

Investment Trusts in Japan 2014

Investment Trusts Association, Japan

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About The Investment Trusts Association, Japan

With a view to promoting sound development of investment trusts in Japan, the Investment Trusts Association, Japan, (SHOKEN TOSHISHINTAKU KYOKAI in Japanese language) was established in July 1957. It existed under a license of the Minister of Finance. It has been actively engaged in a wide range of activities, with particular emphasis on the promotion of self-regulatory practice in respect to operations of securities investment trusts. But because of the limited nature of the purpose underlying establishment and the voluntary nature of its statutory status, the effectiveness of its activities had been necessarily limited.

Growing concern gave rise to urgent requests to redefine the character of the Association as guardian of the public interest, and particularly to reinforcing its power to implement self-regulatory practices in the industry in order to protect investors (beneficiaries) of securities investment trusts and to promote healthy development of the industry. As a result, the Securities Investment Trust Law was amended in August 1967. The amendment defined the Association's purposes, business and so on in the Securities Investment Trust Law. The amendment also strengthened the supervisory power of the Ministry of Finance over the Association.

The significant amendment to the Law Concerning Securities Investment Trusts and Securities Investment Companies in 2000 permitted investment trusts to mainly invest in the Specified Assets such as real estates (Formerly, they had to invest mainly in the securities). At the same time, the Law was renamed the Law for Investment Trusts and Investment Companies. In line with this amendment, the Investment Trusts Association changed its name from SHOKEN TOSHI SHINTAKU KYOKAI to TOSHI SHINTAKU KYOKAI in the Japanese language. The present purpose of the Association is “to protect investors and to contribute to the sound development of investment trusts and investment companies.” (Investment companies or corporate-type investment trusts were introduced by the amendment of the Law in 1998.) The Association was positioned as Recognized Financial Instruments Firms Association under the Financial Instruments and Exchange Act, which defines the Association's purposes and business.

Membership of the Association included 143 Full Members (investment trust management companies and investment advisers for investment companies, hereinafter referred to collectively as investment fund management companies) and 19 Supporting Members as of December 31, 2014.

The Association has the general membership meeting, the board of directors, several committees, the disciplinary council and the secretariat.

The board of directors resolved to establish the Self-Regulation Committee, the Policy Committee, the Special Measure Committee and the Director Recommendation Committee. Each committee covers following matters:

A. The Self-Regulation Committee

1. Matters related to self-regulations of management, valuation, accounting and disclosure for investment trusts and investment companies,
2. Matters related to self-regulations of subscriptions, private placements or other transactions of beneficiary certificates, investment certificates and investment company bonds,
3. Matters related to self-regulations of other investment management business conducted by full members.

B. The Policy Committee

1. Matters related to operations of the Association,
2. Matters related to the system of investment trust and investment company,
3. Matters related to the taxation,
4. Matters related to educational activities for promoting knowledge on investment trust and investment company,
5. Matters related to other activities of investment trust industry.

C. The Special Measure Committee

Measures to be taken in the emergency cases such as the suspension of trading on exchanges or foreign exchange markets.

D. The Director Recommendation Committee

Recommendations of candidates for the directors to the chairman.

The association has the disciplinary council as an advisory body of chairman which deliberates matters related to the disciplinary measures of the members.

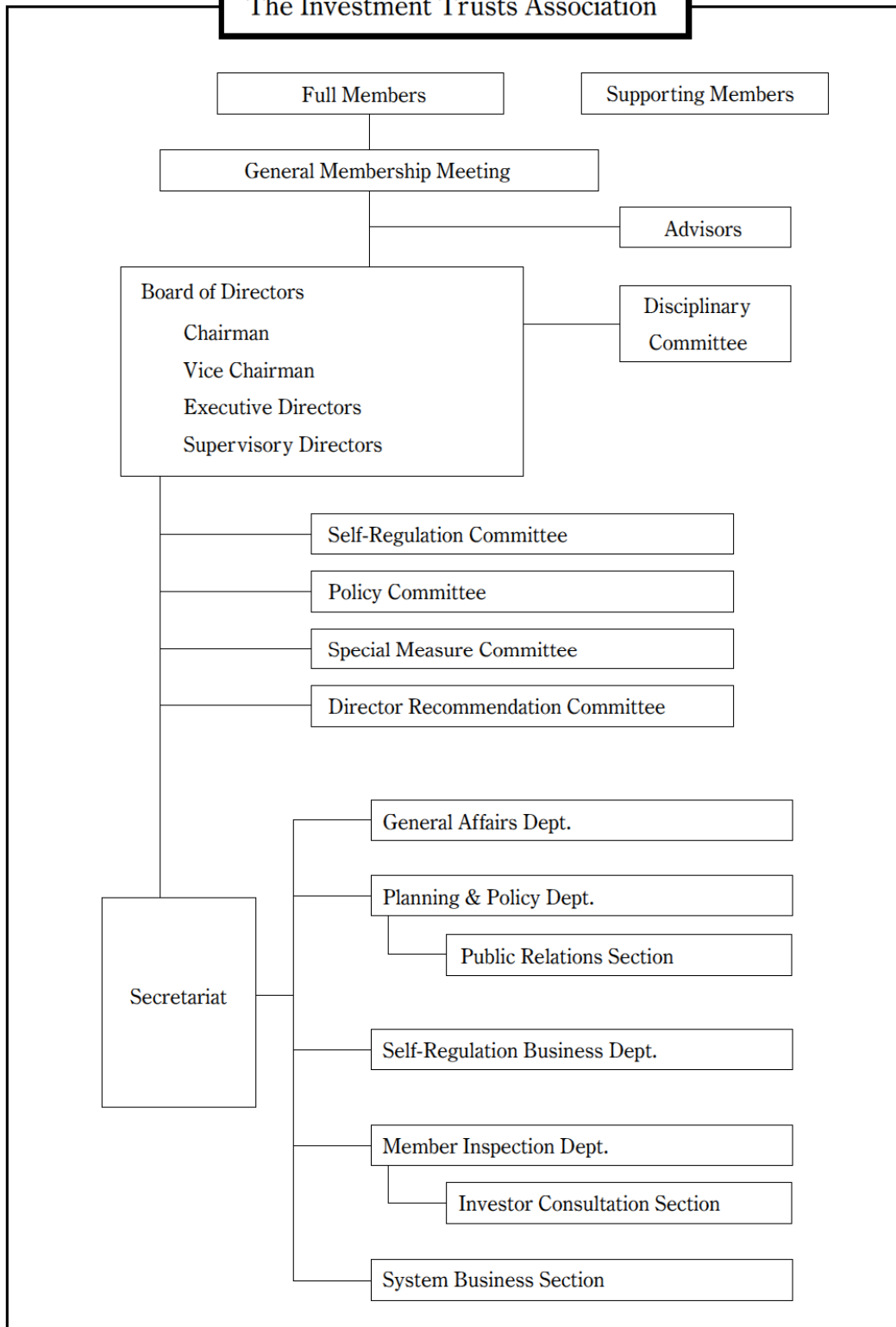
The Association has the Secretariat to deal with the management of board of directors and committees and other daily business. The Secretariat consists of four departments and three offices.

Business of the Association

The Association represents the Japanese investment trust industry and engages in following business:

- A. The guidance and recommendations in order to have full members comply with laws and regulations in engaging in financial instrument business and other business,
- B. The inspections, guidance and recommendations necessary for protecting investors such as proper asset management and sales of beneficiary certificates in relation to financial instrument business and other business conducted by full members,
- C. The inspections of full members in complying with the Financial Instruments and Exchange Law, the Law for Investment Trusts and Investment Companies, Association's articles and rules, trust deed of investment trust, articles of incorporations of investment company and faith for transactions,
- D. The settlement of complaints by investors concerning financial instrument business conducted by full members,
- E. The mediation of disputes about financial instrument business conducted by full members,
- F. The enactment of self-regulatory rules necessary for ensuring the proper financial instrument business conducted by full members,
- G. Business concerning protection of personal information handled by full members,
- H. The educational activities for promoting knowledge on investment trusts and investment companies,
- I. Preparation and release of statistical information on investment trusts and investment corporations,
- J. The researches, studies and releases on investment trusts and investment companies, and international exchanges,
- K. The promotion of mutual understanding and the adjustment of opinions among members or between members and relevant associations (including foreign bodies),
- L. The proposals, requests and communications to competent authorities and other relevant bodies,
- M. Other business including publicity activities to investors and other business necessary for achieving the Association's purposes.

The Investment Trusts Association



CHAPTER ONE

Transition of Investment Trusts

I. Establishment of Securities Investment Trusts

Publicly offered securities investment trusts of contractual type were first established in June 1951, when the Securities Investment Trust Law was passed and became effective. There were some funds in Japan which had analogous structure of the investment trusts before that. In legal terms, however, they were specified money trusts which found their legal support in the Civil Law, the Trust Law and the Trust Business Law. Investment trusts in Japan were finally established by the enactment of a special law, the Securities Investment Trust Law. Date back to 1948, the Securities and Exchange Law was passed and became effective, Japan took a first step toward the reconstruction after the War. At that time, the market was glutted with new issues which far exceeded demands because of the dissolution of the Zaibatsu (giant financial and industrial combines).

The birth of Japanese investment trusts were mostly because of government policy requirement. But after that, they had achieved own growth and development to meet the demands of the various ages as mentioned below.

