lakyara vol.250

Fiduciary best practices for Japanese asset management companies

Sadayuki Horie

28.October.2016

Nomura Research Institute, Ltd.

Sadayuki Horie

Senior Researcher

Financial Technology & Market Research Department

Preface

How long has it been since fiduciary duty first became a topic in Japan's asset management industry? Personally, I distinctly recall the term, with its definition appended, entering the asset management and pension fund industries' general lexicon in the latter half of the 1990s, when government first started talking about passing the Defined Benefit Corporate Pension Plan Act. Why is this term now attracting renewed attention more than 20 years later?

The reason is that clients are becoming increasingly concerned that financial institutions providing a wide variety of services, including asset management companies, are not adequately fulfilling the key fiduciary duty of loyalty, which means placing their clients' interests above their own when providing services. In Japan, many asset management companies belong to financial groups, making them susceptible to conflicts of interest among various stakeholders, most notably their parent companies. Managing conflicts of interest is consequently a crucial element of fulfilling their fiduciary duties. Asset management companies' clients also have become more vigilant with respect to fiduciary duty. For example, the Government Pension Investment Fund (GPIF) recently disclosed that it will place more priority on stewardship responsibilities and evaluate asset management companies largely based on how they manage conflicts of interest.

In light of such, this report recommends conflict-of-interest management methods for Japanese asset management companies, drawing from overseas practices. With many overseas asset management companies likewise members of financial groups, many of their conflict-of-interest management practices should be instructive for their Japanese counterparts. I hope asset management companies find this report helpful as they rethink how they manage conflicts of interest going forward.

Introduction

Asset management companies as fiduciaries

Asset management companies as fiduciaries

Asset management companies (AMCs) are primarily in the business of investing clients' money on the clients' behalf. In doing so, they assume a fiduciary duty to act solely in their clients' interests. AMCs are expected to help investee companies enhance their value and to contribute to their sustained growth through constructive dialogue targeted at specific objectives. As a minimum prerequisite to fulfilling this role, AMCs must be fulfilling their fiduciary duties.

Acting solely in clients' interests while investing on their behalf is easier said than done. Every AMC has an inherent incentive to place their own revenues or profits above clients' interests. Additionally, financial institutions' asset management subsidiaries are often exposed to various conflicts between clients' interests and their parents' interests when investing clients' assets. In Japan, a financial institution's ownership of an AMC can take several forms. The AMC could be a wholly owned subsidiary of the financial institution; a sibling of the financial institution, both owned by a holding company; or co-owned by multiple financial institutions. Whichever the case, financial institutions are prone to seek to influence their AMC's management and investment practices.

Among Japanese AMCs, those that are financial institutions' subsidiaries account for over 90% of industry-wide AUM, making management of conflicts of interest a particularly important issue. For example, when an AMC exercises its voting rights as a shareholder, it is duty-bound to make voting decisions based solely on its clients' interests but its parent may have some sort of business relationships with some of its investee companies and pressure the AMC to cast pro-management votes. Alternatively, when trading securities, an AMC may preferentially route its orders to its parent or another affiliate[1]. In addition to these two examples, AMCs potentially face a wide range of other conflict-of-interest scenarios. Management of conflicts of interest is thus crucially integral to fulfilling fiduciary duties.

NOTE

1) Japanese asset management companies are legally required to disclose such order flows routed to their parent and/or other affiliates.

Lessons from overseas

Conflicts of interest can be managed by various means, one of the most important of which is establishing a governance framework. In a fiduciary context, governance can be defined as an organizational framework intended to ensure that an AMC is efficiently organized and operated solely in its clients' interests, not its own interests[2].

2) This definition was adapted from IOSCO's definition of collective investment scheme governance (2006).

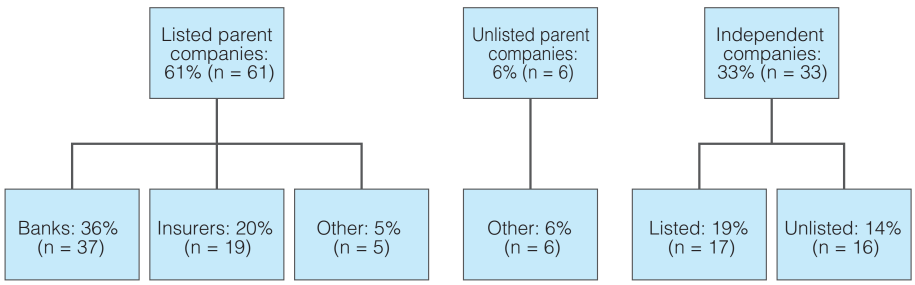
Overseas AMCs offer instructive examples of optimal governance structures for Japanese AMCs, the vast majority of which are owned by financial institutions. Even overseas, where independent AMCs are seemingly more common, a majority of AMCs are financial institutions' subsidiaries.

Figure 1 shows the breakdown by capital structure of the world's top 100 AMCs as ranked by total assets at 31 December 2014. The non-independent ones owned in some form by a parent company account for nearly 70% of the 100 companies' total AUM. Their parent companies are mostly banks, insurers and other financial institutions. Independent AMCs' share of total AUM is 33%. Given how many overseas AMCs have parents like in Japan, suspected conflicts between clients' interests and parent companies' interests are not confined to Japan. Japanese AMCs therefore may be able to learn from how overseas AMCs, particularly those with financial-institution parents, deal with conflicts of interest vis-à-vis their parents and manage their operations client-centrically.

Prioritizing clients' interests above all else

While many financial institutions and nonfinancial companies aspire to place utmost priority on their customers' interests as one of their core principles, AMCs must actually put this principle into practice instead of merely paying lip service

Figure 1:
Breakdown of top 100 AMCs by capital structure and listed/unlisted status



Source: NRI, based on rankings in Towers Watson's "The 500 largest asset managers" (November 2015) and AMC annual reports to it. Being in the business of investing clients' money in securities on the clients' behalf as noted above, AMCs are charged with a fiduciary duty to place utmost priority on their clients' interests in managing the clients' assets. The fact that AMCs invest as a business means that they earn revenues and profits from their investment activities on behalf of clients. However, their clients are clearly their top priority in their investment activities.

I believe AMCs must implement controls to ensure that they place utmost priority on clients' interests by preventing various potential conflicts of interest. In this report, I present examples of overseas AMCs' efforts to avoid various conflicts of interests and make recommendations applicable to Japanese AMCs also. Between April and June 2016, I visited 17 AMCs[3] in the US, UK, France and Switzerland. They manage assets ranging from the equivalent of several trillion yen to over ¥100 trillion. They constitute a diverse sample in terms of capital structure and include independent, publicly traded companies. In Chapter 1, I discuss governance structures fundamental to fulfilling fiduciary duties, using the AMCs I visited as examples. Chapter 2 features specific examples of how the AMCs I visited manage conflicts of interest and manage their operations client-centrically. In Chapter 3, I draw upon overseas examples to make a case that Japanese AMCs must create a framework for fulfilling fiduciary duties on a group-wide basis instead of within their own organizations only.

