

Keynote Speech by Yasuhisa Shiozaki
Former Minister of Health, Labour and Welfare
Member of House of Representatives, Japan
at Program on Public Pension and Sovereign Funds
2nd Annual Conference, Columbia University
February 26, 2018

Today, I feel indeed honored to have a chance to speak at the Program on Public Pension and Sovereign Funds' 2nd Annual Conference, organized by the Center on Japanese Economy and Business at Columbia Business School.

Professor Ito and I have long been friends. Especially when he served as a member of the Council on Economic and Fiscal Policy from 2006 to 2007, when I was the Chief Cabinet Secretary, he exercised his leadership throughout the whole range of economic reform agenda, from monetary and fiscal policy, to social security, education and aviation, and many other areas. We all have to thank Ito-sensei for making direct flights possible to Haneda Airport in addition to Narita Airport from both the United States and Europe, since the Ministry of Transportation at that time was strongly against such an idea. I would like to express my sincere gratitude to his great contribution reforming the Japanese economy and industry. And in the recent GPIF reform, which I would like to talk about today, his contribution was also eminent.

As you all know, GPIF, or the Government Pension Investment Fund of Japan, is the world's largest government pension fund with the asset size of over 160 trillion yen, or 1.5 trillion U.S. dollars today.

The GPIF was established in 2006 as an Independent Administrative Agency in charge of managing Japan's public pension assets. Despite its tremendous asset size, the organization was long governed under a "single manager governance system", where the president was given full authority to make decisions on all management issues, lacking any strong governance structure or risk management framework.

The Japanese public pension fund has a long history of adopting a so-called "safe investment principle," excessively investing over 67% of their entire portfolio in one time on JGBs with very low return. This conservative policy was designed as a reflection of our nation's unfortunate history up until the 1990s of mismanagement of pension assets, including big losses arising from aggressive investments in huge resort real estate development projects.

Right after the start of the Second Abe Administration in late 2012, as the Acting Chairman of Policy Research Council of Liberal Democratic Party, I proposed a fundamental reform of the asset management policy of Japan's public and semi-public funds. My proposal argued for such funds to introduce further diversification and sophistication of their investment policy, together with strengthened governance and risk management in the new economic environment.

Obviously, the main target in my mind was GPIF. GPIF's traditional investment approach was not only too conservative, but also theoretically contradictory to the Abe Administration's focus on "growth" and "exit from deflation". In other words, in the process of the expected economic recovery under "Abenomics", the yield curve would become steeper while equity prices would increase with the yen depreciation. It is quite reasonable that, if we could diversify GPIF's investment by increasing the weight of equities and foreign assets, GPIF would be able to better enjoy the fruits of the nation's economic recovery.

Following my policy proposal, in 2013 the government established an expert panel on the reform of portfolio and risk management and the governance of public funds, of which Professor Ito was appointed as chairman.

The panel's final report, the so-called "Ito Paper," which was released in November 2013, clearly expressed that portfolio change and strengthening governance were inseparable and both had to be carried out simultaneously. The panel made a bold proposal to replace the conventional way of decision making under a "single manager governance model" with a "board structure" designed on a consensus-based decision making with a plural number of members just like the boards of directors of companies. The essence of the proposal was to separate "decision making and supervision" from "execution," which is simply the standard practice among pension and sovereign funds globally.

Then in September 2014, I was appointed as the Minister of Health, Labour and Welfare, a position officially in charge of GPIF reform. The Tokyo stock market rose over 260 yen on the day my appointment was announced.

However, immediately after I came into the office in the ministry to jump start such reform, I faced strong resistance from within the ministry and GPIF to the proposed change of GPIF's governance structure. I suspect the reason behind this was the ministry's fear of losing control over GPIF and its investment decisions.

In fact, when Professor Ito reported the conclusion of the panel to the Prime Minister's Office

in November 2013, I have heard that the senior official of the Pension Bureau of our ministry looked very dissatisfied and turned his face away from the main table.

While GPIF's portfolio weight was significantly diversified in November 2014 shortly after I took office as the Minister, the proposed governance reform which was supposed to be introduced concurrently faced strong political resistance, and legislative revisions were suspended.