II. Growth and Development of Securities Investment Trusts

A. From Registration System to Licensing System

The Securities Investment Trust Law was amended in 1953. Before the amendment, any company desiring to act as an investment trust management company was able to begin its business by registering with the Ministry of Finance, if it was a joint stock company (kabushiki-kaisha) with capital of 50 million yen or more and met certain requirements. The change to the licensing system came from the concern that the Ministry of Finance could not refuse the registration, even if the applicant was not adequate as an investment trust management company that deals with money of the investing public. At the same time, the amendment also strengthened the supervisory power of the Ministry of Finance.

B. Decline of Stock Market and System Reform

Stemming from the tight-money policy of 1964, Japanese economy came under the tightening grip of a recession of serious proportions. Under the impact, a debilitating dullness hung heavily over the stock market and stock prices plunged to alarming depths. Securities industry had difficult times due to the long stagnant stock market, and one big securities company went into bankruptcy. Securities held in the portfolio of securities investment trusts were no exceptions to this precipitous downturn of the market, and the net-asset

value of some of the investment trusts fell far short of the original investment, taking a heavy toll of new subscriptions. Adding insult to injury, the cancellation figures of existing funds increased, drastically whittling the total net assets of investment trusts.

To absorb these stocks and supply money to the companies was urgent task for Japanese government. As a solution for that, the utilization of investment trusts was conceived.

Confronted with such a dire difficulty, the investment trust industry searched unrelentingly for remedies that would improve the ailing system and, indeed, the management of individual investment trusts themselves. Finally, in November 1966, the Investment Trusts Association came forward with a three-point recommendation, urging (1) establishment of an independent management system for individual management companies, (2) strengthening of self-regulation by the industry, and (3) improvement of the unit type investment trust system (one type of securities investment trusts). In parallel with this movement, the Ministry of Finance put the then existing Securities Investment Trust Law to critical scrutiny and the Law Partially Amending the Securities Investment Trust Law was enacted in August 1967 and took effect in October of the same year, adding, among other things, a provision defining the management company's fiduciary duties to the beneficiary (investors of investment trusts) and a provision relating to the Investment Trusts Association.

C. Introduction of Medium-Term Government Securities Fund and Growth of Stock Investment Trusts Thanks to Rising Stock Market

Since then, the investment trust system has had various specific points improved further. Due to these improvements and the subsequent efforts of persons concerned, coupled with the upward movement in the stock market, the total net assets of securities investment trusts have continued to grow favorably.

Among others, the Medium-Term Government Securities Fund, which was launched in 1980, contributed a great deal to vitalizing the securities investment trust market. Its characteristics such as the convenience similar to bank deposit and the expectation for higher yield met the needs of wide range of investors. On the other hand, the upward trend of stock prices and the expansion of trade volume after 1985 especially accelerated the growth of stock investment trusts. It was in 1988 that the total net assets of securities investment trusts exceeded ¥50 trillion, and thus, they came to occupy an important position in the financial vehicles for the individual investors.

D. New Entries in Investment Trust Management Business

Meanwhile, in line with the growth securities of investment trusts, the liberalization and the internationalization of the Japanese financial markets made rapid progress. As a result, the circumstances surrounding investment trusts changed substantially. To copy with these changes, a Study Group on Investment Trusts (a private advisory body to the Director General of the Securities Bureau, the Ministry of

Finance) started in October 1988 to basically review a wide range of questions on investment trusts, including the issue of new entries into the investment trust business. The Group submitted a recommendation entitled “An Ideal Way for the Investment Trusts in Coming Years” in May 1989. The main points of the recommendation are as follows:

1. The necessity to further diversify the products to meet any conceivable needs of investors;
2. The necessity to introduce measures into unit-type investment trusts for stabilizing the size of the fund throughout the entire trust period;
3. The necessity to further improve the disclosure requirements;
4. The necessity to further augment the independence of investment trust management companies;
5. The necessity to allow domestic and foreign companies, with proper qualifications, new entry into the investment trust management business.

Along the lines of the Group’s recommendation, the industry implemented various improvements related to the investment trust system. Moreover, the Ministry of Finance announced “Guidelines for Licensing Investment Trust Management Companies” in December 1989, making clear its response, in a forward-looking manner, to the new entry by foreign and domestic companies. The Guidelines made it possible for foreign affiliated investment trust management companies to enter into the investment trust business in Japan. The Ministry of Finance revised the Guidelines in April 1992 in the interest of making them clearer. In addition, discretionary investment advisory companies were permitted in January 1995 to concurrently engage in the investment trust management business by obtaining the license of an investment trust management company. Further, investment trust management companies were permitted in January 1996 to share directors, personnel and offices with the investment advisory companies, if these investment trust management companies are established by foreign investment advisory companies which entered Japanese markets in the form of branches.

III. Slump of Stock Investment Trusts

The total net assets of investment trusts reached a record high of ¥58.6 trillion at the end of December 1989. However, because the stock market has been depressed and stagnant since the beginning of 1990, the total net assets decreased considerably, compounded by the net outflow of money and the devaluation of portfolio stocks. This sharp decrease in the total net assets was attributed largely to the decrease in the net assets of stock investment trusts. The net assets of stock investment trusts reached a record high of ¥45.5 trillion at the end of December 1989, but since then have continuously decreased, dropping to ¥9.9 trillion at the end of 1997. Under the impact of falling stock prices, the performance of some stock investment trusts was hurt so badly that their net asset values fell below the par value at the time of redemption. Therefore, investment trust management

companies began in January 1992 to extend the trust periods of such funds further to three years from the time of original redemption, if the investors wished to do so. However, despite strenuous efforts by management companies to improve performances, prolonged stagnation in the stock market forced some of these funds to redeem their shares, even when the net-asset values were still below the par values at the end of extended trust periods. The Japanese economy has been still depressed during 1997, and some financial institutions and securities companies failed one after another over the year's end due to the prolonged stagnation of the Japanese stock market and the severe credit contraction in the financial market. Especially, the collapses of parent securities companies caused the drastic decrease in the net assets of those investment trusts managed by their affiliated investment trust management companies, because these investment trust management companies relied almost all sales of their investment trusts on the parent securities companies. Such decrease in the net assets of these investment trusts, in turn, resulted in the decrease in the total net assets of all securities investment trusts in Japan.

IV. Improvement of Securities Investment Trust System

A. Study Council on Investment Trusts

As noted already, stock investment trusts were in a difficult situation, as evidenced by the decrease in the total net assets and the lower investment performances due to the long stagnation of the stock markets. In addition, such developments as the sharp increase in the accumulation of personal financial assets and the ongoing deregulation and globalization of financial and capital markets created a vastly different environment for investment trusts. However, the investment trust system based upon the framework, which has been maintained since its establishment in 1951, could not adequately respond to these changes.

Under these circumstances, the Ministry of Finance set up a Study Council on Investment Trusts in November 1993 to study measures for improving the investment trust market and the investment trust system. In June 1994, the Study Council submitted a report on the measures for the reform of investment trusts, entitled "Proposals for Reform of Japan's Investment Trust System - In Order to Enhance Their Expected Functions and Roles."

Since then, the Ministry of Finance and the Investment Trusts Association considered the issue of how to implement the Study Council's recommendations, and they finally decided on concrete measures for the reform of investment trusts in December 1994 and January 1995, respectively. The content of this reform (hereinafter referred to as the reform of investment trusts in 1994) can be summarized as follows:

1. Sweeping deregulation of investment management and profit distributions;
2. Enhancement of the contents of prospectuses and financial reports;

3. Improvement of the disclosure system for fund performance and the preparation for the creation of suitable private rating agencies in the future;
4. Establishment of the fair trade rule;
5. Review of the Guidelines for Licensing Investment Trust Management Companies;
6. Review of regulations on domestic sales of foreign investment trust securities, and so on.

B. Financial System Reform (Japanese version of Big Bang)

In November 1996, the Japanese government decided to implement the financial system reform (the Japanese version of Big Ban) in order to revitalize the Japanese financial market as a leading international market under three principles of free, fair and global by 2001.

As a part of this financial system reform, the Securities and Exchange Council began to consider the reform measures necessary for the securities industry, and made public its interim results as the document entitled "Issues for Discussions" which described the various issues of the Japanese securities market, the basic philosophy and vision for the reform and the general direction of the reform. In January 1997, the Securities and Exchange Council began to discuss the concrete and individual reform measures in the context of "Issues for Discussions", and made public in June 1997 its recommendations as the report entitled "Comprehensive Reform of the Securities Market."

Along the lines with the recommendations by the Securities and Exchange Council, the Ministry of Finance announced in July 1997 a package of deregulatory measures for the financial and securities industry. Referring to investment trusts, the deregulatory measures listed below were implemented in 1997.

1. Improving the approval system for trust deeds (August 1997)
2. Improving the MMF and the Medium-Term Government Securities Fund from the investor's usage point of view (August 1997)
3. Introducing the Asset Management Account and establishing the Money Reserve Fund (October 1997)
4. Direct marketing by investment trust management companies at financial institutions by borrowing their office space (November 1997)
5. Permitting investment trusts to invest in unlisted / unregistered stocks (September 1997)

6. Improving the preservation method of legal books (August 1997)

C. Implementation of Financial System Reform Law and Reform of Investment Trust System

In order to implement the financial system reform, “The Law to Amend Laws Related to Financial System Reform” was enacted in June 1998 and became effective in December 1998.

