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Investment Funds

Japan: Trends & Developments
Anderson Mori & Tomotsune

2019

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Trends and Developments

Contributed by Anderson Mori & Tomotsune

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Investment Funds in Japan

The most popular and widely used form of investment fund in Japan is an investment trust (*toushi shintaku*) (Investment Trust) formed pursuant to the Act on Investment Trusts and Investment Corporations of Japan (Investment Trust Act). Investment Trusts are sold both on the retail market (through public offerings) and on the institutional market (mostly through private placements). Investment Trusts are also made available for investors in Japan through various channels, such as DC (Defined Contribution) pension programmes, VA (Variable Annuity) insurance products offered by life insurance companies, and 'wrap account' products offered by securities brokers and asset management companies. Most exchange-traded funds (ETFs), listed and traded on the Tokyo Stock Exchange, also take the form of Investment Trusts.

According to statistics published by the Investment Trust Association, Japan (JITA), as of 30 November 2018, the total net asset value (NAV) of publicly offered Investment Trusts was approximately JPY 112.5 trillion, placed in 6,134 funds (excluding investment corporations). At that same time, the total NAV of privately placed Investment Trusts was approximately JPY 90.7 trillion, placed in 6,103 funds (excluding investment corporations). Among the publicly offered Investment Trusts, 183 funds were ETFs, with total NAV of approximately JPY36.2 trillion.

The Investment Trust Act also provides an investment corporation (*toushi houjin*) (Investment Corporation) as a form of corporate investment fund. An Investment Corporation is primarily used for real estate investment and is commonly called a J-REIT (Japanese Real Estate Investment Trust), even though it is not based on a trust arrangement. According to JITA statistics, the total NAV of publicly offered J-REITs as of 31 October 2018 was JPY9.5 trillion (placed in 61 funds; all listed on the Tokyo Stock Exchange). According to the website of The Association for Real Estate Securitization (ARES), the aggregate market price of J-REITs as of 31 January 2019 was approximately JPY13.6 trillion, placed in those same 61 funds. Per JITA statistics, there were 31 privately placed J-REITs as of 31 October 2018, with the total NAV of approximately JPY1.7 trillion.

A number of offshore investment funds (eg, those established in offshore jurisdictions such as the Cayman Islands, Luxembourg and Ireland) have been offered in Japan, both as public offerings and as private placements. According to statistics published by the Japan Securities Dealers Association (JSDA), 910 outstanding offshore investment funds (including sub-funds under the same umbrella fund) were distributed publicly in Japan as of 30 November 2018. The total NAV of these funds attributable to investors in Japan was JPY5.6 trillion. As of the end of September 2018, funds domiciled in the Cayman Islands and Luxembourg account for 51.8% and 37.6% of the total NAV of the publicly offered offshore funds respectively. Most of the remaining NAV is comprised of offshore funds domiciled in Ireland.

Investment Environment

The Nikkei Stock Average, commonly known as the Nikkei 225, is a representative index of Japanese stocks. The Nikkei 225 showed a relatively steady upward trend in 2017 and climbed approximately 19% during that year (to JPY22,764.94 at the end of December 2017). However, in 2018 the Nikkei 225 started to fluctuate to a large extent, with the last reported price of JPY20,014.77 approximately 12% lower than the year before. (As of the time of the last report on 11 January 2019, the Nikkei 225 was JPY20,359.70.)

Global equity markets have generally shown similar trends to Japanese stock markets, with varying features among different regions and segments. These features reflect, among other things, global economic and political risks, such as Brexit.

Interest rate levels in Japan have been close to zero for some time (due in large part to the Bank of Japan's negative interest rate policy) and the value of the Japanese Yen against other major currencies has generally been stable in recent years. This is in contrast to global trends, where it continues to be difficult to accurately predict changes in interest and currency exchange rates.

Considering these factors, it may not be easy for investment funds in Japan to achieve desired performance indicators in 2019 and in the coming years.

