance of private annuities in welfare pension funds amounted to ¥25.6 trillion in March 1991. Investment of private annuities in qualified annuities amount to ¥13.0 trillion. Altogether, private annuities total ¥38.6 trillion, which is 4.3% of the total financial asset balance. The investment balance of trust banks is ¥22.9 trillion, which is 59% of all investments. The investment balance of life insurance companies is ¥15.6 trillion, which is 40% of all investments.

Trust banks and life insurance companies invest annuity assets differently. While trust banks invest annuity assets separately from other trust assets, life insurance companies pool annuity assets with other insurance assets in the form of joint investments. Consequently, the annuity funds entrusted to trust banks have a different yield for each fund. However, the annuity funds held by life insurance companies have the same yield. Therefore, the general life insurance dividend yield is the same as the annuity yield.

Public annuities consisting of welfare pension insurance are a source

* Nihon University (Economics Faculty).

of funding for treasury investments. Public annuities have also been invested in financial assets as approved by the Ministry of Welfare. These types of independent investments have been allowed since 1986. Revenue for independent investments is borrowed by the Ministry of Health and Welfare at the same interest rate as the deposit rate of the welfare pension insurance reserve funds deposited by the Ministry of Finance, Asset Investment Division. This revenue is invested in national bonds, regional bonds, deposits and savings, money trusts, and life insurance. The investment proceeds are appropriated for part of the annuity finances of the Ministry of Health and Welfare. The independent investment balance increases year by year and in March 1991 increased to 15.6% (¥12.6 trillion) of the welfare pension insurance balance of ¥80.4 trillion, and in the future is expected to increase to one third of the welfare pension insurance balance.

II. INVESTMENT OF ANNUITY ASSETS BY TRUST BANKS

The annuity assets entrusted to the trust banks are separated from general trust property, such as money trusts, loan trusts, or securities investment trusts, and are invested separately. The Banking Bureau of the Ministry of Finance has regulations governing the working assets of trust banks.

The actual portfolio of annuity trust assets changed greatly in 1973 during the oil shortage. Up until the first oil shortage, over 70% of the total annuity assets were invested as loans in response to the flourishing demand for equipment funds for business. However, with the oil shortage, most of the annuity asset investments switched from loans to securities investment due to the declining demand for capital investment. The investment percentage of loans in March 1991 was 16% (71% in March 1971), bonds were 40% (23% in March 1971), stocks were 27% (6% in March 1971), and foreign currency securities were 17% (0% in March 1971). Beginning with foreign currency securities investment, stock investment aimed at foreign asset investment and capital gain has increased. However, the dropping stock values since January 1991 have caused appraisal losses.

III. INVESTMENT OF ANNUITY ASSETS BY LIFE INSURANCE COMPANIES

The annuity assets entrusted in life insurance companies consisting of welfare pension funds, qualified annuities, and individual annuities are usually invested together with life insurance payments. Consequently, the degree of risk of individual funds is lessened, and a high yield rate is not likely.

The percentage of total assets used for asset investment of life insurance companies is regulated by the Insurance Business Act, Enforcement Regulations, clause 19, and administered by the Banking Bureau of the Ministry of Finance. Under this regulation, stocks must be under 30% of total assets, immovable property detention must be under 20%, retention of stocks or bonds of the same company must be under 10%, loans to a single individual must be under 10%, deposits or trusts in the same bank must be under 10%, and loans guaranteed by the same article must be under 5%. Apart from these investments, annuities can be invested in national bonds, regional bonds, and bonds of a special corporation. There is no investment percentage limit for bonds believed to have no risk.

Investment in foreign securities has been observed in stocks since 1970 and in bonds since 1975. The total balance of foreign securities investment is limited to less than 10% of total assets. This balance limit was relaxed to 25% in March 1986 and to 30% in August 1986.

The spread of life insurance in Japan has surpassed that in foreign countries in terms of coverage, population per capita coverage, and percentage of GNP and has become greater than in any other country in the world. The total assets of the twenty-five life insurance companies in Japan were ¥116 trillion as of March 1990. Assets of the life insurance companies make up 9.1% of the total assets of all financial organizations, while assets of Japanese banks make up 38.9%. Annuity assets are 11.6% (¥13.5 trillion) of the total of ¥116 trillion in life insurance assets. The investment breakdown of life insurance total assets in March 1990 was: 47.2% securities, 35.4% loans, 5.7% current deposits, 5.6% immovable property, and 6.1% other. In recent years, the rise of securities has been great. In the 1970s, loans were the main item of asset investment. Subsequently, securities increased in the investment percentage, and loans decreased. Securities investment overtook loan investment in 1986.