In this connection, “The Securities Investment Trust Law” was renamed into “The Law for Securities Investment Trusts and Securities Investment Companies” and was amended to include additionally the provisions regarding the securities investment companies (corporate type investment trusts) and the foreign securities investment trusts and investment companies sold in Japan. This amendment made it also possible to establish privately placed investment trusts and investment companies. In addition, the amended Securities and Exchange Law made it possible for registered financial institutions to distribute securities investment trusts and investment companies.

This was the most drastic reform of the investment trust system since its establishment in 1951, and this reform made the system in Japan comparable with that system in the U.S.A. and in European countries.

The content of this reform can be summarized as follows.

1. Product Development

(1) Filing system of trust deed

Formerly, the trust deed of investment trust had to be approved by the Minister of Finance in advance of its establishment. This approval system is changed in the filing system.

(2) Introduction of privately placed investment trusts

Privately placed investment trusts aiming at 2 to 49 investors fill the gap between the discretionary investment advisory contract with one customer and the publicly offered investment trusts aiming at 50 investors or more.

(3) Introduction of securities investment companies (corporate type investment trusts)

In addition to the contractual type, corporate type, the mainstream in the U.S.A. and Europe, are introduced.

(4) Payment of salaries in Asset Management Account

The payment of salaries in the Money Reserve Fund (MRF) is permitted.

(5) Introduction of wrap account

Securities companies are permitted to provide customers with the wrap account (for example, the investment trust wrap account) by obtaining the authorization of the discretionary investment advisory business.

(6) Establishment of foreign currency denominated investment trusts

Investment fund management companies are permitted to establish foreign currency denominated funds.

2. Investment Management

(1) Authorization system for investment fund management companies

Former licensing system for investment fund management companies is changed into the authorization system.

(2) Permitting investment fund management companies to engage concurrently in the securities business

Investment fund management companies are permitted to concurrently engage in the securities business. (They were already permitted in 1995 to engage concurrently in the discretionary investment advisory business.)

(3) Outsourcing of fund management

Investment fund management companies are permitted to outsource the part of or entirety of management to the outside companies.

(4) Expansion of permissible use of derivatives

Investment trusts are permitted to use the OTC securities options transactions, the OTC forward index transactions and the OTC financial futures transactions etc.

3. Sales of Investment Trusts

(1) Sales of investment trusts by financial institutions

Financial institutions such as banks and insurance companies are permitted to distribute investment trusts.

(2) Liberalization of sales charges.

The Business Rules of the Investment Trusts Association were revised to abolish the provision prohibiting the discount of the sales charges. As a result, the sales charges are fully liberalized.

4. Improvement of Disclosure

(1) Application of disclosure requirements under Securities and Exchange Law to investment trusts

Investment trusts management companies are required to file the securities registration statement and the securities report with the Minister of Finance and to deliver the prospectus to investors.

(2) Outside audit of investment trusts

Accounting documents of investment trusts such as the balance sheet and the profit and loss statement must be audited by the public accountants.

(3) Delivery obligation of financial report

The delivery of the financial report to investors is obligated by the Law for Securities Investment Trusts and Investment Companies. (Formerly, the delivery obligation was set forth by the Association's self-regulatory rules.)

(4) Stipulating the prohibited activities of investment trust management companies by the Law

Prohibited activities of investment fund management companies are stipulated by the Law. (Formerly, these activities were stipulated by the Ministerial Ordinance of Finance.)

(5) Valuation of unlisted securities by market values

The valuation method of unlisted securities will be changed from acquisition value basis to market value basis from July 1999 in principle.

(6) Shortening the retention period of legal books

The legal books must be maintained for ten years after the end of each accounting period. (Formerly, they had to be maintained for ten years after the expiration of the trust period.)

V. Discussions on Collective Investment Schemes and Reform of Investment Trust System

The Ministry of Finance set up the Financial System Council in August 1998 and began to study how to create the stable and vital financial system for the 21st century.

The First Committee of the Council considered the legislation that covers the whole range of financial transactions comprehensively and in cross-sectional manner with the ultimate goal of enacting the so-called “Japanese version of Financial Services Law” in mind.

One of four Working Groups of the First Committee, the Working Group on Collective Investment Schemes, discussed the legislative framework for collective investment schemes, which comprise the asset management and the asset securitization.

A. The asset management schemes:

Those schemes, under which funds from the public investors are pooled and invested in various assets by professional fund manager, and the income accruing from the investment management of the funds are shared by investors.

B. The asset securitization schemes:

Those schemes, under which the specified assets, are securitized and separated from corporations.

The First Committee made public the second interim report in December 1999, and urged to amend the laws related to the collective investment schemes. Regarding the asset management schemes, the First Committee recommended to revise the Law for Securities Investment Trust and Securities Investment Companies so that investment trusts are able to invest in the broader range of assets including real estates.

Along the line with the recommendations, the Ministry of Finance submitted the bill to revise the Law for Securities Investment Trusts and Securities Investment Companies to the Diet, which was passed in May 2000 and became effective in November 2000. The Law was renamed the Law for Investment Trusts and Investment Companies, deleting the word “Securities.”

The main points of revisions were as follows:

1. Expansion of Main Investment Objectives

The Law for Investment Trusts and Investment Companies permits investment trusts to invest mainly in real estates, assets related to real estates and so on (Specified Assets). Formerly, all funds had to invest mainly in the securities, but this is still true for securities investment trusts and securities investment companies.

Thus, the Law made it possible for investment fund management companies to establish real estate investment trusts and investment companies.

2. Introduction of Investment Trusts Managed by Trustee

The Law for Investment Trusts and Investment Companies introduced the “investment trusts managed by trustee” as one type of investment trusts of contractual type. The investment trust managed by trustee means any trust, under which the trustee (trust bank) accepts the money from trustors (beneficiaries = investors) through the trust agreements concluded between the trustee and trustors in accordance with the single trust deed. Then, the trustee manages it collectively by investing mainly in the Specified Assets other than securities.

3. Duties of Reasonable Care and Skill

In addition to the duties of loyalty, the Law for Investment Trusts and Investment Companies imposed the duties to exercise reasonable care and skill upon the investment fund management company for the sake of beneficiaries of investment trust and investors in an investment company.

These duties are also imposed upon the trustee in the case of the investment trust of trustee-managed type and upon the promoter, administration service provider and the custody company in the case of the investment company.

4. Survey of Specified Asset Prices

Under the Law for Investment Trusts and Investment Companies, if investment trusts acquire or transfer the Specified Assets whose prices are difficult to objectively evaluate, the investment fund management company must entrust the survey of their prices and other related matters to the third parties. This provision applies also for the trustee in the case of the trustee-managed investment trusts. This provision does not apply for securities listed on securities exchanges.

5. Procedure for Amendments to Important Provisions of Trust Deed

When the investment trust management company amends the important provisions of the trust deed, it must make the public announcement and deliver the writ-ten notice to the beneficiaries in order to inform that the beneficiaries can oppose the important amendments within a certain period (This period must be more than one month).

If the beneficiaries who have more than one half of all beneficiary rights oppose the important amendments, the investment trust management company may not amend the trust deed.

If the beneficiaries who have more than half of all beneficiary rights would not oppose amendments and the important provisions would be amended, those beneficiaries who opposed the amendments have the right to demand the repurchase of their beneficiary certificates of the trustee.

6. Investment Company Bonds

The Law for Investment Trusts and Investment Companies permitted the closed end investment companies to issue investment company bonds up to the amount as set forth by their articles of incorporations.

VI. “Shift from Saving to Investing” and Implementation of Financial Instruments and Exchange Law

A. Shift from Saving to Investing

In spite of the joint efforts of government and people to implement various measures adopted by the Financial System Reform, Japanese financial market was still stagnant at the beginning of 2001. As the delay of the economic recovery was viewed as more seriously, the stock market plunged sharply. Therefore, in order to promote the economic recovery, the government decided the “Urgent Economic Measures” in April 2001 and the “Basic Policies for Economic and Financial Management and Structural Reform” in June 2001. The Council on Economic and Fiscal Policy of the government drafted these Measures and Basic Policies, which recommended to shift the policy “from the preferential treatment of savings to the preferential treatment of investing” for the purpose of fostering individual investors.

Along the line of the recommendation, the Financial Services Agency made public the “Program for Structural Reform of Securities Markets” in August 2001 and the “Program for Promoting Securities Markets Reform” in August 2002. These Programs included various reform measures for securities markets.

B. Implementation of the Financial Instruments and Exchange Law, etc.

The First Subcommittee of the Financial System Council made public the report entitled “To Establish Financial System with Market Functions Set as Its Core” in December 2003 and recommended to consider the wide range of measures to protect investors including the possibility to remodel the Securities and Exchange

Law into the Investment Services Law. The First Subcommittee began in September 2004 to consider legislation for the Investment Services Law and made public the report entitled “Legislation for the Investment Services Law (Provisional Title)” in December 2005. This report recommended as the basic framework of the Investment Services Law as follows:

- To review the current sectional business laws and establish the framework covering a wide range of financial instruments.

- To characterize the Investment Services Law as a general law regarding sales of financial instruments and asset management and apply the same regulations to financial instruments whose economic functions are identical regardless of types of service providers.

- To integrate the Foreign Securities Firm Law, the Law for Regulating Securities Investment Advisory Business, Financial Futures Trading Law and other laws with similar characteristics into the Investment Services Law to the fullest possible extent.

- To review the contents of the Financial Instruments Sales Law and integrate it into the Investment Services Law.