3) I actually visited 18 asset management companies. One of these 18 visits involved an interview with the chairman of the board of directors of an investment trust managed by another of the asset management companies I visited. I therefore count only 17 of the companies as asset managers.

Chapter 1

Overview of overseas AMCs' governance

Three governance structures

Figure 2 presents an overview of the governance structures of the 17 AMCs I visited. Seven of the 17 are headquartered in the US, seven in the UK, two in France and one in Switzerland. All but three have a parent company. One of the three parentless companies is a publicly traded corporation; the other two are organized as partnerships. Five of the 17 have no board of directors. These five include the aforementioned two partnerships. The other three are merely business units of their respective parent banks, not separate legal entities themselves.

Although the asset managers I visited constitute a small sample not representative of the entire asset management industry, they nonetheless demonstrate that AMCs have diverse governance structures, none of which is a standard model. For reference, the 17 companies can be broadly classified into the following three groups based on their governance structures.

(1) Those with no board of directors (five companies)

Figure 2: Overview of governance structures of visited AMCs

Governance structure	Notes		Type of (parent) company	Country
No board of directors	Governed by management committee, executive committee or the like in lieu of board of directors	A	Bank (US)	US
		B	Bank (US)	US
		C	Bank (US)	US
		D	None Partnership (LLP)	US
		E	NonePartnership (GP)	UK
Board consisting entirely of parent's corporate officers and AMC's executive directors	US SEC has no board configuration requirements but Fed is pushing for greater board independence	F	Bank (US)	US
		G	Financial conglomerate (Canadian)	US
		H	Insurer (Canadian)	US
		I	AMC (US)	UK
		J	Foundation (UK)	UK
		K	Bank (French)	France
		L	Bank (Swiss)	Switzerland
Board with independent outside directors	In UK, many AMCs are transitioning to this structure at regulatory authorities' behest. AMCs with majority-independent boards will presumably increase in future.	M	AMC (US)	UK
		N	Insurer (UK)	UK
		O	None Independent listed co.	UK
		P	Insurer (UK)	UK
		Q	Bank (French) Listed company	France

Source: NRI

	Board composition	Notes
A	Management committee (25 members, 15 of which are subsidiaries' CEOs)	Preparing to establish board of directors (or new management committee). Fed has requested that holding company be set up to facilitate divestment of AMC in event of financial crisis.
B	Executive committee only	Co. B is a business unit of parent, not separate legal entity. Has drafted and publicly disclosed conflict-of-interest guidelines for voting/engagement activities.
C	15-member executive committee (all members are partners)	Corporation operating mainly in US. Global organization managed as supra-corporate business unit. Has adopted strict controls against information leaks between organizational units. Almost no personnel reassignments between portfolio management staff and other organizational units. Commented that Fed oversight is much more stringent than SEC's.
D	9-member executive committee (3 permanent partners, 6 2yr-term partners)	Organized as limited liability partnership (LLP).
E	6-member management committee (2 members not involved in management)	Two senior partners act as co-CEOs. Management committee maintains some degree of independence through inclusion of two members largely uninvolved in management functions.
F	US corporation: 5- or 6-member board of directors; Globally: 6-member executive committee (no outsiders)	Has executive committee as global management body and incorporated subsidiaries in every country in which it operates. Prohibits physical contact between portfolio management staff and other organizational units. US corporation's board meets quarterly.
G	19 board members (most of which are founder's family members or parent company directors)	Co. G is LLC. Has complex shareholder structure, with both parent and grandparent listed on stock exchanges. Had no board of directors until acquired by financial institution (previously owned by consulting firm). Board meets at least 8 times annually.
H	4 board members (2 from parent, 2 executive directors)	Small board with oversight mandate only. No outside directors.
I	8 board members (1 from parent, 7 inside directors)	Prioritizes substance over form. Receives management advice from advisory group of 4 outside experts. Board meets quarterly.
J	9 board members (5 nonexecutive directors, 4 executive directors)	Parent company is foundation but is effectively owned by founder's family (which owns 75% equity stake and controls 98% of voting rights).
K	10 board members (7 from parent, 1 from pension fund, 2 executive directors)	Of parent's 7 directors, 5 are retired regional bank officers who function as independent directors.
L	3 board members (2 from parent, 1 executive director)	Under Swiss law, board of directors is subject to mandatory quality assessments by independent third party.
M	10 board members (2 from parent, 5 executive directors, 2 independent outsiders)	Two independent outsiders added to board since 2014, one of whom is former CEO of major UK AMC. Board's risk management committee is chaired by outside director. Board meets quarterly.
N	6 board members (3 independent outsiders, including chairman)	Board reconfigured in March 2016 at parent insurer's behest to increase its independence to parity with listed companies' boards.
O	12 board members (7 independent outsiders, including chairman)	Founder still owns 48% equity stake, enabling company to be managed from long-term perspective as if it were partnership. Board meets monthly.
P	7 board members (4 inside directors (including parent insiders), 3 independent outsiders)	Board includes 3 independent outside directors since 2006. Chairman also is outsider. Co. P is unique in having adhered since its inception to policy of aligning its governance with clients' interests by adopting governance structure equivalent to investee companies'.
Q	12 board members (4 independent outsiders)	French listed companies are required to fill at least one-third of their board seats with independent outside directors.

Source: NRI

(2) Those with a board of directors comprised entirely of corporate officers of their parent companies and their own executive directors (seven companies)
(3) Those with a board of directors that includes at least one independent outside director (five companies)

Four of the five without a board of directors are in the US. One of the five is an internal business unit of a publicly traded bank, not a separate legal entity, despite managing the equivalent of over ¥100 trillion of assets. Two others are organized as partnerships[4].

4) Some of the asset management companies without a board of directors have a body equivalent thereto, such as a management committee or executive committee comprising executive officers and/or partners.

The second group consists of AMCs that have a board of directors composed entirely of the parent company's nonexecutive directors and the AMC's executive directors, without any independent outside directors. Such a governance structure is common among unlisted US AMCs.

The third group consists of AMCs whose boards include at least one independent outside director. This governance structure is the norm for publicly traded independent AMCs. Nearly all US or European publicly traded AMCs have independent outside directors occupying a majority of their board seats in accord with their respective home countries' stock exchange rules, corporate governance codes or other such guidelines.

In the UK, even unlisted asset managers are increasingly adding independent outside directors to their boards as of late. The UK's Financial Conduct Authority (FCA), which supervises the asset management industry, recommends such a governance structure in the belief that it is important for unlisted AMCs to have independent boards like their publicly traded counterparts to better ensure that they manage their operations from a client-centric perspective. Unlisted UK AMCs have increasingly been appointing independent outside directors at the FCA's behest.

