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Investment Funds

Japan: Trends & 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 (*toushi shintaku*), formed pursuant to the Japanese Act on Investment Trusts and Investment Corporations (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 30 November 2020, the net asset value (NAV) of all publicly offered investment trusts was approximately JPY135.7 trillion, placed in 5,919 funds (excluding investment corporations). At that same time, the NAV of all privately placed investment trusts was approximately JPY104.8 trillion, placed in 7,415 funds (excluding investment corporations). Among the publicly offered investment trusts, 192 funds were ETFs, with a total NAV of approximately JPY53.3 trillion.

The Investment Trust Act also provides for the creation of an investment corporation (*toushi houjin*) 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 31 October 2020 was approximately JPY10.7 trillion (placed in 62 funds, all listed on the Tokyo Stock Exchange) and there were 40 privately placed J-REITs, with a total NAV of approximately JPY2.3 trillion.

A number of offshore investment funds (those that are established in offshore jurisdictions such as the Cayman Islands, Luxembourg and Ireland) are offered in Japan, both as public offerings and as private placements. According to statistics published by the Japan Securities Dealers Association (JSDA), 785 outstanding offshore investment funds (including sub-funds under the same umbrella fund) were distributed publicly in Japan as of 31 December 2020. The NAV of all these funds attributable to investors in Japan was approximately JPY6.6 trillion. As of 30 September 2020, funds domiciled in the Cayman Islands and Luxembourg accounted for 51.3% and 37.4% of the total NAV of publicly offered offshore funds, respectively. Most of the remaining NAV invested in publicly offered offshore funds can be attributed to offshore funds domiciled in Ireland.

(The NAV figures cited above are rounded to the nearest one-tenth of a trillion.)

Investment Environment

The Nikkei Stock Average, commonly known as the Nikkei 225, is a representative index of Japanese stocks. The Nikkei 225 experienced an unprecedented fluctuation in 2020, falling significantly to around JPY16,500 temporarily in the latter half of March, reflecting the spread of COVID-19. However, it gradually climbed towards the end of the year and closed at JPY27,444.17 at the end of December 2020, representing a 16% rise compared to the end of December 2019.

This relatively strong positive trend in the Japanese stock market in 2020 may be attributed, in part, to the Bank of Japan's monetary easing measures, which include continuing the "negative interest rate" policy and the purchase of ETFs on the market. There is no assurance, however, that these measures will continue into 2021, due to difficulties in predicting how the COVID-19 situation will develop, and its impact on global markets. In addition to the effects of the COVID-19 pandemic on the global economy, there are other potential global economic and political risk factors, such as post-Brexit turbulence, political turmoil in Hong Kong and US-China trade friction.

Considering these factors, it may not be easy for investment funds in Japan to achieve their desired performance in 2021, and potentially 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 that are considered "safe" or "principal guaranteed", rather than in stock markets or other "relatively risky" investments. In response to this preference, 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 in recent years.

In particular, the following investment mechanisms were created as a consequence of a rapidly decreasing birthrate and an aging population. These trends will inevitably lead to the increase of social security expenses and the future reduction of per-person pension payments. Therefore, it has become increasingly important for each individual to build up his/her own assets via investment in securities (eg, equities, bonds and investment funds) to provide for his/her retirement, instead of relying exclusively on the public pension.

As part of those measures, the Nippon Individual Saving Account (NISA) system was introduced in January 2014, 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, under which minors (under 20 years of age) are allowed to open specially designed NISA accounts. Furthermore, in January 2018, the monthly investment (*tsumitate*) NISA (now called an Accumulation NISA Meet-up) was introduced as an alternative to the Basic NISA.

Since the inception of the NISA system, the aggregate number of NISA accounts has steadily increased. 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 2020, was approximately 8.87 million, an increase of 13.4% compared to the previous year. The amounts accumulated through investments in the Basic NISA accounts (from 2014 until 30 September 2020) and Accumulated NISA Meet-up accounts (from 2018 until 30 September 2020) are approximately JPY14.10 trillion and JPY 321.2 billion, respectively. In 2020, the investment period under Accumulated NISA Meet-ups has been extended by five years to 2042, and the Basic NISA will be revised into a two-tiered system with effect from 2024.

In 2020, market trends in investment funds changed due to the impact of COVID-19 on market environments. At the beginning of 2020, "balanced funds" that invest multiple asset classes, such as equities and bonds (domestic and global), in a well-balanced manner carried over their popularity from 2019. However, most balance funds fell as risk assets in general suffered sharp declines because of fears about the spread of COVID-19. This trend might continue to suppress investors' appetite for balanced funds. As a result, global equity investment funds attracted investors as the US equities market turned over and maintained an upward trend toward the end of 2020, mainly led by a rally in hi-tech stocks.

Pressure from the market to lower management fees and distribution fees continued to accumulate throughout 2020. The lowering of fees for investment managers and distributors is in line with the JFSA's expected outcome after the introduction of "fiduciary duties" in 2017. In particular, internet securities companies now handle a wide range of no load funds, in which distributors do not charge their clients an initial distribution fee (which generally used to be approximately 2% to 3% of the purchase amount). Supported by this trend, the aggregated NAV of EFTs also increased by 24.8% in the last 12 months.

A remarkable trend in 2020 was widespread interest in environmental, social and governance (ESG) related funds among investors. In Japan, many investment management companies have previously signed the United Nations Principles for Responsible Investment and made it clear that they have integrated ESG factors into their investment decision-making process. Despite this, until last year, ESG-related funds drew attention mainly from institutional investors. In 2020, however, major investment management companies sequentially launched new ESG-related funds aimed at retail investors. Some of these funds raised large amounts of capital from retail investors, in tandem with a growing interest in the Sustainable Development Goals (SDGs), which make up 17 international development goals relating to the economy, society and environment.

In connection with the above, the Stewardship Code established by the Council of Experts on Japan's Stewardship Code was revised for the second time on 24 March 2020, three years after the first revision in 2017. The Stewardship Code is a collection of principles considered to be helpful for institutional investors that wish to act as responsible investors while fulfilling their stewardship responsibilities, giving due regard both to their clients and beneficiaries, and to investee companies. The Stewardship Code puts emphasis on improving and fostering the investee companies' value, as well as promoting sustainable growth through constructive engagement with the management of investee companies.

The second revision of the Stewardship Code seeks to enhance the quality of the engagement between investors and companies, by (among other recommendations) requesting that investors conduct engagement based on considerations of sustainability (both medium- and long-term sustainability, while having due regard to ESG factors), which should also be consistent with their investment management strategies. The Stewardship Code also requires that institutional investors clearly specify how they take the issues of sustainability into consideration in their policies, depending on their investment management strategies. As of 30 November 2020, 291 institutional investors have signed up to the Stewardship Code. As a result of the proliferation of the Stewardship Code, institutional investors should not only consider sustainability issues (including ESG factors) when making investment decisions, but also establish their own management policy to address these sustainability issues.

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 two offices in Japan (Osaka and Nagoya) and seven overseas offices. AMT 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 40 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.

Authors

Kunihiko Morishita is a partner who works primarily in the fields of domestic and international banking, securities and asset management. He is a member of the Financial Law Board, an influential advisory body regarding financial law matters sponsored by the Bank of Japan. Kunihiko has extensive experience in representing financial institutions, including investment management companies, before the Financial Services Agency and other Japanese regulatory authorities. He regularly advises a number of multinational financial institutions, located within and outside Japan, in relation to regulatory issues in the fields of securities, trusts, insurance and asset management.

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