In order to remodel the Securities and Exchange Law into the Financial Instruments and Exchange Law along the line with the report, the Financial Services Agency submitted in March 2006 the “Bill for Amending Securities and Exchange Law and Other Financial Laws” and “Bill for Amending and Abolishing Related Laws to Implement Bill for Amending Securities and Exchange Law and Other Financial Laws” to the Diet, and both Bills were passed in June 2006 and fully implemented in September 2007.

The amendment largely consists of the following four pillars:

- Establishing a cross-sectional legislative framework for investor protection covering financial products with strong investment characteristics (the so-called legal framework for investor services)

- Enhancing disclosure requirements

- Ensuring appropriate management of self-regulatory operations by exchanges

- Strict countermeasures against unfair trading

The Financial Instruments and Exchange Law defined additionally the collective investment schemes, beneficially rights of trusts and mortgage securities as the “securities” under the Law. The Law for Investment Trusts and Investment Companies additionally incorporated the provision for issuance of short-term

investment company debenture, and pursuant to the amendment of the Trust Law in December 2006, the Law incorporated the provision for merger of investment trusts managed by investment trust management companies with the same trustee, the provision for resolution in writing for the material amendment to the trust deed.

As the results of the sequence of amendments of the Laws, investment trusts management business and investment adviser business for investment companies, which were formerly provided in the Law for Investment Trusts and Investment Companies, were collectively positioned as the “investment management business” under the Financial Instruments and Exchange Law, and they need to register under the provision of the Law. The regulation for business and action of the investment management companies is provided in the Financial Instruments and Exchange Law.

VII. Plan for Strengthening the Competitiveness of Japan’s Financial and Capital Markets

In order to sustain economic growth in Japan where the population is rapidly aging, strengthening the competitiveness of the country’s financial and capital markets has become a pressing policy issue. Therefore, the Financial Services Agency put together the “Plan for Strengthening the Competitiveness of Japan’s Financial and Capital Markets” and made public it in December 2007. The Plan consists of following four pillars:

- ◇ Creating reliable and vibrant markets,
- ◇ Realizing business environment that vitalizes the financial services industry and promotes competition,
- ◇ Improving the regulatory environment (better regulation),
- ◇ Improving the broader environment surrounding the markets.

The first pillar includes such measures as diversification of ETFs and creation of new markets exclusively for professional investors.

The Financial Services Agency submitted the Bill for Revising Financial Instruments and Exchange Law and other related Laws to the ordinary session of the Diet in March 2008 in order to implement measures incorporated in the Plan for Strengthening Competitiveness of Japan’s Financial and Capital Markets. The Bill passed the Diet in June 2008, and the revised Financial Instruments and Exchange Law and other related laws took effect in December 2008. The followings are some of main items of amendments:

- ◇ Diversification of ETFs,
- ◇ Creation of new markets exclusively for professional investors,

- ◇ Review of firewall regulations among securities firms, banks and insurance companies,
- ◇ Broadening of the scope of business permitted to bank or insurance groups

This regulatory reform permitted investment trusts including ETF to invest directly in commodities, commodity futures and other commodity derivatives.

VIII. Action Plan for Invigoration, etc. of Financial/Capital Markets and Financial Industry

In the New Growth Strategy–Blueprint for Revitalizing Japan (Cabinet Decision dated June 2010), Financial Strategy is positioned as one of the seven strategic areas.

Later, the FSA announced “the Action Plan for Invigoration, etc. of Financial/ Capital Markets and Financial Industry to Implement the New Growth Strategy” which summarizes measures for the FSA to take in the future to develop an environment for Japan’s financial sector in three pillars:

1. Supply of funds to the companies commensurate with borrowers’ size and stage of development
2. Financial sector serving as a bridge between Asian and Japanese economies
3. Provision of asset management capabilities to utilize Japanese national assets safely

This plan also provided a) review of the legal framework concerning investment trusts and investment corporations and b) relaxing registration requirements for investment management businesses with limited types of clients such as professional investors, as measures related to the framework of investment trusts and investment companies.

The contents of relaxing registration requirements for investment management businesses with limited types of clients such as professional investors were included in the amendment of the Financial Instruments and Exchange Law enacted in May 2011, and became effective in April 2012.

IX. Review of the Legal Framework Concerning Investment Trusts and Investment Corporations and Revision of the Relevant Laws

In January 2012, the Minister for Financial Services asked the Financial System Council (the Council) to deliberate the review of the legal framework concerning investment trusts and investment corporations. The Working Group on Review of the Investment Trust and Investment Corporation system discussed on the theme since March 2012, and released its final report in December 2012.

The main points proposed by the report are as follows:

a. Regulatory review on investment trust funds

- Establishing “summary investment report”
- Providing information about risks etc. to investors on sales and solicitation
- Notification of a total return to investors
- Introducing limits over contents of trust asset

b. Regulatory review on J-REITs

- Introduction of the options (e.g. rights offering) to stabilize the financial constitution of J-REITs.
- Including J-REITs under the current insider trading regulation
- Removing impediments to investments in real estate abroad

In June 2013, the revised Financial Instruments Exchange Act and Act on Investment Trust and Investment Corporation passed the Diet. This revision includes establishing “summary investment report”, introduction of the options to stabilize the financial constitution of J-REITs and including J-REITs under the current insider trading regulation.