Boards' roles and composition

What specific roles do AMCs' boards perform? The FCA, for example, wants AMCs' boards to fulfill the board functions stipulated in the UK's Corporate Governance Code, including those enumerated below. Although the list below is specific to the UK, AMCs' boards in other countries likewise perform largely equivalent functions.

(1) Set business strategy

(2) Set the business's appetite for risk

(3) Oversee and control the business's financial performance

(4) Manage any conflicts of interest that exist within the business

(5) Govern the business's compliance with regulatory requirements and risk management

(6) Exercise operational and organizational governance

While overseas nonfinancial companies' boards of directors seem to typically meet 6-8 times annually[5)], most of the AMCs I visited hold board meetings quarterly or thereabouts. The lower meeting frequency presumably reflects two factors. First, most AMCs, unlike the typical nonfinancial company, specialize in a single business (asset management). Second, AMCs' boards generally focus exclusively on oversight functions because operational execution has been delegated to the CEO and executive management team.

5) Many Japanese nonfinancial companies' boards of directors meet monthly.

At AMCs whose boards consists entirely of their own executive directors and their parent companies' corporate officers, the board typically serves as a forum for reporting on the status of the AMC's business. In contrast, boards that include independent outside directors seem to be more involved in oversight, probing into the AMC's operations from various angles like publicly traded companies' boards typically do[6)].

6) Among the companies I visited, those with independent outside directors on their boards were all in the UK and most of them had added the outside directors to their boards only recently. Such companies' optimistic comments on independent outside directors' role may need to be discounted somewhat.

The AMCs that have a board of directors have adopted some version of the multi-committee (e.g., compensation committee, audit committee) board model that is one of the board configurations permitted by Japan's Companies Act. Among unlisted AMCs, however, nominating committees are uncommon, unlike at listed AMCs[7)].

7) Of the companies I visited, only one of the unlisted companies has a board with a nominating committee.

Many AMCs have set up compliance risk and compensation committees subordinate to their boards. Management of conflicts of interest is an important board function. Compliance risk management committees' functions include vetting conflict-of-interest management regulations. Compensation committees assess how well executives' compensation is aligned with clients' interests. Compensation arrangements play a major role in client-centric management because linking compensation to clients' returns instead of the AMC's revenues or profits is more conducive to client-centric management.

Most of the AMCs with a parent company do not have nominating committees.

Such companies use a variety of CEO appointment methods. In some cases, the parent financial institution's board's nominating committee appoints the asset management subsidiary's directors and officers[8].

8) This approach is also common among AMCs that are an internal business unit of their parent company and therefore do not have a board of directors.

In other cases, the AMC's board make CEO appointments itself. In such cases, the appointment process seems to usually involve three steps. First, the current CEO selects successor candidates in consultation with the parent company's officers who serve on the AMC's board. Second, the board interviews the candidates. Lastly, the board decides which candidate to appoint.

Factors behind governance structure variations

In sum, AMCs have diverse governance structures. Such diversity reflects several factors. One key determinant of governance structure is whether a company is publicly traded. Publicly traded AMCs have boards with multiple, if not a majority of, independent outside directors, depending on their home country's regulatory requirements. In contrast, unlisted companies, which account for a majority of AMCs even overseas, sometimes have no board of directors.

A second factor behind variations in governance structure is differences in regulatory bodies' stance towards governance. In the UK, the FCA strongly advocates client-centric management of AMCs. It wants AMCs to have independent outside directors on their boards. In response, many UK AMCs have now started to add outside directors to their boards. Additionally, UK AMCs are required to obtain FCA approval of director appointments pursuant to the so-called approved persons rule (see sidebar on FCA). The FCA also verifies directors' qualifications.

The US, home to the world's biggest asset management industry, is less of a stickler for board independence than the FCA is. However, the US regulatory landscape seems to be distinguished by differences in attitude towards governance among regulators, though the group of companies I visited is not a big enough sample to draw generalized conclusions. Whereas the Securities and Exchange Commission (SEC) does not seem to impose many requirements with respect to governance structure, The Federal Reserve Board (Fed) is pressuring AMCs to establish boards and increase their boards' independence à la the FCA[9].

9) The Fed is doing so for different reasons than those of regulators in other countries. By explicitly separating financial institutions' asset management business units (AMCs) from their other business units, the Fed reportedly aims to prevent contagion through expeditious divestment of asset management business units in the event of a financial crisis. Some US asset managers' parent companies are banks designated as systemically important financial institutions (SIFIs), meaning that their bankruptcy would have major repercussions on the financial system. Once an asset management business unit has been separated from other business units, the board of directors of the US holding company that ties together the financial group's global operations can sell the asset management company, including any subsidiaries, more swiftly. The Fed therefore wants to strengthen the function of boards of asset management subsidiaries independent of their parent companies.

International differences in regulators' attitude toward governance (particularly between the US SEC and UK FCA) may reflect different mindsets regarding how to enforce fiduciary duties. In short, the US uses a rules-based approach to enforce fiduciary duties while the UK gauges fiduciary compliance from an information disclosure standpoint.

For example, the US Employee Retirement Income Security Act (ERISA) imposes severe penalties for conflict-of-interest violations when AMCs manage pension fund assets. The US aims to ensure fiduciary compliance by enacting stringent laws and prosecuting violations thereof. The idea behind this approach is that even without requiring a high degree of board independence, regulators can prevent conflicts of interest and ensure thorough fiduciary compliance by severely penalizing rule violations[10].

10) Incidentally, the US's basic framework for protecting pension beneficiaries' claims to pension benefits is also based on strict rules. Such rules include (1) early vesting of pension benefits, (2) establishment of Pension Benefit Guaranty Corporation and (3) avenues for pursuing liability for violations of duties. Rule-based protection of rights is a fundamental principle in the US.

The UK apparently aims to prevent conflicts of interest through information disclosure. One example of this approach is disclosure of potential conflicts of interest. UK AMCs disclose to clients their own interests, their parent companies' interests, the fact that these interests may not be aligned with clients' interests, how they aim to avoid conflicts of interest and how well they actually do so. A high degree of transparency with respect to managing and vanquishing conflicts of interest is considered important in the UK.

A third factor behind variations in governance structure is that AMCs tend to be relatively small operationally. Their workforces are generally much smaller than those of nonfinancial companies with comparable revenues or profits. Some overseas AMCs managing the equivalent of trillions of yen of client assets are staffed with only about 100 personnel. Even among AMCs with the equivalent of ¥100 trillion of AUM, few employ more than 10,000 personnel. Consequently, asset management industry has a deeply rooted preference for boards that combine both executive and oversight functions (the managing board model[11]) over boards that predominantly fulfill an oversight function (the monitoring board model). The managing board model is seen as a better fit for AMCs than the monitoring board model and has in fact been adopted by many AMCs. Some AMCs are skeptical that installing independent outside directors on their boards would add value to their companies. A comment I heard from more than one company I visited is that cultivating a corporate culture that prioritizes clients' interests is much more important than adopting board configuration standards.