The asset investment distribution ratio of securities of life insurance companies is as follows: 46.3% stocks, 32.5% foreign securities, 8.4% national bonds, 8.3% company bonds, 1.6% regional bonds, and 2.9% other (March 1990). The increase in foreign securities was 22.4% as of March 1984. Total securities holding percentages by organization as of March 1990 are as follows: banks 30.7%, trusts 14.2%, life insurance 13.9%, Post Office Life Insurance and postal annuities 5.8%, and other

35.4%. Stock investments made up over 80% of the securities investment assets until 1975. In 1975, the demand to invest decreased due to the drop in yield caused by increase in capital, increase of issuings at market price, and increase in stock prices. However, stock trading was used constructively to compensate the exchange losses of foreign currency assets due to the strong yen following the Plaza Accord in September 1985 and has increased again since 1987.

Foreign securities investment has begun to increase since the investment balance regulations were relaxed in 1986. Foreign securities investment amounted to ¥17.8 trillion in March 1990, which was 15.3% of the total asset investments. Bonds are ¥14.4 trillion (80.9% of foreign securities investment), and stocks are ¥3.4 trillion (19.1% of foreign securities investment). The major portion of bonds consists of American TB bonds. Also, overseas financing by life insurance companies has increased to 4.8% of total assets (¥5.5 trillion in March 1990). The concentration of domestic savings has been heavily invested in life insurance companies because of delays in liberalization of deposit interest rates. The delay in liberalization of deposit interest rates is considered to be indirectly responsible for the investment of life insurance assets in foreign currency.

The objective of investing in foreign currencies, such as foreign securities and foreign financing, are: (1) diversification of growing life insurance asset investments; (2) insurance of asset value against a drop in the yen due to a major disaster such as an earthquake; and (3) lucrative investments based on the difference in foreign and domestic interest rates. Life insurance companies without foreign currency liabilities who invest in foreign currency assets face an exchange risk. Against this background, life insurance assets are invested as part of the government's financial policy to avoid domestic inflation due to the rapid increase of operating revenue and expenditures.

IV. PROBLEMS WITH SECURITIES INVESTMENT

One problem with investment of annuity assets is the appraisal losses that occur when foreign securities transactions are subject to variations in exchange rates due to the drop of securities prices. Exchange losses of securities in dollars took place when the yen became strong following the Plaza Accord of September 1985. Another example of stock appraisal losses is the 42% fall of the Tokyo Stock Exchange listed stock values (Nikkei Average Value: ¥38,000 to ¥32,000) which has occurred since January 1991. There is no definite policy for appraisal losses because the range of annuity accounts and information disclosure is unclear. In the case of individual investments of trust bonds, it is possible to transfer profits and losses between each annuity asset. In the case of the merged investments of life insurance companies, the profits and losses are transferred between insurance and annuities. Because the responsibility of those entrusted with annuity investments is unclear, the basis of profits and losses is not shown to the annuity recipients. For securities that change prices from moment to moment, various operations are possible, leaving room for dishonesty.

Another problem is that a certain amount of annuity investments are invested in stocks of related business entities called *Keiretsu*. Various types of *Keiretsu* exist, including old *Zaibatsu* type organizations with very strong ties between affiliated life insurance companies and trust banks, as well as other organizations made up of independent organizations with weak ties. In a *Keiretsu* organization, the percentage of loans and stocks retained for the group business of annuity assets is determined by a gentleman's agreement among group members. It has become common practice that once *Keiretsu* organizations acquire stocks, they permanently retain them. In fact, 70% of stocks listed on the Tokyo Stock Exchange are held by businesses and financial organizations and do not enter the market. This type of investment benefits the *Keiretsu* organization but does not always benefit beneficiaries.

There is growing pressure to avoid the losses to beneficiaries that arise from investment of annuities in *Keiretsu* organizations. As the balance of annuity assets is increasing, the voice of annuity beneficiaries is becoming louder. Due to the aging society, demand for the sharing of profits amongst beneficiaries is growing stronger. In response to beneficiaries' dissatisfaction with stock dividend returns of less than 1% per annum, two alternative choices for managing annuities have been proposed. Companies managing annuities could move away from investing in stock, or they could relax *Keiretsu* ties to make stocks more attractive as financial assets.