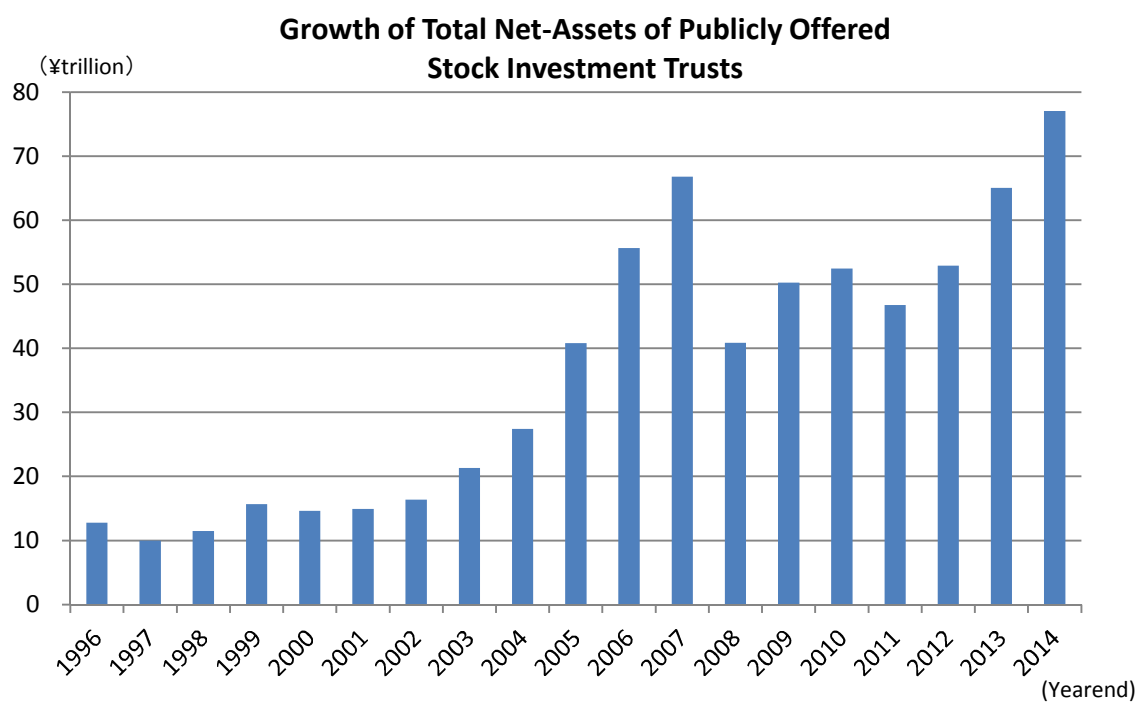
CHAPTER TWO

Current Situation of Investment Trusts and Investment Companies

I. Publicly Offered Securities Investment Trusts

A. Stock Investment Trusts

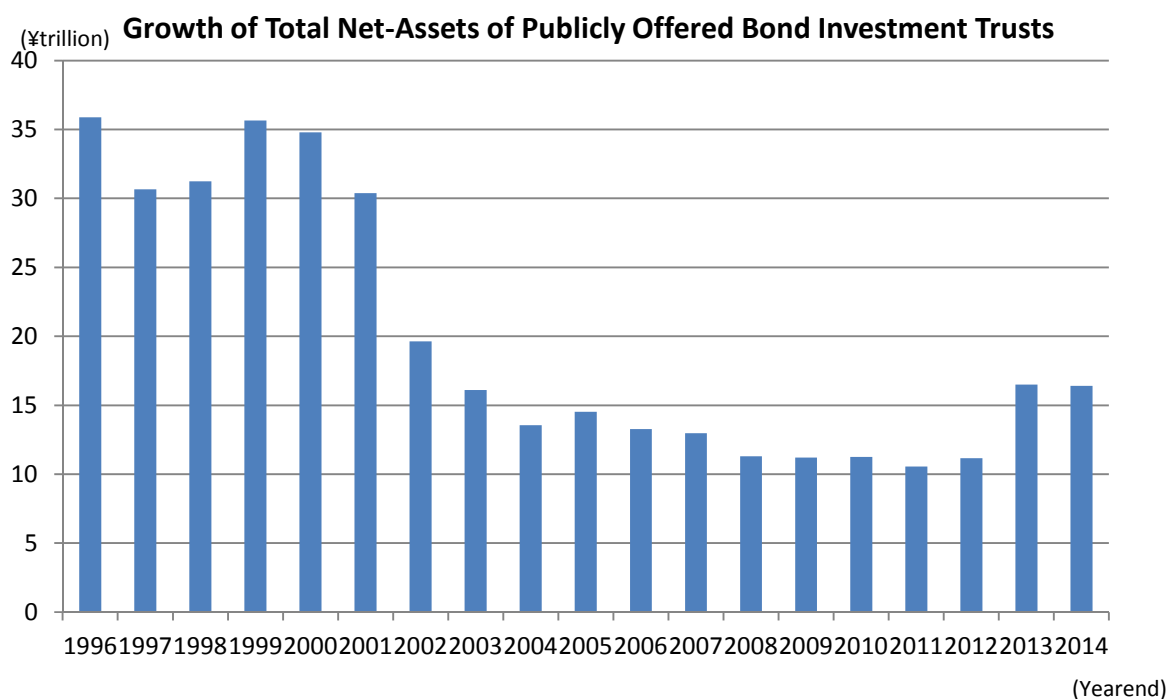
The total net assets of stock investment trusts had grown steadily until 2001, increased rapidly every year from 2003 to 2007, and reached record high of ¥66.7 trillion at the end of 2007. Their total net assets decreased to ¥40.8 trillion at the end of 2008 due to the decline in stock prices caused by Lehman shock in September 2008. They recovered in 2013 and 2014, reached all-time year-end record of ¥77.9 trillion at the end of 2014.



B. Bond Investment Trusts

The total net assets of bond investment trusts reached a record high of ¥35.8 trillion at the end of 1996. They kept ¥30 trillion level thereafter, and recovered to ¥35 trillion level at the end of 1999. However, some MMFs, which had invested in securities issued by Enron (U.S. major energy firm), saw their net asset value per share fall below the principal value due to the Enron's collapse. This caused the outflow of money from those and other bond funds. As a result of this out-flow, the total net assets of bond investment trusts decreased to ¥19.6 trillion at the end of 2002. As the ultra-low interest rate continued, they kept ¥10-¥11

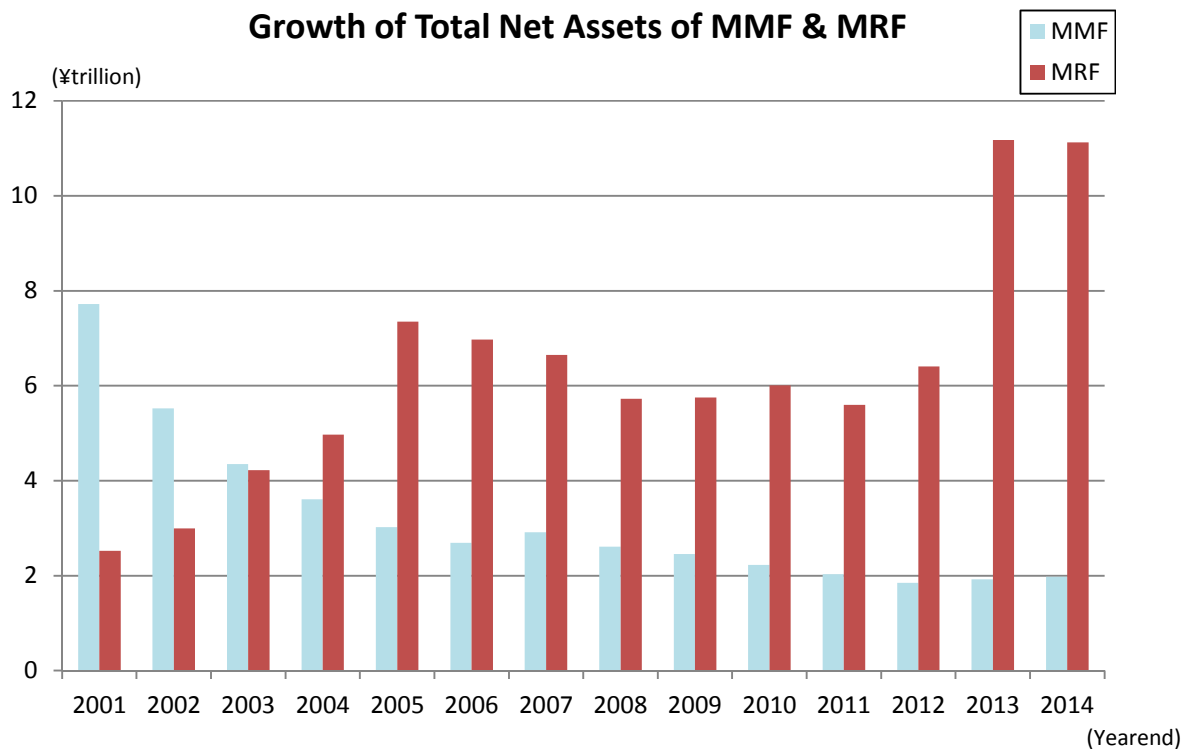
trillion level since 2008, but they recorded ¥16.4 trillion at the end of 2014 mainly because of increase of total net assets of MRF thereafter.



MMF (Money Management Fund), MRF (Money Reserve Fund)

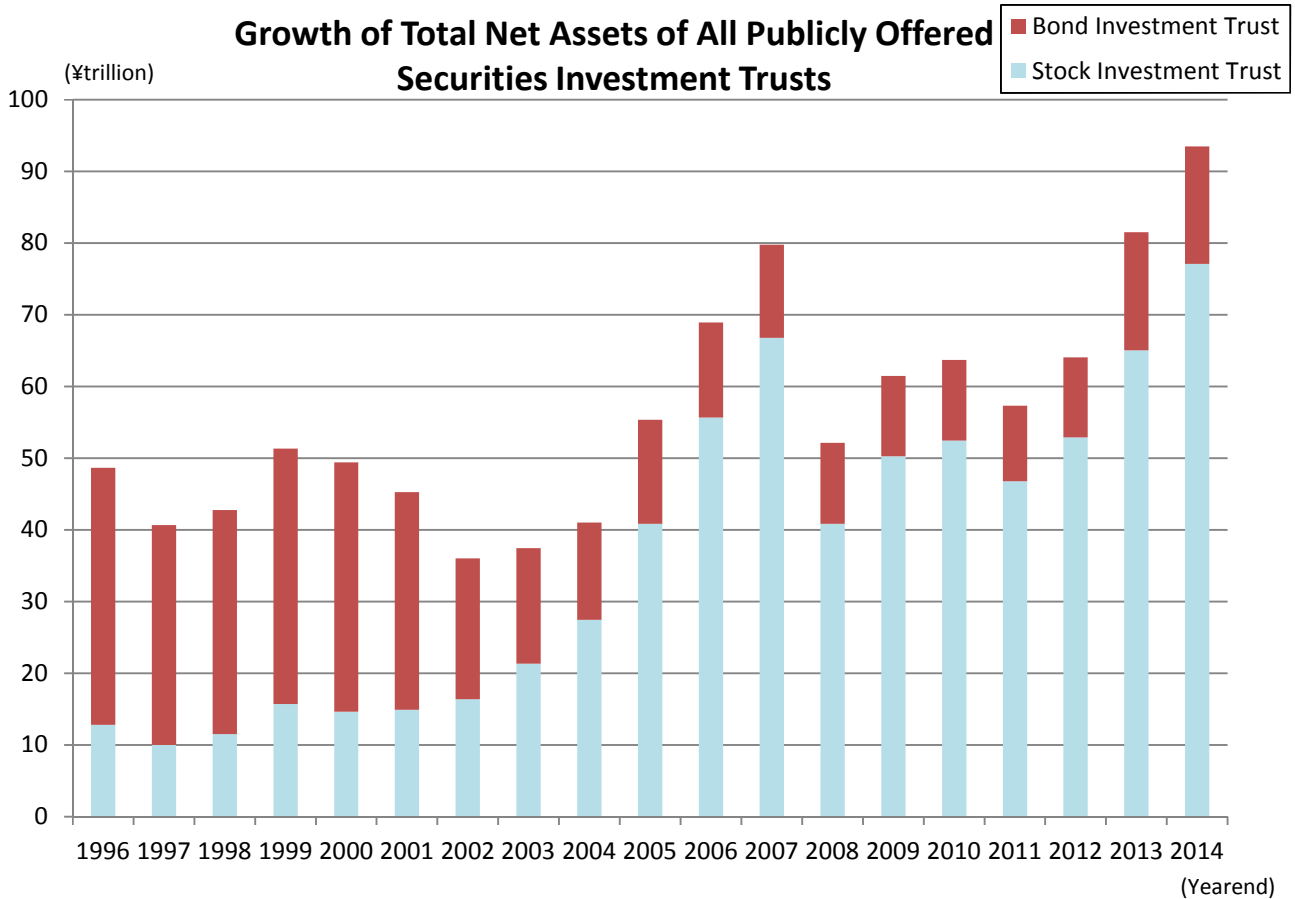
The MMF increased favorably since its establishment in 1992. Its total net assets exceeded ¥21 trillion at the end of May 2000. However, due to the decision of the Bank of Japan in August 2000 to discontinue the zero-interest policy (in the inter-bank credit market rate), the total net assets of MMF decreased to ¥10.9 trillion at the end of 2000. They recovered to ¥18 trillion in early 2001, but because of the vast outflow of money caused by the NAV falling below ¥1 per share as mentioned above, their total net assets decreased to ¥7.7 trillion at the end of 2001, ¥5.5 trillion at the end of 2002. As the decrease of assets continued, their total net assets kept ¥2 trillion level since December 2006, and recorded ¥1.9 trillion at the end of 2014.

