The GPIF and its reform

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Japan's Government Pension Investment Fund (GPIF) is one of the largest investment funds in the world, with assets of ¥130,884.6 billion (as of end-September 2014).

It has been announced that the GPIF will change its policy asset mix, governance and other key aspects this year. This reform will impact the market and asset management industry. In this article, the details of changes in the asset mix and the governance system will be described.

The GPIF and policy asset mix

The GPIF is an independent administrative institution with the objective of managing and investing the Reserve Funds of the Employees' Pension Insurance and the National Pension. The GPIF also manages and invests the Reserve Funds of the Government Pension Plans entrusted by the Minister of Health, Labour and Welfare, in accordance with the provisions of the Employees' Pension Insurance Act (Law No. 115 of 1954) and the National Pension Act (Law No. 141 of 1959). It is responsible for contributing to the financial stability of both plans by remitting investment profits to the Special Accounts for the Government Pension Plans.

The policy asset mix of GPIF has been changed (see Matrix 1). The new policy asset mix will be applied from 1 April 2015. Meanwhile, the proportion of equities held under the GPIF will increase at the expense of bonds—a shift that is likely to impact the market. Japanese equity indices such as the Nikkei 225 and TOPIX have gradually been moving upward.

In the new asset mix, the GPIF’s exposure to equities will rise from 24% to 50% (both Japanese and foreign equities will increase from 12% to 25%). Exposure to foreign currencies will also rise, from 23% to 40% (foreign bonds will increase from 11% to 15%, and foreign equities from 15% to 25%). Exposure to safer assets such as Japanese bonds will therefore decrease, from 60% to 35%.

Matrix 1: Policy asset mix

	Japanese bonds	Foreign bonds	Japanese equities	Foreign equities	Cash etc.
Old asset mix	60%	11%	12%	12%	5%
New asset mix	35%	15%	25%	25%	-

So far, so good. The return from the portfolio has been almost ¥3 billion since the third quarter of the 2012 financial year, when Shinzo Abe became Prime Minister of Japan. The GPIF enjoys returns that make up for the risks that the GPIF has been taking during the period of ‘Abenomics’.

Some professionals point out that the GPIF needs to be careful with respect to risks in view of these exposures to the equity and foreign exchange markets. The largest U.S. pension fund, known as CalPERS (California Public Employees’ Retirement System), allocates 61% of its assets to equities and has an advanced risk management system and organisation. There may be many points that GPIF can learn from CalPERS or other leading institutional investors in risk management of equity in its asset portfolio.

On the other hand, market participants have welcomed this change in view of the strong impact of the GPIF, particularly on the Japanese equity market. It is said that a 1% increase by the GPIF in its allocation of the Japanese equity market will bring ¥1 trillion into the market.

Some may wonder whether the GPIF will have any exposure to alternative assets. It was announced that the GPIF will allocate a maximum of 5% of its assets to alternatives such as real estate, infrastructure and private equity. These alternatives will be recognised as equity or bonds according to their characteristics.

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Governance

The GPIF reform strengthens three areas, with the aim of improving governance: (1) internal control, (2) risk management capabilities and (3) human resource management.

Regarding internal control, GPIF managers will appoint a compliance officer, bolster the internal audit system by expanding the role of the internal auditor, review and develop its disclosure policy to enable effective investment management and upgrade its IT security management system.

With regard to risk management, the GPIF's macroeconomic and market analysis capabilities will be strengthened. It has hired external consultants and installed an IT system to analyse both investment assets and expected payouts in 2014, and is in the process of developing a sophisticated risk management system.

In order to strenghten internal control and risk management, the human resources function also needs reform. The remuneration system has been changed so that external experts can be hired, and the GPIF has already announced that, in January 2015, it will appoint Hiromichi Mizuno, a partner from Coller Capital, as executive managing director and Chief Investment Officer (CIO).

Before these changes, the policy asset mix of the GPIF had been decided under its internal rules by its president, without requiring the agreement of other GPIF members. This past summer, GPIF changed that system and set up an investment committee to establish pre-clearance of essential decisions made by the president. The reform of the GPIF's governance is still in progress.

Japan's Stewardship Code

The Principles for Responsible Institutional Investors, referred to as 'Japan's Stewardship Code' were published by the Japanese FSA in 2014. So far, 160 institutional investors, including the GPIF, have complied with these principles.

The seven principles of Japanese 'stewardship' are reproduced below:

1. Institutional investors should have a clear policy on how they fulfil their stewardship responsibilities, and publicly disclose it.

2. Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities, and publicly disclose it.

3. Institutional investors should monitor investee companies so that they can appropriately fulfil their stewardship responsibilities with an orientation towards the sustainable growth of the companies.

4. Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.

5. Institutional investors should have a clear policy on voting and disclosure of voting activity. The policy on voting should not be comprised only of a mechanical checklist; it should be designed to contribute to the sustainable growth of investee companies.

6. Institutional investors in principle should report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.

7. To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the investee companies and their business environment and skills and resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities.

The main purpose of the principles is to promote the sustainable growth of companies through the 'engagement' of asset managers (investment companies) or asset owners (pension funds, etc.). Engagement is defined as a dialogue between investors and companies, and such engagement is supposed to promote mutual understanding between investors and companies.

The Japanese FSA will soon publish a code for a higher level of corporate governance for Japanese companies. These two codes are seen as essential for achieving sustainable growth of the Japanese equity market. The GPIF must, in this context, have better governance.

Secure Japanese pension system

It is not appropriate to classify the GPIF as a Sovereign Wealth Fund (SWF), as it has the liability of pension payments. When we look at the size of the GPIF, it is clear that it needs to have the same or even a higher level of governance through a clear decision-making system, strong internal auditing, a sophisticated risk management system and a secure IT system. The GPIF is on the path toward being a better organisation, and this progress will affect not only the Japanese market but other markets too.