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Investment Funds

Japan

Trends and Developments

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Trends and Developments

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Investment Funds in Japan

The most popular and widely used form of investment fund in Japan is an investment trust (*toushishintaku*), formed pursuant to the Act on Investment Trusts and Investment Corporations of Japan (Investment Trust Act). Investment trusts are marketed and sold on both retail markets (through public offerings) and institutional markets (mostly through private placements). They are also made available for investors in Japan through various other channels, such as Defined Contribution (DC) pension programmes, Variable Annuity (VA) 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 31 December 2019, the net asset value (NAV) of all publicly offered investment trusts was approximately JPY123.2 trillion, placed in 6,034 funds (excluding investment corporations). At that same time, the NAV of all privately placed investment trusts was approximately JPY98.9 trillion, placed in 6,794 funds (excluding investment corporations). Among the publicly offered investment trusts, 176 funds were ETFs, with a total NAV of approximately JPY43.3 trillion.

The Investment Trust Act also provides for the creation of an investment corporation (*toushihoujin*) as a form of corporate investment fund. An investment corporation that is primarily used for real estate investments is popularly known as a Japanese Real Estate Investment Trust (J-REIT), which could be misleading since it is not created out of a trust. According to JITA statistics, the NAV of all publicly offered J-REITs as of 30 November 2019 was JPY10.1 trillion (placed in 63 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 December 2019 was approximately JPY16.4 trillion, placed in 64 funds. Per JITA statistics, there were 34 privately placed J-REITs as of 30 November 2019, with a total NAV of approximately JPY2 trillion.

A number of offshore investment funds (those that are 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), 879 outstanding offshore investment funds (including sub-funds under the same umbrella fund) were distributed publicly in Japan as of 31 December 2019. The NAV of all these funds attributable to investors in Japan was JPY6.2 trillion. As of 30 September 2019, funds domiciled in the Cayman Islands and Luxembourg accounted for 52.2% and 37.0% of the total NAV of publicly offered offshore funds, respectively. Most of the remainder of the NAV of publicly offered offshore funds came from 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 generally showed an upward trend in 2019, and climbed approximately 18% to JPY23,656.62 at the end of December 2019 in defiance of a consumption tax increase from 8% to 10% which took place on 1 October 2019, although it did indicate a few fluctuations during the year.

Global equity markets have generally shown upwards trends, but with varying features among different regions and segments. These features reflect, among other things, global economic and political risks, such as post-Brexit turbulence, the political turmoil in Hong Kong, Iran and the US-China “Trade War”.

Interest rate levels in Japan continued to stay close to zero, primarily due to the Bank of Japan’s negative interest rate policy and the value of the Japanese Yen against other major currencies being 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 performances in 2020 and in the immediate coming years.

Recent Developments

Traditionally, Japanese retail investors have had a strong preference for placing their money in bank deposits and other investments that 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 been introducing several measures to encourage retail investors to invest their money in capital markets for years.

As part of those measures, in January 2014 the Nippon Individual Saving Account (NISA) 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 above) 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 of age) 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 Accumulated NISA Meet-up accounts) opened with JSDA member securities brokers, as of 30 September 2019, was approximately 7.82 million. The amount accumulated through investments in the Basic NISA system (from 2014 until 30 September 2019) is approximately JPY11.68 trillion. In 2020, the investment period under the Accumulated NISA Meet-up will be extended by five years, and the Basic NISA will be revised to a two-tiered system with effect from 2024.

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 due to the JFSA’s repeated criticisms and warnings (including the introduction in March 2017 of the concept of “fiduciary duties”, to come under the purview of the JFSA’s regulatory supervision over financial institutions), the number of these “monthly distribution” funds has significantly decreased, despite them still being popular among the older generation of investors.

Another recent trend is the increase in the emphasis on “balanced” or “index” funds over “active” funds, which continued to rise throughout the year in 2019. This could also be due to pressure from the market to lower management fees and distribution fees. The lowering of fees of investment managers and distributors is in line with the JFSA’s expected outcome after the introduction of “fiduciary duties” in 2017. In 2019, some of the distributors – in particular the Internet securities companies – announced that they no longer charge their clients an initial distribution fee (which generally used to be at a rate of 2%-3% of the purchase amount) (ie, selling investment funds on a “no-load” basis). In line with this trend, the aggregated NAV of EFTs also increased by 29.1% in the last 12 months.

Following the JFSA’s announcement of its policy “For Providing Better Financial Services in the Era of Transition – Financial Services Policy: Assessments and Strategic Priorities 2018” on 26 September 2018, the government is continuing its efforts towards “promoting long-term personal asset building” by encouraging long-term, regular and diversified investment, as well as enhanced transparency of investment products. These efforts are in response to growing concerns over the financial sustainability of the public pension system due to a rapidly ageing population in Japan, which is one of the major challenges the country is facing.

Struggling with prolonged low interest rates, banks, financial institutions and pension funds continue to pay close attention to investment funds that can provide good returns in the face of difficult financial conditions. Based on these circumstances, private equity funds, which normally take the form of limited partnerships, become attractive modes of investing for institutional investors and wealthy and high net worth individuals. In addition, several specialised investment trusts have been launched recently, which invest predominantly in certain issues or products by utilising an exemption from credit risk diversification requirements under the rules of Investment Trusts Accusation, Japan.

ARFP

The Asia Region Fund Passport (ARFP) was formally launched on 1 February 2019, and 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. Joint committee meetings have been held twice since its launch, in May and October, and Australia, Japan, the Republic of Korea, New Zealand and Thailand are the initial participating economies under the ARFP.

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

JFSA has started to accept offshore ARFP funds at the time of the launch of ARFP in February 2019; however, Japan has not yet observed any ARFP funds being exported from or imported into Japan.

JAPAN TRENDS AND DEVELOPMENTS

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Anderson Mori & Tomotsune is one of the largest and most international Japanese law firms. It is best known for its long history of advising overseas companies doing business in Japan and in cross-border transactions. The main office in Tokyo is supported by offices in Osaka, Nagoya, Beijing, Shanghai, Singapore, Ho Chi Minh City and Bangkok, as well as a Jakarta Desk and an associated firm in Hong Kong. Anderson Mori & Tomotsune has considerable experience in matters relating to investment funds, including expertise in investment trusts, investment corporations such as J-REITs, infrastructure funds,

exchange-traded funds, partnerships and other forms of collective investment schemes. The firm works with increasingly diversified international and Japanese-based investment funds, including private equity funds, venture capital funds, hedge funds, funds of funds and commodity funds. The team consists of about 15 partners and 30 associates, and provides comprehensive advice on all stages of the investment funds process and helps clients to navigate a broad range of regulatory matters relating to asset management.

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