11) Boards of directors can be broadly classified into two types: (1) managing boards, which possess both executive and oversight functions, and (2) monitoring boards, whose function is limited to oversight. In companies with monitoring boards, executive and oversight functions are segregated from each other.

AMCs have thus adopted diverse governance structures for a variety of reasons. There is no standard governance model in the asset management industry. When assessing Japanese AMCs' governance structures, one must consider what type of governance model is most appropriate in light of the company's operating environment and attributes.

Sidebar

Multi-tier governance structures

One distinctive attribute of overseas AMCs' governance is a trend toward multi-tier governance structures. "Multi-tier" has two meanings. First, it means that governance of separately managed accounts (SMA) and governance of collective investment schemes (CIS) that pool together many clients' assets coexist in parallel. Second, it means country-specific and global governance likewise coexist in parallel (Figure 3).

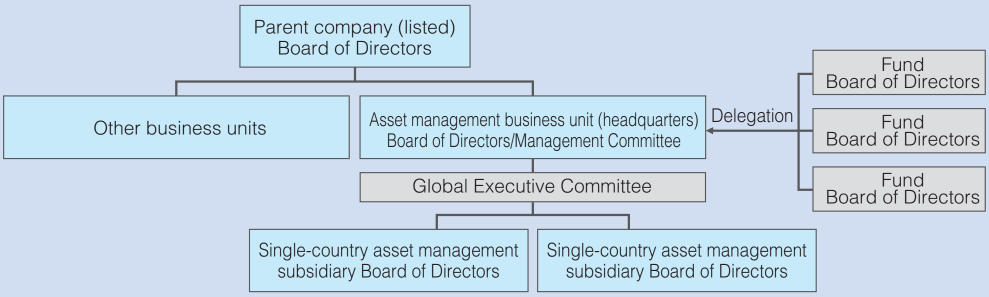
AMCs that offer both SMA and CIS products often have a CIS governance structure that is independent of themselves. Broadly speaking, there are two CIS models: corporate and contractual. The former is predominant in some countries; the latter, in others.

In countries where the corporate model is predominant, such as the US, CISs are incorporated like a nonfinancial corporation. Many such countries require every fund to have its own board of directors with a substantial number of independent outside directors, like publicly traded companies outside of Japan. These funds' boards of directors delegate management of their funds to an AMC. In other words, management control of a fund resides in the fund's board of directors, not the AMC. The fund's board of directors, is empowered to hire, on behalf of the fund's unit holders, an AMC as the fund's investment advisor. The AMC's sole role is to manage the fund's assets as authorized by the board. The AMC is not in a position to influence the operation of the fund as a whole. The fund's board can replace the AMC if it fails to deliver satisfactory investment returns.

In the UK, by contrast, 80% of funds are contractual unit trusts. The remaining 20% are incorporated investment trusts. Funds with independent boards are much less common in the UK than in the US. Luxembourg-domiciled funds that are marketed globally are required to have a board of directors under Luxembourgish law. Luxembourg has been pushing for greater independence for funds' boards in recent years.

AMCs have also been adopting governance structures with separate tiers for global and country-specific businesses. AMCs that operate globally generally have multiple offices housing portfolio management and/or marketing staff in various locations throughout the world. For such AMCs, a global coordination function is essential. In addition to building governance structures in compliance with the laws of the individual countries in which they operate, global AMCs must have an entity that makes global management decisions because they need to optimize their global operations, unconstrained by individual countries' regulations. To do so, some global AMCs have established a global executive committee or other such body.

Figure 3:
Typical governance structure of AMC (manager of incorporated funds) that has parent company



Source: NRI, based on interviews and documents

Sidebar

UK FCA's role and AMCs' assessment thereof

The UK's FCA is conducting a detailed survey on AMCs' operations. It plans to publish its findings in late 2016. Following is a discussion of some of the FCA's ongoing initiatives and AMCs' assessment thereof.

First, the FCA is pursuing an initiative to enhance the transparency of boards' nominating processes. Many AMCs' boards of directors do not have nominating committees. The process by which CEOs are nominated consequently tends to be less transparent at AMCs than at publicly traded companies. The FCA is endeavoring to rectify this disparity. In the UK, nominees for key positions that involve "controlled functions" must be approved by the FCA. The FCA vets nominees to verify that they possess the requisite skill set, thereby making the nomination process more transparent. The FCA approves only individuals that pass its "fit and proper" test and comply with its Statement of Principal and Code of Practice. Those approved are known as "approved persons".

In another initiative, the FCA is requesting that AMCs make their boards more independent. The UK AMCs that have been asked to do so are generally in favor of this initiative. Personally, I was impressed by the comments of the CEO of a US AMC (whose parent company is a publicly traded commercial bank) that has multiple asset management subsidiaries in the UK. The CEO said, "Independent outside directors obviously contribute substantial value to a board. The funny thing is we were opposed to appointing outside directors when asked to do so by the FCA 5-6 years ago. Today, however, every boutique AMC has at least two if not three outside directors on their boards. We appointed outside directors because we recognize their value and we can hire them at a relatively low, fixed cost. We have learned these things through several years of experience with outside directors. Outside directors frankly ask hard questions and bring problems to the attention of management." In short, the CEO was initially reluctant to appoint independent outside directors to his subsidiaries' boards, but his attitude dramatically changed once he actually heard outside directors' input at board meetings.

An executive of another AMC, this one owned by an insurer, opined that AMCs seeking better governance from their investee companies should comply with FCA requests as a matter of course. He said, "As an investor, we have been stressing the importance of corporate governance, including engagement, to our investee companies. We have always believed that it's important for us to follow our own advice. We believe that ensuring that our own board of directors is independent encourages investee companies to upgrade their corporate governance."

Meanwhile, some AMCs consider compliance with board configuration standards to be largely meaningless. For example, one AMC executive said, "We disagree with adding independent outside directors to our board just because regulators tell us to. Instead of appointing outside directors, we have assembled a group of external advisors. We believe that this advisory group adds value and contributes to business expansion. Such an advisory group is more valuable [than outside directors] in terms of upgrading our management. We have a strong aversion to conformism just for the sake of complying with superficial standards. Instead of such superficiality, the more important issue is whether we can take meaningful action in our actual investment processes. We would not add outside directors to our board unless doing so adds value."

Such contrary opinions were in the minority. Most of the UK companies we visited were generally in favor of having outside directors on their boards.