MRF increased favorably since its establishment in 1997, and its total net assets reached ¥7.3 trillion at the end of 2005. Their assets hovered between ¥5 trillion and ¥6 trillion level in the following years, but they kept ¥11 trillion level since 2013, recorded ¥11.1 trillion at the end of 2014.



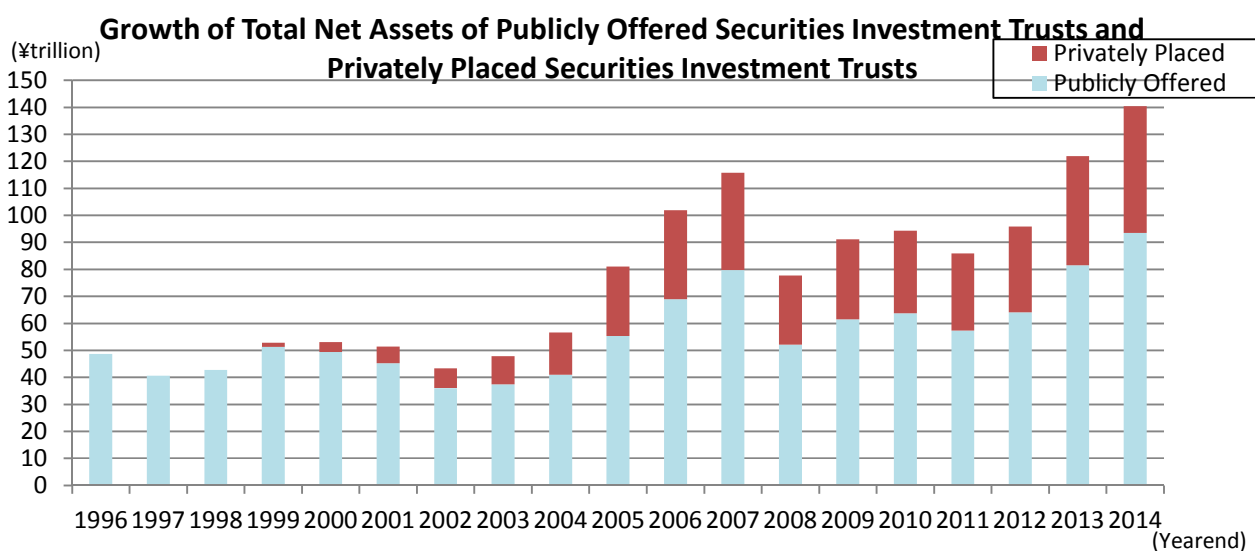
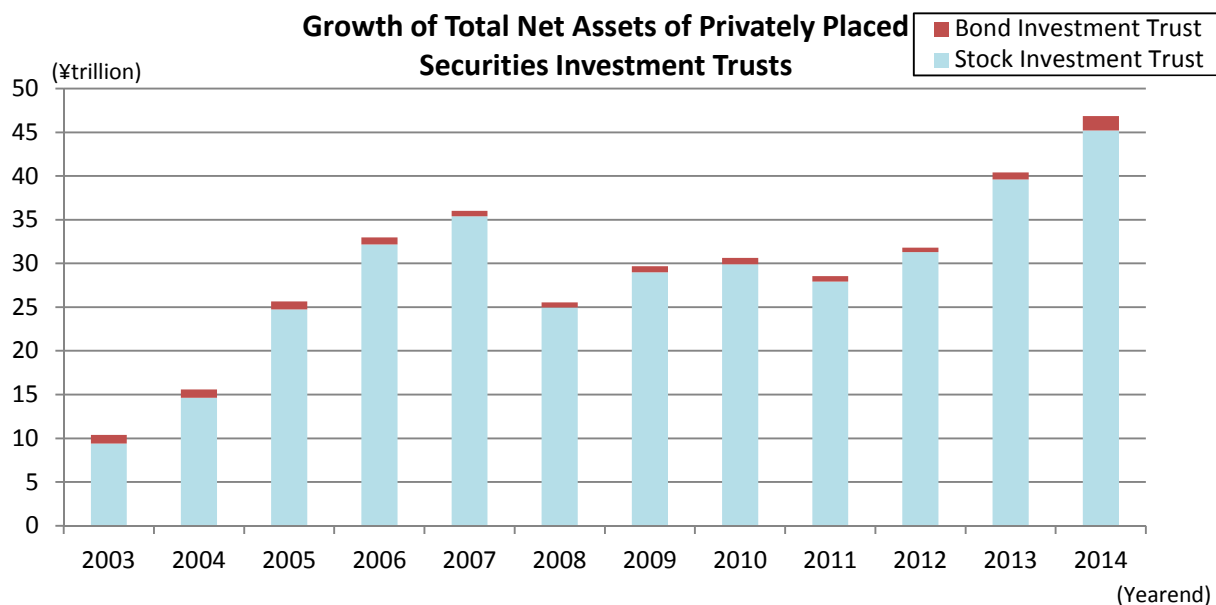
C. All Publicly Offered Securities Investment Trusts

The total net assets of all publicly offered securities investment trusts decreased from ¥58.6 trillion at the end of 1989 to ¥40.6 trillion at the end of 1997. Thanks to the growth of the MMF, they turned to recover since then and reached temporarily ¥60.4 trillion at the end of June 2000. However, they declined again due to the MMF's decrease and amounted to ¥36.0 trillion at the end of 2002. Thanks to the growth of stock investment trusts, they recovered after that and reached the record high of ¥79.7 trillion at the end of 2007. They declined to ¥52.1 trillion at the end of 2008 largely because the total net assets of stock funds declined due to the Lehman shock. They reached ¥93.5 trillion at the end of 2014 due to the large increase of the assets of MRF and stock investment trusts in 2013 and 2014.



II. Privately Placed Securities Investment Trusts

The privately placed securities investment trusts were first established in January 1999. They were marketed mainly for the institutional investors at the beginning. In recent years, they were also marketed for the defined contribution pension plans and variable annuity products. Their total net assets increased rapidly every year, and reached ¥36.0 trillion at the end of 2007. They declined to ¥25.5 trillion at the end of 2008, but continued to grow steadily thereafter, increased largely from 2013 to 2014 as the bond investment trusts, reached a record high of ¥46.8 trillion at the end of 2014.

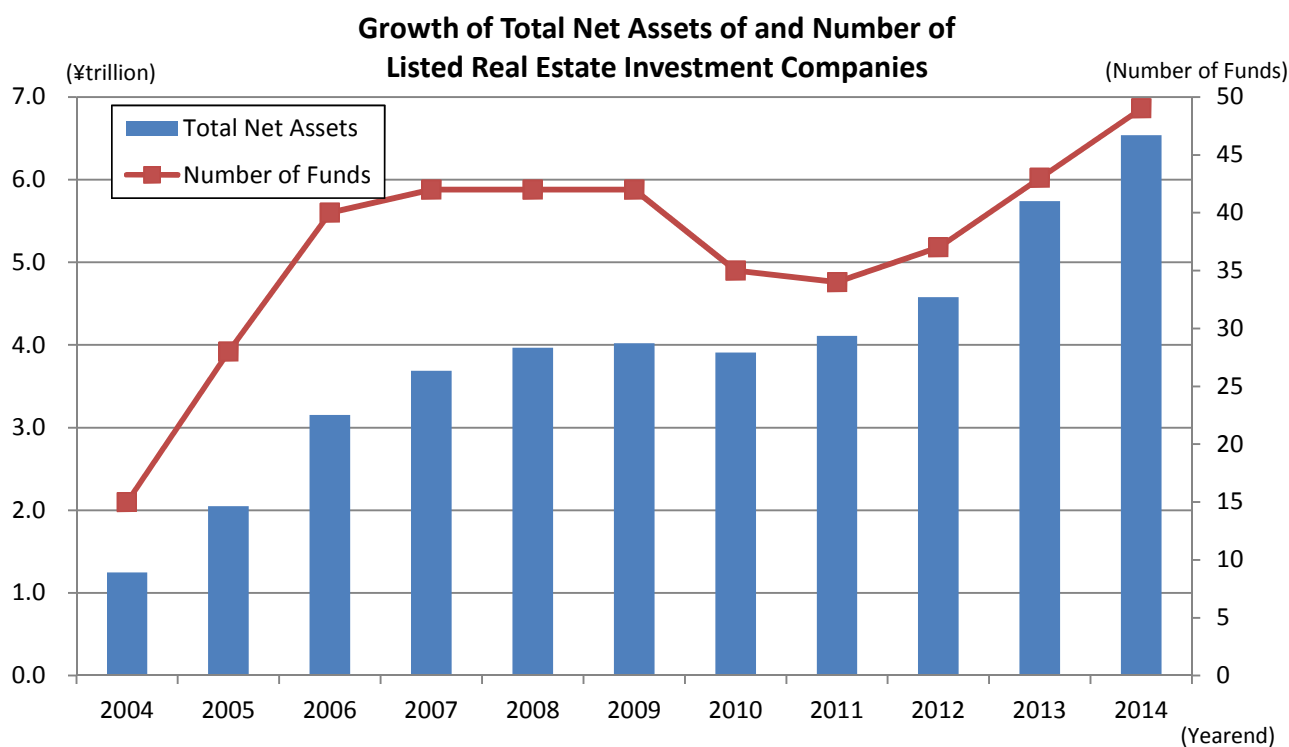


III. Investment Companies

The first investment company in Japan, which invests mainly in foreign special purposes companies, was established in August 2000. The discretionary investment advisory company authorized under Item 1 of Article 24 of the Law for Regulating Securities Investment Advisory Business has managed this investment company.