Recent Developments

Traditionally, Japanese retail investors have had a strong preference for placing their money in bank deposits and other investments which are considered 'safe' or 'principal guaranteed', rather than stock markets or other 'relatively risky' investments. The Japanese government, in particular the Financial Services Agency of Japan (JFSA), has introduced several measures to encourage retail investors to invest their money in capital markets.

As part of those measures, in January 2014 the NISA (Nippon Individual Saving Account) system was introduced. The NISA system is modelled after the Individual Saving Account system from the United Kingdom. Under the basic NISA system (Basic NISA), individual investors (aged 20 or older) are given a tax exemption on dividends and capital gains derived from listed shares and publicly offered Investment Trusts. In 2015 the 'Junior NISA' system was also introduced, where minors (less than 20 years old) were also allowed to open specially designed NISA accounts. Furthermore, in January 2018, as an alternative to the NISA account system, the monthly investment (*tsumitate*) NISA (now called an 'Accumulation NISA Meet-up') was introduced. According to JSDA statistics, the number of NISA accounts (including monthly investment accounts) opened with JSDA member securities brokers, as of 30 September 2018, was approximately 7.21 million. The amount accumulated through investments in the Basic NISA system (since 2014) is approximately JPY9.70 trillion. In 2006 the annual investment limit was raised from JPY1 million to JPY1.2 million. A further increase of the investment limit, if implemented, would enhance the attractiveness of NISAs and is expected to increase inflow into investment funds.

In the past decade, a large number of so-called 'monthly-distribution' investment funds were launched. However, in the recent low-interest environment, many of these funds paid monthly distributions from their capital accounts. Partly as a result of the JFSA's repeated criticisms and warnings (including the introduction, in March 2017, of the 'fiduciary duties' concept in the JFSA's regulatory supervision over financial institutions), the number of these 'monthly distribution' funds have significantly decreased recently.

Another recent trend is increasing emphasis on 'balanced' or 'index' funds over 'active' funds. This is also related to the lowering of management fees, particularly in 2018. The lowering of fees is in line with the JFSA's expected outcome for investment mangers' and distributors' review of their practices after the introduction of 'fiduciary duties'.

On 26 September 2018, the JFSA published 'For Providing Better Financial Services in the Era of Transition - Financial Services Policy: Assessments and Strategic Priorities 2018'. The strategic directions and priorities for the 2018 programme year include, among other things, the changing environment of finance in light of:

- accelerating digitalisation;
- the declining population/ageing society; and
- the prolonged low-interest environment.

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The document discusses a number of points which are identified as challenges to be evaluated going forward. These include, 'promoting long-term personal asset building' by promoting long-term, regular and diversified investment, as well as enhanced transparency of investment products.

These issues reflect concerns for a rapidly ageing society in Japan, which is one of the major challenges the county is facing. To address these issues, the government wishes to encourage the creation of long-term and diversified personal asset portfolios, not only by depositing money in banks, but also through investment into capital markets (including investment trusts). In addition, the government is also encouraging financial institutions to conduct more customer-oriented business and to compile a code of conduct for the benefit of the financial industry and its customers.

ARFP

The Asia Region Fund Passport (ARFP) formally launched on 1 February 2019. ARFP is an international initiative enabling cross-border offerings of eligible collective investment schemes to retail investors, with investor protection, in economies participating in the ARFP. Initial participating economies are Australia, Japan, the Republic of Korea, New Zealand and Thailand.

Under the ARFP, a fund may be 'exported' to another participating economy if that fund complies with the regulations of the home economy in which the fund is registered, applicable regulations relating to the offer in the host economy and the ARFP passport rules.

JFSA has released implementation guidelines for the application procedure for authorisation of offshore funds and registration of domestic funds under the ARFP framework. Under these guidelines, if an offshore ARFP fund intends to conduct a public offering in Japan, it must first submit a notification statement to the JSDA. The JSDA will review whether the fund meets the selection criteria set forth by the JSDA's rules. Upon the JSDA confirming that the offshore fund meets selection criteria, the fund shall submit notification documents to the JFSA. After these notification documents are reviewed by the JFSA, the JFSA will confirm that the fund satisfies the ARFP requirements.