Chapter 2

Specific examples of conflict-of-interest controls

Chapter 1 noted that overseas AMCs have varied governance structures that differ from each other largely as a function of international differences in the regulatory environment. One commonality that transcends these differences is how AMCs manage conflicts of interest. Below I present examples of conflict-of-interest controls common to multiple AMCs, including information sequestration, proactive information disclosure, restrictions on personnel reassignments and cultivation of a corporate culture that places utmost priority on existing clients. Most of the examples pertain to AMCs parented by financial institutions.

Information sequestration

One method of managing conflicts of interest is to sequester information within an AMC, thereby keeping it out of the hands of the AMC's parent company. AMCs typically sequester client information and investment information. If an AMC were to provide information about its clients to its parent, the parent might meddle in investments of clients with which it has an existing business relationship. AMCs consequently have internal regulations that strictly prohibit disclosure of client information to their parent companies.

With the exception of mandatory public disclosures[12], AMCs do not disclose their investee companies' identities to their parent. AMCs often invest in nonfinancial companies that have a business relationship with their parents. If investee information were leaked to a parent company, the parent's staff might pressure the AMC's portfolio managers in various ways[13]. In addition to information on investee companies, many AMCs' have internal regulations strictly prohibiting disclosure of voting-related decisions[14] to not only their parents but their own boards of directors also.

They do so because their boards of directors may include corporate officers of their parent companies. Although a board may not be able to properly make management decisions without such information in certain cases, it is important for AMCs to demonstrate a commitment to conflict-of-interest management as

12) Investment trusts' holdings are publicly disclosed on a delayed basis. This information becomes available to AMCs' parent companies at the time of its disclosure.

13) For example, a parent company might question portfolio managers about how they will vote in certain proxy battles. If thus questioned, portfolio managers might be more likely to vote in accord with the parent company's wishes.

14) Such decisions might include approval of voting guidelines and public disclosure of votes cast based on the guidelines.

a top priority. To compensate for information sequestration's drawbacks, some AMCs limit their boards' role to oversight with no executive functions.

In addition to being mandated by internal regulations, such information sequestration is of course thoroughly incorporated into information system controls also.

Proactive information disclosure

Many AMCs anticipate conflicts of interest that could arise vis-à-vis their parent company under various scenarios, establish explicit guidelines for managing those conflicts, and publicly disclose the guidelines. For example, one US AMC has established guidelines for managing conflicts of interest related to shareholder voting and engagement activities. It not only manages conflicts of interest in accord with its guidelines, it has increased its internal processes' transparency by publicly disclosing the guidelines (Figure 4). Shareholder voting and engagement activities entail a variety of potential conflicts of interest between an AMC and its parent. By contemplating a wide variety of hypothetical scenarios, formulating

Figure 4:
Examples of managing conflicts of interest related to proxy voting

Subject matter	Conflict-of-interest provisions
Procedures to mitigate potential conflicts of interest include:	Providing sole voting discretion to members of AMC's Corporate Governance Team. Members of the corporate governance team may from time to time discuss views on proxy voting matters, company performance, strategy etc. with other employees including portfolio managers, senior executives and relationship managers. However, final voting decisions are made solely by the corporate governance team, in a manner that is consistent with the best interests of all clients, taking into account various perspectives on risks and opportunities with a view of maximizing the value of client assets. Exercising a singular vote decision for each ballot item regardless of our investment strategy. Prohibiting members of AMC's Corporate Governance Team from disclosing our voting decision to any individual not affiliated with the proxy voting process prior to the meeting or date of written consent, as the case may be. Mandatory disclosure by members of the AMC's Corporate Governance Team, Global Proxy Review Committee ("PRC") and Investment Committee ("IC") of any personal conflict of interest (e.g., familial relationship with company management, serves as a director on the board of a listed company) to the Head of the Corporate Governance Team. Members are required to recuse themselves from any engagement or proxy voting activities related to the conflict. Voting decisions related to AMC's parent and/or affiliates will be outsourced to independent outside third parties. Delegated third parties exercise vote decisions based upon our in-house policies. Reporting of voting policy overrides, if any, to the PRC on a quarterly basis.
Cases when conflicts of interest could arise	When a conflict of interest has been identified and either: (i) the matter does not fall clearly within the Guidelines; or (ii) AMC determines that voting in accordance with such policies or guidance is not in the best interests of its clients, the Head of AMC's Corporate Governance Team will determine whether a Material Relationship exists. If so, the matter is referred to the AMC's PRC. The AMC's PRC then reviews the matter and determines whether a conflict of interest exists, and if so, how to best resolve such conflict. For example, the AMC's PRC may (i) determine that the proxy vote does not give rise to a conflict due to the issues presented, (ii) refer the matter to the AMC's IC for further evaluation or (iii) retain an independent fiduciary to determine the appropriate vote.

Source: NRI, based on AMC disclosures

explicit guidelines and publicly disclosing them, this AMC is demonstrating that is managing conflicts of interest between its clients and parent company with respect to how it votes its shareholdings.

Restrictions on personnel reassignments

To avert conflicts of interest with their parents, many AMCs prohibit reassignment of executive officers and staff between themselves and their parents. As noted above, AMCs' investees and their parents' corporate customers often overlap substantially. Such being the case, if corporate officers or staff were reassigned to an AMC from its parent, the reassigned personnel may undermine the AMC's commitment to prioritizing its clients' interests above all else. As an example, suppose a parent company reassigns a lending officer from its commercial banking division to its AMC subsidiary's equity investment department. The reassigned employee expects to eventually return to his previous position as a lending officer, putting him at risk of making investment decisions from a creditor's standpoint instead of placing utmost priority on the interests of the AMC's investor clients by making investment decisions from a shareholder's perspective. Whereas equity investors make decisions from the standpoint of maximizing investee companies' value, creditors may do otherwise[15]. At one AMC, an executive told me, "Our parent company has many customers and so do we. If one of our parent company's corporate officers were appointed as one of our executive officers, preventing conflicts of interest involving each other's customers would be more difficult. We therefore do not have any corporate officers that came from our parent." Such a mindset is shared by many AMCs. In fact, of the AMCs I visited that have a financial institution as a parent, hardly any have executive officers or lower-level staff that came from their parents.

15) I was told of one case where half of a portfolio management team that had been involved in proprietary trading years earlier was transferred to a certain AMC from its parent's investment banking division, but the AMC reportedly implemented controls to ensure that absolutely no information was subsequently exchanged between the reassigned team members and their former colleagues in the investment banking division.

Personnel reassignments between affiliated companies have been criticized as not very beneficial in terms of the skill sets that the reassigned personnel bring with them. For example, a parent company's executive officers would in most cases be experienced managers in financial services businesses other than asset management but have little if any knowledge of the asset management business. No one I interviewed while visiting overseas AMCs thought that parent company executive officers' management skill sets are transferable to the asset management business. The vast majority of AMCs therefore hire executives with long careers in the asset management industry to serve as their CEOs and manage their front-office operations.