Then, two real estate investment companies, which invest mainly in real estate such as office buildings and were managed by investment advisers under the Law for Investment Trusts and Investment Companies, were established in September 2001 and listed on the J-REIT market of Tokyo Stock Exchange. Their total net assets amounted to ¥6.5 trillion at the end of 2014 from ¥236.6 billion at the end of 2001. The number of listed real estate investment trusts was 49 at the end of 2014.

The total net assets of privately placed real estate investment trusts was ¥596.7 billion and the number of them was 13 at the end of 2014.



Further, an investment company, which invests mainly in stocks of venture firms, was established in October 2001 and listed on the Osaka Securities Exchange. Additionally, one investment company of the same type was listed also on Osaka Securities Exchange later. Their total net assets amounted to ¥4.9 billion (2 funds) at the end of 2014.

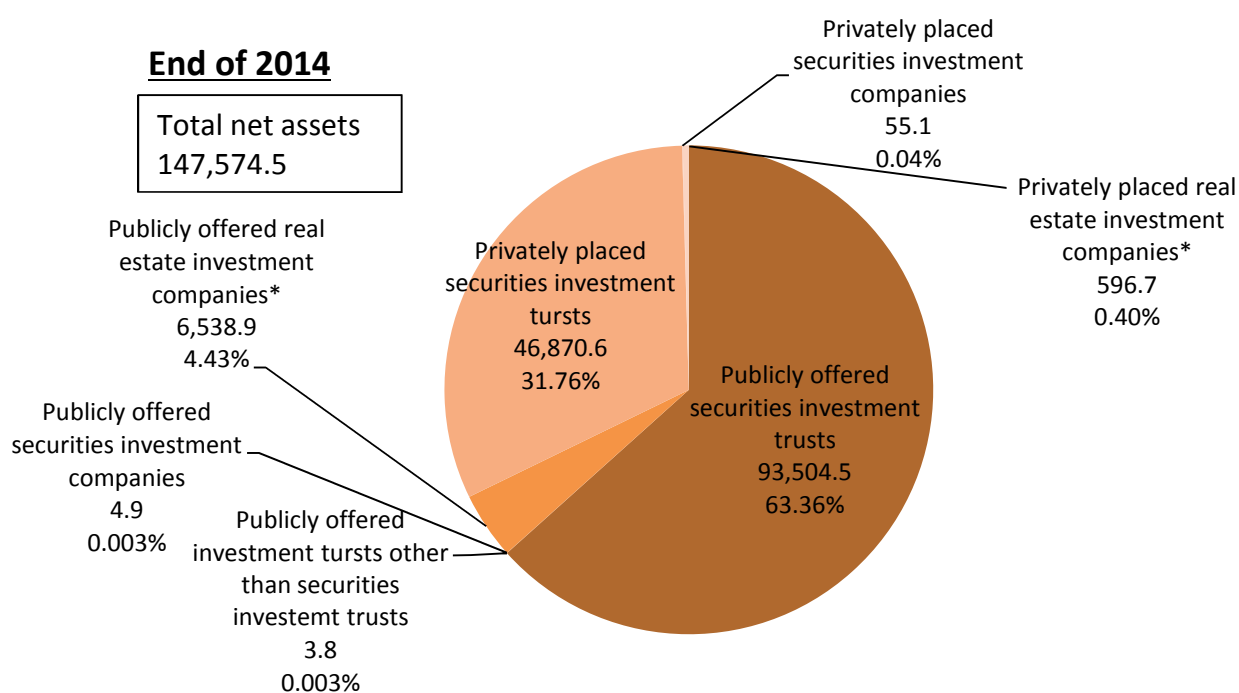
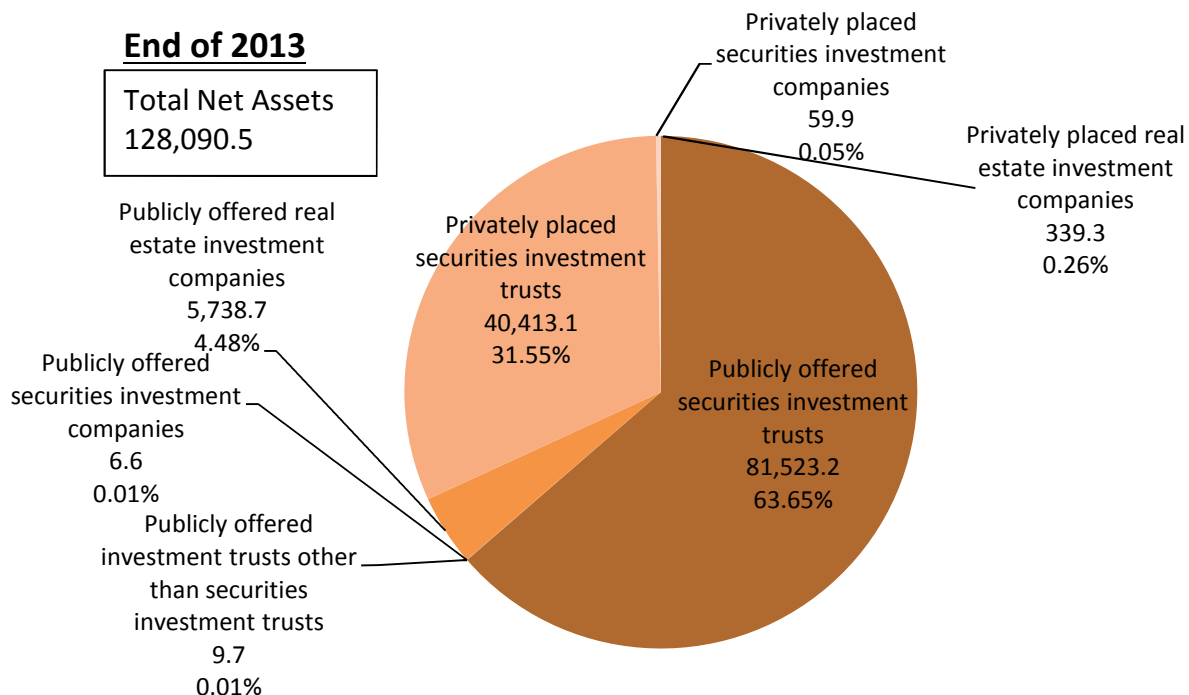
In addition to these publicly offered investment companies, there were 3 privately placed securities investment companies with the assets under management of ¥55.1 billion at the end of 2014.

IV. Publicly Offered Investment Trusts Other Than Securities Investment Trusts

The investment trusts other than securities investment trusts invest mainly in rights regarded as securities by each Item of Paragraph 2 of Article 2 of the Financial Instruments and Exchange Law, while securities investment trusts invest mainly in securities (except for rights regarded as securities by each Item of Paragraph 2 of Article 2, but including the securities-related derivative transactions as prescribed by Item 6 of Paragraph 8 of Article 28, the same applies hereinafter). The investment trusts other than securities investment trusts can take the form of either the investment trust managed by investment trust management company or the investment trust managed by trustee. They invest mainly in beneficiary rights backed by loan credits.

The investment trusts other than securities investment trusts managed by trustee do not exist at present, while the total net assets of investment trusts other than securities investment trusts managed by investment trust management company amounted to ¥3.8 billion (6 funds) at the end of 2014.

Total Net Assets by Type of Funds (in ¥billion)



CHAPTER THREE

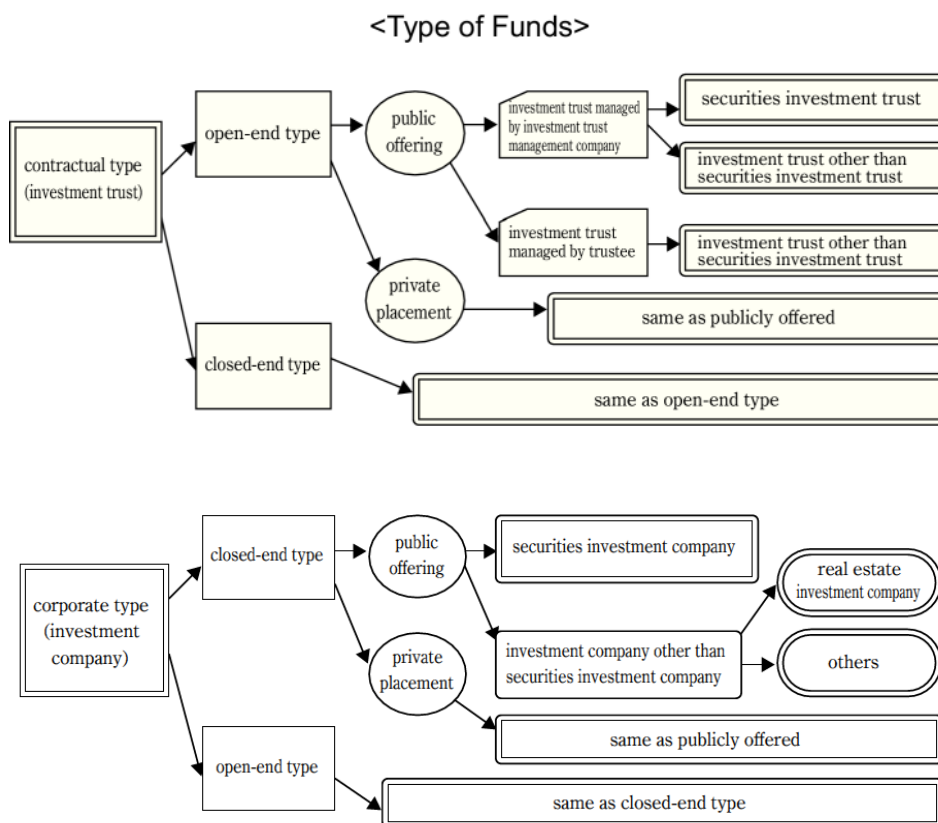
Characteristics of Japan's Investment Trust System

