Rocky Privatization Starts
Japan Post's Bank/Insurance Units

By SAKAI Katsuhiko

A privatization program started on October 1, 2007, for Japan's postal system that had remained a public entity for 136 years. Japan Post has thus transformed itself into the Japan Post Group that consists of Japan Post Holdings Co. and its four subsidiaries, with some 24,000 offices, 240,000 employees and ¥330 trillion in total assets. The holding company is still 100% owned by the government. Among the four subsidiaries, Japan Post Bank Co. and Japan Post Insurance Co. will seek to implement their respective initial public offerings within fiscal 2010 ending in March 2011. Their privatization may be completed by the end of September 2017. But the privatization will not be so easy. The largest problem is that they are far bigger than their rivals. The two financial firms that have grown too big with government support will have to be integrated into market economy order. This is a grandiose test. Regulatory authorities, financial industries at home and abroad, and financial market players are closely watching the test with both hopes and worries.

World's Biggest Bank in Deposits

Japan Post Bank has ¥188 trillion in deposits against ¥100 trillion at the Bank of Tokyo-Mitsubishi UFJ, ¥66 trillion at Sumitomo Mitsui Banking Corp. and ¥53 trillion at Mizuho Bank. The deposit comparison between Japan Post Bank and the nation's three biggest megabanks indicates Japan Post Bank is remarkably large. It is the biggest in the world in terms of deposits, accounting for a quarter of Japan's outstanding household deposits.

In contrast to the US postal savings system that had supplemented private-sector financial services before its termination in the mid-1960s, Japan's postal savings system has consistently expanded. An instrument that triggered the expansion was the fixed-amount savings account created in 1941 to raise funds for World War II. The maximum term to maturity is 10 years. Withdrawal can be accepted after the first six months. An interest rate is fixed and compounded semiannually. With these attractive features, the fixed-amount postal savings account has become a highly liquid savings instrument that commercial banks cannot offer. In the early 1990s just before the economic bubble burst in Japan, the annual interest rate exceeded 6% on the fixed-amount postal savings account and the savings ceiling was raised to ¥10 million per depositor. Massive funds thus flew into the postal savings instrument. As banks went bankrupt with interest rates lowered in the 1990s, the fixed-amount postal savings continued to swallow funds from the private sector on the strength of the government's backing. Interest earnings from the instrument were accumulated at a fast pace.

The *kampo* postal life insurance system has expanded along with the postal savings system amid difficult business conditions for private-sector life insurers in the 1990s by taking advantage of the popular endowment insurance policy that offers both death security and savings functions. Japan Post Insurance, which has taken over the system, boasts ¥114 trillion in gross assets, far bigger than ¥50 trillion at Nippon Life Insurance Co. that had been the largest insurer in Japan.

Rivals Growing Wary

While Japan Post Bank has joined the commercial banking industry, its position in the industry has remained vague. Its annual net profit after the privatization is estimated at the ¥300 billion level, far less than ¥670 billion posted by the Bank of Tokyo-Mitsubishi UFJ for the year to March 2007. Its profitability is remarkably inferior. Its financial profile is vulnerable. Of Japan Post Bank's assets for investment, ¥130 trillion, more than 70%, has been invested in Japanese government bonds. In this sense, Japan Post Bank is a giant institutional investor rather than a megabank. It is thus vulnerable to huge appraisal losses on a bond market decline. If a yield on the benchmark 10-year JGB issue rises from present levels below 2% to 4% on a bond market decline in the next five years, Japan Post Bank's net profit is estimated to fall to ¥78 billion from the present projection of ¥304 billion for fiscal 2011 ending in March 2012.

Japan Post Bank is willing to offer housing and card loans to diversify earnings sources. But long-standing commercial banks are embarrassed. "Japan Post Bank is too big to do the same as an ordinary commercial bank," says Oku Masayuki, who chairs the Japanese Bankers Association. "The bank should give priority to improving its business efficiency rather than to offering new services." Regional banks and *shinkin bank* credit associations are strongly opposed to Japan Post Bank's possible lending services. The Bank of Yokoyama, the largest among regional banks in Japan, has decided on a ¥15 billion brand campaign, its biggest in 50 years, to tackle competition from Japan Post Bank. Small regional banks are teaming up to counter the new megabank.