Organizational conflict-of-interest management arrangements

Many AMCs or the financial groups to which they belong have specialized organizational units charged with managing conflicts of interest. For example, one AMC has established a Conflict of Interest Committee. This committee comprehensively discusses and prescribes safeguards against all conceivable conflicts of interest that the AMC could face. This AMC also makes its employees attend educational programs on conflicts of interest. Additionally, it has set up an internal reporting system whereby employees can report any perceived conflicts of interest to an organizational unit independent of the management team. It has also established a channel to report such information to its board of directors.

Another AMC has established a Global Conflict-of-Interest Management Committee. The committee meets regularly to resolve any conflicts of interest that may arise between this AMC and its parent. For example, when the AMC enters into an agreement with a client, it is required to agree not to make any private equity investments in businesses affiliated with its parent company. It also discloses voluminous information on mitigation of conflicts of interest, mainly regarding what types of conflicts of interest could arise between itself and its parent's existing customers.

This AMC's parent has a Global Conflict Officer (GCO) who leads a conflict-of-interest management team. The GCO also attends meetings of the aforementioned Global Conflict-of-Interest Management Committee. The GCO's primary role is to review all of the parent company's private transactions, including investment banking transactions and deals involving M&A-related funding. Such transactions/deals may involve the AMC's investee companies and therefore could pose conflicts of interest. During the review process, the GCO may, for example, ask the parent's investment banking unit or AMC to abort a transaction/deal because it poses a conflict of interest.

The key takeaway from this example is that the GCO gathers information on all of the parent company's pending transactions, monitors the status of the AMC's transactions and figures out how to deal with potential conflicts of interest before they actually arise. The team led by the GCO is continuously vetting pending transactions from a fiduciary standpoint to ensure that the AMC fulfills its fiduciary duties. It also routinely checks the parent company's transactions to determine if they involve any fiduciary elements. Off-exchange transactions in particular often involve complexly intertwined interests. In comparison to transactions conducted on securities exchanges, off-exchange transactions require more diligence in terms of conflict-of-interest management.

Cultivation of culture that places utmost priority on existing clients

Some AMCs are of the opinion that the most effective way to prevent conflicts of interest is to foster a corporate culture that places utmost priority on existing clients. Every AMC probably claims to put clients' interests first in their sales pitches. To literally do so, however, AMCs must deeply instill a client-first mindset in all of their personnel. Among the AMCs I visited, one that is organized as a partnership[16) has built such a culture and it did so by simple means.

16) In the case of AMCs organized as a partnership, the shareholders, top management and portfolio managers are often one and the same. The AMC cited in the example was acquired by a US AMC over 10 years ago, whereupon the acquirer became its sole shareholder. In this case the shareholder is separate from the AMC's management.

First, it identified four groups of stakeholders that warrant consideration in its business decisions and explicitly ranked them in order of priority. Ranked in descending order, they are (1) clients, (2) employees, (3) regulators and (4) parent company (shareholder). Clients' status as the top priority is absolute. The AMC turns its attention to its parent company's interests only after taking the other three groups' interests into consideration.

Next, it holds weekly meetings to review information on its entire clientele. The meetings' objective is to accurately ascertain the state of all clients' accounts, including investment returns, and to determine how to best serve the clients. The meetings are open to all staff members, enabling everyone to clearly see that top management places top priority on clients and is committed to staying up to date on their status and investment goals. The meetings also clarify what top management is focused on in managing the company.

Another important aspect of fostering a corporate culture is setting management goals. Several of the AMCs I visited do not set any AUM targets and also limit the number of new clients they will accept annually. Their rationale is that if management sets an AUM growth target, staff may get the misimpression that the company is being run in pursuit of AUM growth, not for clients' benefit. Meanwhile, management pays attention to metrics such as AUM and revenues to impress upon staff that growth in AUM and revenues is a byproduct of placing utmost priority on serving clients.

Another AMC reported that it once publicly announced an AUM growth target but ended up immediately retracting the target because its clients had interpreted the target to mean that the AMC wanted to grow bigger. The clients were concerned that the company would start pitching a wide assortment of products to them. Many of the AMCs I visited told me that linking staff's compensation to clients' investment returns is also important. Devising ways to link compensation to clients' returns, not to AUM or revenues as mentioned previously, is seen as a crucial management task. It is important to combine many such measures to realize a client-first mindset in actual practice, lest "client first" ends up as an empty slogan.

To inculcate all staff with a client-first mentality, AMCs must make decisions that subordinate their own interests to their clients' interests. Top management must possess firm resolve and put that resolve into practice as specific measures incorporated into actual management processes. Such an approach is in fact a powerful deterrent against conflicts of interest.

Chapter 3

Recommendations for Japanese AMCs

Two key takeaways from the above discussion of overseas AMCs is that they have diverse governance structures and common conflict-of-interest management approaches that transcend the differences in their governance structures. For Japanese AMCs to fulfill their fiduciary duties, they must first devise policies compatible with their individual circumstances.

Japanese AMCs' environment

The vast majority of Japanese AMCs are unlisted companies. Although unlisted companies are not required to have a board of directors under Japan's Companies Act, most Japanese AMCs do have one. Additionally, the vast majority of AMCs in Japan, excluding those owned by foreign interests, are subsidiaries of financial institutions. Few Japanese AMCs have more than 1,000 employees even though the Japanese asset management industry has over ¥400 trillion of total AUM. In terms of scale of operations, Japanese AMCs are generally smaller than their European and US counterparts.

How to best manage conflicts of interest is a major challenge for Japanese AMCs, most of which are relatively small subsidiaries of financial institutions. Recent events have revealed that Japanese AMCs are encountering various difficulties in managing conflicts of interest. One such event was the advent of Japan's Stewardship Code. The Stewardship Code's second principle says that institutional investors should formulate and disclose policies on managing conflicts of interest as one of their stewardship responsibilities. Initially, AMCs failed to adequately comply with the second principle's disclosure requirement. As of June 2014, shortly after the Stewardship Code was unveiled, few AMCs had even acknowledged that conflicts of interest are an inevitable for all AMCs. Since 2015, AMCs have superficially improved their disclosures by following the example set by certain AMCs considered exemplars of Stewardship Code-mandated disclosures. AMCs' actual practices, however, have not improved commensurate with their superficial progress on the disclosure front.

For example, nearly all of Japan's major AMCs, most of which are affiliates of financial institutions, have top management teams comprising stakeholders who

17) Former corporate officers are often appointed instead of current ones. Whether a former corporate officer directly represents the parent company's interests is a case-by-case question.

represent their parent companies' interests, such as corporate officers[17] and/or directors, of the parent company. The extent to which directors dispatched from the parent company understand the importance of fulfilling fiduciary duties is a big question mark. More than a few observers are skeptical of how vigilant such directors are vis-à-vis conflicts of interest.