Under the parliamentary system, in order for new legislation to materialize in Japan, the councils in each ministry have to endorse the outline of the government proposed bills. In order to overcome the strong influence by the bureaucracy, I invited some fresh reform-oriented members, once again including Prof. Ito, to a new task force on the council on pension issues. In January of 2015, they issued a taskforce report to the Pension Council, convincing the Council to support the strengthening of GPIF's governance by creating a management board type of governance structure.

Even though the Pension Council basically accepted the introduction of the board structure to GPIF, the resistance from bureaucracy and GPIF continued. But they seemed to have finally given up when I was re-appointed as the minister in charge in October 2015.

In sum, it took over 2 years to pass a GPIF governance enhancement bill in the national Diet in the fall of 2016, and finally the new GPIF was established under the new law in October 2017.

One of my final tasks as the minister in charge was the appointment of the 9 new members of the newly created Board of Governors of the GPIF.

Since October 2017, the Board of Governors has been established under the new law, where the Board, consisting of non-executive outside experts, except for the President, was granted authority to supervise the President and the operations conducted by the executive office. Also, a classic "three lines of defense" internal controls system was introduced allowing three outside management board members to conduct an audit function.

I am very proud of the establishment of the Board of Governors structure, a result of a hard fought political battle, one definitely worth fighting for, and a historical step forward in terms of strengthening GPIF's governance as its assets are being invested in a more diverse and sophisticated manner which necessitates stronger risk management. However, this achievement should not be seen as the completion of GPIF's governance reform, but rather as just the beginning of a long series of challenging reforms to come.

I would like to touch upon three main areas in which GPIF should focus its efforts in improving its governance structure: internal control, transparency, and talent.

First is the strengthening of “internal controls”. The expected oversight by the Board of Governors can only properly function with a robust internal control structure in place. The existing organization’s internal control structure, which has been designed to serve the historical single manager governance system, must be fundamentally changed. Therefore, one of the first important tasks by the Board of Governors should be an expeditious introduction of the basic principles of its internal control system and risk management to be complied by the executive office.

Since the introduction of the Corporate Governance Code in 2015, listed companies in Japan have all been accelerating their efforts to modify their internal rules, strengthen internal audit functions, broaden whistleblower hotline coverage, and invite closer scrutiny from outside board members. GPIF, an organization with its asset size far larger than any listed company, should look to these private practices not as a goal to reach, but as a minimum standard, and seek to go beyond, leading by example to establish the highest standards of governance globally.

Second is “accountability”. In June 2017, GPIF issued a request to various investment institutions and funds which it invests in to disclose proxy voting records on individual agenda items for each of their target companies following the principles of Japan’s Stewardship Code. This is an example of how GPIF can function as an engine to promote better corporate governance in the global market. But, if GPIF seeks accountability of its vendors, then it must also be willing to lead by example by being transparent and accountable to its stakeholders.

Since the time I was appointed as the Minister of Health, Labour and Welfare in 2014, GPIF’s total asset value has increased by about 30 trillion yen, thanks to great leadership by its managers including President Takahashi here. However, we all know that the market has its ups and downs, and that there will probably be times in the future when GPIF may incur short term losses. That is why the principles of transparency and accountability, backed by a robust internal control system, are fundamental for GPIF to continue to be entrusted with the fate of the nation’s pension funds.

And my final point is about “talent”. A great organization with great governance policies and structures will only be great if equipped with the best talents of the world.

One of the major obstacles for GPIF in trying to gather the best talents in the world is its compensation policy. Japanese government institutions, probably like any other country, have traditionally been very conservative in terms of their employee compensation. But if you were betting your nation's pension, would you rather hire a cheap and unskilled investment manager, or an expensive but talented one? I believe we should explore further flexibility in the conditions for gathering the best talent, perhaps introducing further means to allow for a performance-based compensation structure closer to market value. Again, these changes would be better served if led and reported under the supervision and guidance of the Board.

GPIF is not only a large pension fund, but it is also the single largest fund in the world. Therefore, GPIF not only should, but must be equipped with the world's best governance structure and the world's best talents. This is neither an easy nor a quick task. This is an important, difficult, and long-term task critical for protecting the future welfare of all Japanese citizens.

We need the world's best talent. That means we need people from Columbia, too. Yes, we sent Professor Ito here on a recruiting mission. So, if any of you who are talented in investment and looking for a good place to work, and perhaps also interested in being able to watch the Olympic and Paralympic Games in 2020 with the best cuisine in the world, please come to Japan, and please come to GPIF.

Thank you very much.