The business environment is not comfortable for Japan Post Insurance either. Its mainstay endowment insurance has become less attractive as a savings instrument as investment returns have deteriorated since the burst of the economic bubble. Demand for death security has declined in the aftermath of the falling birthrate and aging population. Growing popular are medical, cancer and other third-sector insurance that conventional insurance firms have been offering. These companies view the giant post office network as a new promising sales channel and are willing to provide Japan Post Insurance with their products for sale. But they are wary of Japan Post Insurance's possible introduction of money-making third-sector insurance.

Postal System Bound by Huge Gov't Bond Holdings

Citizens' savings collected through post offices throughout Japan have become financial resources for the fiscal investment and loan program (FILP) that is known as the second national budget. Postal savings funds have been lent to public corporations, allowing postwar Japan to develop social infrastructure without depending on overseas funds. At the same time, the large-scale financial intermediation depending on government guarantees for public corporations has distorted financial markets. The fiscal 2001 FILP reform has allowed the postal system to independently invest postal savings and life insurance funds. Lacking investment know-how, however, the postal system has had no choice but to concentrate investment of these funds in safe government bonds.

As a result, Japan Post Bank and Japan Post Insurance have some ¥200 trillion worth of government bonds. They are required to diversify their investment portfolios that are now dominated with government bonds and vulnerable to interest rate hikes. But they have yet to specify how best to do so.

Financial market participants have no serious concern about the diversification while watching the situation. "We expect the diversification to have no serious effect on financial markets," Nikko Citigroup Ltd. chief strategist Sano Kazuhiko told the government Postal Services Privatization Committee in August 2007. The reason for such expectations is the huge portfolio size. "In a sense that even a small amount of government bond sales by the postal system could be taken as heavy selling pressure on the bond market, the system has great influences over the market. If such sales work to lower bond prices, however, it may be unfavorable for the postal system. Any dynamic reallocation of portfolio assets is difficult. The market is relieved that the postal system's portfolio diversification would be very slow." The two Japan Post firms are expected to refrain from taking any action that could cause a backlash to themselves.

Photo: PANA

Cutting the tapes at a ceremony launching the Japan Post Group are (from left) former Internal Affairs & Communications Minister Suga Yoshihide, Financial Services Minister Watanabe Yoshimi, former Prime Minister Koizumi Junichiro, former Japan Post President Ikuta Masaharu, Japan Post Holdings Co. President Nishikawa Yoshifumi, Prime Minister Fukuda Yasuo, and incumbent Internal Affairs & Communications Minister Masuda Hiroya (at Japan Post Holdings Co. in Tokyo's Kasumigaseki government office area).

Developing Business Models for Survival

Japan Post Bank and Japan Post Insurance are the largest lenders for the government, holding some 30% of outstanding government bonds. Their balance sheet realignment may undoubtedly affect the government's debt management policy. While huge government bond issues are expected to finance growing social security expenditures, the Ministry of Finance has been trying hard to sell government bonds to individuals in Japan and to foreign investors in a bid to get prepared for the two Japan Post firms' possible shift away from government bonds.

"Japan had long been unable to brief foreign countries on the business principle for the postal system that holds a quarter of the people's deposits," said Tanaka Naoki, chairman of the Postal Services Privatization Committee. "The postal services privatization is also designed to make Japanese financial markets internationally assessable."

The postal services privatization would allow savings of people to be utilized for invigoration of the economy by funneling postal savings and insurance funds to the private sector instead of the government sector, including public corporations. As private-sector companies, the two financial firms of the Japan Post Group would have greater management freedom to increase their creativity and efficiency, leading to better and more diversified services benefiting customers. If these government-set goals for postal services privatization were to be achieved, the two Japan Post financial firms would have to develop business models for their survival as private-sector companies. They have just launched a struggle to survive. JS

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