The Government Pension Investment Fund (GPIF) expressed similar concerns in its Summary Report of GPIF's Stewardship Activities in 2015 (published on 28 January 2016). The report noted multiple cases in which external asset managers took their parent companies or affiliates' interests into consideration when voting or engaging with investee companies and failed to respond organizationally when the GPIF questioned their conduct.

The JSDA's Asset Management Working Group made a similar comment about investment trusts in a June 2016 report. The report recommended that AMCs upgrade their governance as one means of fulfilling their fiduciary duties.

The good news is that some Japanese AMCs appear to have embarked on governance reforms upon becoming Stewardship Code signatories. Since 2014, a number of Japanese AMCs have installed independent outside directors on their boards. One of them has also recently established a committee majority-staffed with outsider directors to review its management of investment trusts. This committee is subordinate to the AMC's board of directors and its composition is intended to ensure its independence. Additionally, a number of Japanese AMCs have issued "fiduciary duty manifestoes," contracted with third parties to monitor their conflict-of-interest relationships and are publicly disclosing the third parties' recommendations and their responses thereto.

While signs of progress are thus evident in certain corners of Japan's asset management industry, I personally feel there is a large gap between pension funds/regulators' and AMCs' respective notions of fiduciary duty. This perceptual gap seems particularly wide between public pension funds and AMCs with respect to the issue of how to best manage conflicts of interest. Some Japanese AMCs are reportedly frustrated that they do not get enough credit for their governance from public pension funds despite having already embraced stringent conflict-of-interest management. I believe that the root cause of this difference in perceptions is that a fiduciary mindset has not yet sufficiently pervaded the AMCs' financial groups.

For example, many AMCs have established specialized committees to make shareholder voting decisions. Such committees are likely an adequate safeguard against interference from the parent company. AMCs presumably strictly maintain the confidentiality of information on voting decisions within their own organizations. However, public pension funds apparently suspect that investee companies make requests of AMCs' parent financial institutions with respect to shareholder voting and the financial institutions in turn pressure their asset management subsidiaries to vote as requested. In other words, the pension funds' suspicions are not confined to the asset management subsidiary but must be resolved on the level of the financial group as a whole.

Such suspicions arise for several reasons. First, AMCs generally do not have impenetrable information firewalls between themselves and their parent companies. Second, even if such a firewall does in fact exist, outsiders would be unlikely to know about it because its existence would not be publicly disclosed. Third, nonfinancial companies assume that various nonpublic points of contact exist between AMCs and their parent companies (e.g., through personnel reassignments). They accordingly further assume they can apply pressure on an AMC through its parent company. To dispel suspicions, AMCs must recognize that conflict-of-interest management is a group-wide undertaking, formulate conflict-of-interest controls and publicly disclose them. Potential controls include establishing robust information firewalls, restricting personnel reassignments, adopting conflict-of-interest management regulations and group-wide organizational controls, and appointing independent outside directors. I will first recommend measures that should be implemented on a group-wide basis and then methods of managing conflicts of interest within an AMC.

Robust information firewalls

First, an AMC should set up a robust information firewall between itself and its parent company. The firewall must prevent leaks of both investment information and client information.

For investment information, the minimum requirement for setting up an information firewall is IT system infrastructure that does not permit any system connectivity between the parent company and the AMC's investment staff[18]. In cases where a directory of internal telephone numbers and/or e-mail addresses of key staff, including asset management subsidiaries' investment staff, is available to all personnel within a financial group, another requirement is to omit at least the

18) To clarify, I am not opposed to sharing of infrastructure, including backbone IT infrastructure, between parent companies and their asset management subsidiaries. Sharing of backbone IT infrastructure is common practice within overseas financial groups. My point is that information must be appropriately managed to fulfill fiduciary duties.

investment staff's phone numbers and e-mail addresses from the listing and otherwise prevent e-mail exchanges between the investment staff and the parent company's front-office organizational units. In addition to such physical barriers to communication, face-to-face contact also should be prohibited. In particular, financial groups must issue internal regulations barring all contact between asset management subsidiaries' investment staff and the parent company's organizational units that have business relationships with the subsidiaries' investee companies.

In sum, AMCs should not share any information about their securities holdings or shareholder voting, excluding information already publicly disclosed, with their parents. To safeguard their investment decisions from their parents' influence, AMCs must set up information firewalls that cover all potential communication channels, including person-to-person contact. Setting up a robust information firewall and publicly disclosing its existence are the minimum requirements to dispel overseas institutional investors' suspicions about parent companies' influence on investment decisions and to put investee companies on notice that any pressure the parent might attempt to exert would be to no avail.

Some readers may dispute my recommendation's effectiveness on the grounds that however robust an information firewall may be, it can be readily circumvented by investee companies sharing investment information (e.g., shareholder voting information) with the parent company. The point I want to emphasize is that a financial group must have internal controls that make investee companies aware that no matter how heavily they pressure the parent company, asset management subsidiaries' investment decisions would never be reversed to the detriment of clients' interests. To anyone who would argue that form without substance is ineffective no matter how otherwise impressive it may be, my response is that outward displays of form are a prerequisite to gaining the trust of pension funds and other clients.

Various opinions exist on how to best manage client information within a financial group. Financial groups' asset management subsidiaries' investments often begin from relationships formed when a nonfinancial company is introduced to the subsidiary by its parent company at the nonfinancial company's request. In such cases, sharing of client information helps to better serve the client (the nonfinancial company) because the financial group is meeting the client's investment needs. Another common business practice is asset management subsidiaries asking their parents to introduce them to clients and paying the parent a portion of their investment advisory fees in exchange for the referral (marketing assistance). In such cases, sharing of client information is conducive to efficient marketing. On the other hand, a parent company that obtains client information from its asset management subsidiary could end up pestering clients with offers of services of no interest to the clients. In general, financial groups should manage client information in accord with clients' wishes. Based on clients' wishes, they should control which information is permitted to be shared with which organizational units within the group and build information firewalls that manage information flows accordingly.

Restrictions on intercompany personnel reassignments

Next, a parent company's corporate officers and staff who have direct contact with investee companies should be barred from being reassigned to an asset management subsidiary's investment division[19].

19) Because asset management subsidiaries' executive officers typically have substantial contact with investment information, they generally should not be appointed to their positions from the parent company unless they will never return to the parent company.

However, appointment of a parent company's corporate officer or other employee as an asset management subsidiary's director may be permissible provided that the subsidiary's board has no authority over investment processes and that disclosure of client information and investment information to the board is prohibited. Given the potential for conflicts of interest to arise in various forms between an asset management subsidiary and its parent company's front-office organizational units as already discussed, any personnel reassignment to or from an asset management subsidiary should first be approved by a specialized organizational unit at the group's headquarters that looks at whether the reassignment poses any risks in terms of the asset management subsidiary's fiduciary duties. I want to stress that such screening cannot be done by the asset management subsidiary itself. It should be done by the financial group (parent company).

Conflict-of-interest regulations and group-wide organizational controls

Once a financial group sets conflict-of-interest management standards like those discussed above, it should establish a specialized organizational unit or appoint a conflict-of-interest management specialist and document its conflict-of-interest management policies and procedures. At overseas AMCs, responsibility for managing conflicts of interest usually resides with a compliance officer or the chief risk officer. Another option is to place conflict-of-interest management under the purview of a risk management committee headed by the compliance officer or chief risk officer. AMCs acting in a fiduciary capacity, however, are well advised to consider establishing an independent organizational unit, or appointing a specialist, whose sole function is managing conflicts of interest. Such arrangements, examples of which include the global conflict officer position and global conflict-of-interest management committee mentioned in Chapter 2, are effective means of signaling a serious commitment to managing conflicts of interest.

In the case of AMCs parented by a financial institution, the parent company should consider establishing such a specialist position or organizational unit within not only the AMC's organization but its own also. For financial groups with asset management subsidiaries that act in a fiduciary capacity, it is essential to recognize that conflict-of-interest management is a task that should be undertaken on a group-wide basis, not relegated to the asset management subsidiaries alone.

The second principle of Japan's Stewardship Code mandates that the Code's signatories disclose their conflict-of-interest management policies. AMCs should accordingly disclose their policies in detail in their disclosures of their state of compliance with the Stewardship Code. Incidentally, as of July 2016 very few Japanese AMCs have disclosed conflict-of-interest management arrangements like those recommended above[20].

20) One trust bank's conflict-of-interest management policy, disclosed pursuant to the Stewardship Code's second principle, states, "In addition to managing conflicts of interest on a centralized basis through an organizational unit established specifically to manage conflicts of interest, the Bank has established procedures for (1) separating those organizational units (companies) that engage in transactions posing a risk of detriment due to a conflict of interest from other organizational units (companies), (2) revising one or both counterparties' transaction terms or methods of transactions that pose a risk of detriment due to a conflict of interest, and (3) disclosing to customers the risk of detriment due to conflicts of interest."

Appointment of independent outside directors

Lastly, I recommend that Japanese AMCs appoint independent outside directors to their boards. Of the overseas AMCs I recently visited, some questioned whether appointing outside directors would add value for small AMCs that have fostered a corporate culture that places utmost priority on clients. Additionally, the role played by outside directors may be relatively small in countries, like the US, with laws that severely penalize fiduciary breaches and require investment trusts to have independent boards of directors.

In Japan's still-young asset management industry, however, few companies have sufficiently imbued themselves with a client-first culture. Japan has no laws against fiduciary breaches, nearly all Japanese investment trusts are of the contractual variety, and none has an independent board of directors. Amid such an environment, appointing independent outside directors that oversee management on behalf of clients, is one effective means of enforcing fiduciary duties.

As an example, one small Japanese AMC has appointed multiple directors who were formerly managing directors of corporate pension funds. This AMC's CEO speaks highly of these outside directors' effectiveness. He said, "They provide input from perspectives we could not get from inside directors alone. For example, when we set our fees for investment products, they provide feedback from the client's standpoint." While substance is said to be more important than form in corporate governance, outside independent directors are one form that could upgrade AMCs' governance in Japan, where the asset management industry is relatively young and the regulatory environment underdeveloped.

Independent outside directors' role differs somewhat between nonfinancial companies and AMCs. In nonfinancial companies, one of outside directors' purposes is to represent shareholders' viewpoint on the board of directors. In AMCs, by contrast, the parent company's corporate officers almost always occupy seats on the board. With the shareholder's viewpoint thus already well represented on AMCs' boards, independent outside directors' purpose is to promote client-centric management. AMCs' distinguishing characteristic from a fiduciary standpoint is that they must be committed to client-centric management above all else. AMCs have a pool of qualified outside director candidates in the form of their clients' retired executives, like the former pension fund managing directors mentioned above. Japanese AMCs are small enough in number that they should not have much difficulty recruiting outside director candidates.

My hopes for Japanese AMCs

The crux of my recommendations is that AMCs' fiduciary compliance is a group-wide endeavor. In other words, AMCs cannot fulfill their fiduciary responsibilities alone. Financial groups do not seem to realize this point, as exemplified by intercompany personnel transfers within financial groups. Most AMCs' CEOs were previously directors or executive officers of their AMCs' parent companies. When first appointed, AMCs' CEOs often admit they do not know much about asset management yet[21]. Such an admission is a major red flag from a fiduciary standpoint. I have even heard of cases where directors of AMCs with multiple parent companies were selected solely as a function of the balance of power between the parent companies, with little if any consideration given to the interests of clients or other stakeholders.

21) The parent companies' apparent obliviousness to the imprudence of appointing someone who knows nothing about asset management to run an AMC with a duty to place top priority on its clients' interests is astonishing.

I previously worked for an AMC for nearly five years. One of its CEOs appointed by its parent company was early to recognize the importance of fiduciary duties and endeavored to manage the AMC more independently of its parent than in the past. However, without robust information firewalls, conflict-of-interest management regulations and organizational controls like those recommended above, personnel continued to be reassigned between the AMC and its parent, signaling a lax attitude toward fiduciary duties within the financial group. Such personnel reassignments are a major source of outsiders' doubts about AMCs' independence. AMCs' parent companies should tread carefully with respect to reassigning corporate officers and other personnel to their AMCs unless the group rigorously manages conflicts of interest, outwardly demonstrates that the parent company never exerts any pressure on the AMC and ensures that the reassigned personnel are highly knowledgeable about asset management.

From a fiduciary standpoint, upgrading governance, including conflict-of-interest management, has never been as imperative as now for financial groups' asset management subsidiaries (and the groups as a whole). I hope that Japanese financial groups, including their AMCs, dispel the concerns described above through their actions.

I would like to thank the 18 European and American AMCs that, through interviews, provided me with a wealth of information instrumental to writing this report.

References

- JSDA Asset Management Working Group (June 2016), "Asset Management Working Group Report" (in Japanese)
- GPIF (January 2016), "Summary Report of GPIF's Stewardship Activities in 2015"
- Nomura, Akiko (January 2012), "Overseas Investment Trust and Investment Company Regulations," FSA Institute Discussion Paper, FSA Financial Research Center (in Japanese)
- IOSCO (June 2006), "Examination of Governance for Collective Investment Schemes," IOSCO Technical Committee

about NRI

Nomura Research Institute, Ltd. ("NRI", TYO: 4307) is a leading global provider of system solutions and consulting services, including management consulting, system integration, and IT management and solutions for financial, manufacturing and service industries. Clients partner with NRI to expand businesses, design corporate structures and create new business strategies. NRI has 10,000 employees in 35 offices globally and reports annual sales above $3.7 billion.
For more information, visit https://www.nri.com/global/

Inquiries to : Financial IT Marketing Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

http://www.nri.com/global/opinion/lakyara/index