I. Structure of Investment Trusts

As described in Chapter One, the Japanese investment trust system started in 1941 as the specified money trust which found its legal base in the Civil Law, the Trust Law and the Trust Business Law, and the enactment of the Securities Investment Trust Law in 1951 provided the formal legal base for the present type of investment trusts now in operation. However, since their start in 1951, only the publicly offered securities investment trusts of the contractual type had been permitted for a long time until 1998. Therefore, in order to enhance their functions, the government reformed the investment trust system drastically and amended the Law in 1998 and 2000.

These reforms introduced the corporate type investment trusts (investment companies), the privately placed investment trusts and the real estate investment companies. As a result of the reforms, the Japanese investment trust system became comparable with those of Europe and United States.

The following list indicates the categories of the investment trusts legally permissible in Japan at present.



II. Outline of Each Type of Investment Trusts

A. Contractual Type and Corporate Type

Broadly speaking, investment trusts are grouped into the contractual type and the corporate type, although their forms vary from one country to another. The contractual type takes such legal forms as the trust and the common fund. The contractual type in Japan takes the legal form of the trust.

Under the contractual type investment trust in Japan, based on the legal form of trust, “Trustor” that is responsible for giving direction for investment management of trust properties and “Trustee” that is responsible for the administration and safe-keeping of trust properties enter into a trust agreement, and the profits arising from the investment management are delivered to “Beneficiary.” Prior to the amendment to the Law in 1998, only the contractual type was permitted by the Law and is still currently dominant in Japan.

The corporate type investment trust (the investment company), the purpose of which is to invest mainly in Specified Assets, issues investment certificates (shares). Investors obtain the position as shareholder by holding investment certificates and receive the profits arising from the investment management. The amendment to the Law in 1998 made it possible to establish securities investment companies. Further amendment to the Law in 2000 made it possible to establish investment companies investing in real estates and other assets.

The investment company has those elements almost same as the ordinary business company such as the articles of incorporation prepared by the promoter, the registry of incorporation at the registry office, investors (shareholders), the general meeting of investors, executive directors, supervisory directors and board of directors. However, it must entrust its business such as the asset management, the custody of fund’s assets and the general business administration to the outside companies.

B. Open-End Type and Closed-End Type

Depending on the acceptance of investor’s request to redeem, investment trusts are grouped into open-end type and closed-end type. The open-end type accepts the beneficiary’s request to redeem his beneficiary certificates, while the closed-end type does not accept the beneficiary’s request.

As the closed-end type does not accept the beneficiary’s request to redeem his beneficiary certificates, it is listed on the exchange like equities and traded on the exchange at the market-determined prices.

In Japan, most contractual types are the open-end type, while most corporate types are the closed-end type.

C. Public Offering and Private Placement

Since the enactment of the Securities Investment Trust Law in 1951, only publicly offered investment trusts were permitted in Japan, because the Law defined the “Investment Trust” as any trust, under which each beneficiary right is split up and acquired by the unspecified and large number of investors.

The amendment to the Law in 1998 defined clearly the “Public Offering” as follows:

“Public Offering” means any solicitation for purchasing newly issued beneficiary certificates to a large number of persons (except for Qualified Institutional Investor Private Placement etc.). The Cabinet Office Ordinance defined the large number of persons as 50 persons or more. When calculating the number of persons, Qualified Institutional Investors are excluded from 50 persons.

The amendment to the Law in 1998 made it possible to establish the privately placed investment trusts by redefining the “Investment Trust” as any trust, under which each beneficiary right is split up and acquired by two investors or more. At present, the Law defines two types of “Private Placement” as follows:

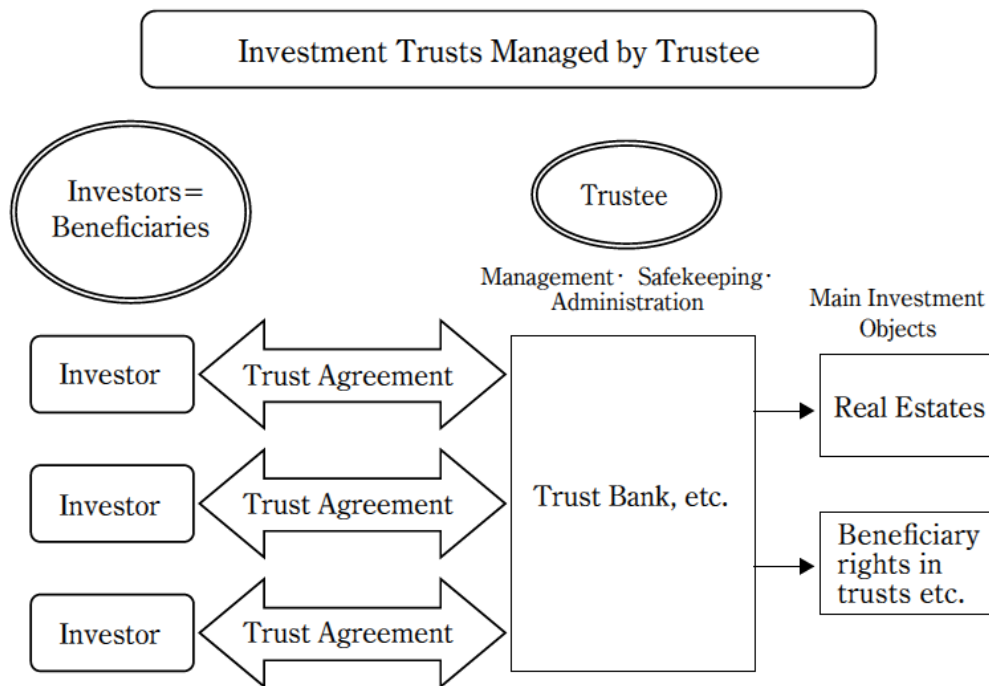
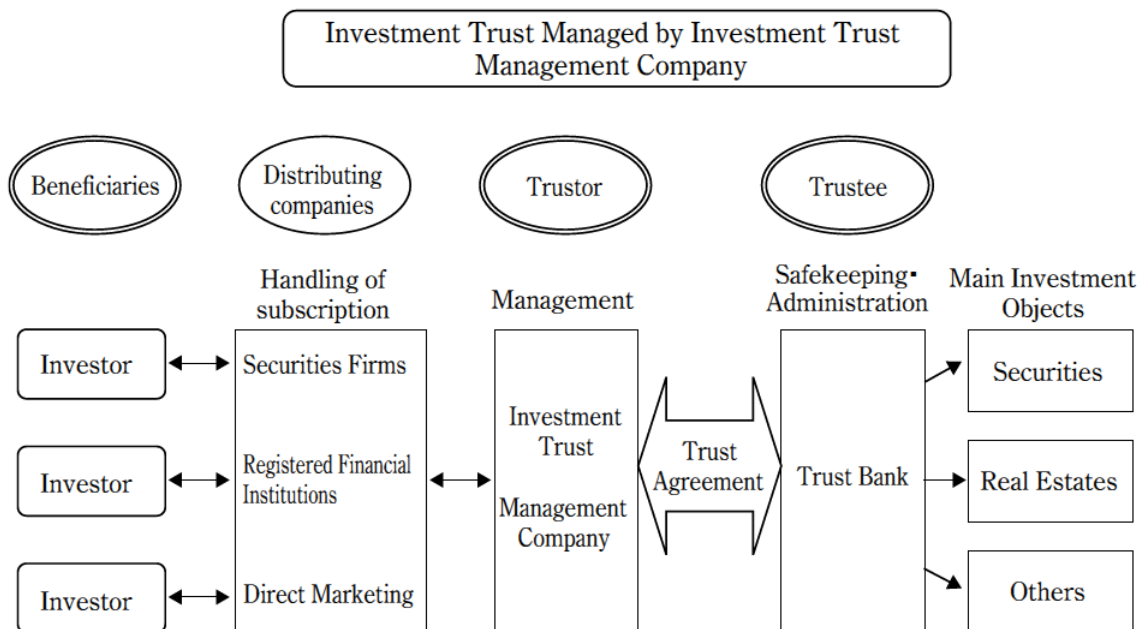
“Qualified Institutional Investor Private Placement etc.” means any solicitation for purchasing newly issued beneficiary certificates only to Qualified Institutional Investors or Professional Investors.

“General Investor Private Placement” means any solicitation for purchasing a newly issued beneficiary certificates which does not fall within the purview of the public offering and the Qualified Institutional Investor Private Placement etc.

D. Investment Trusts Managed by Investment Trust Management Company and Investment Trusts Managed by Trustee

Contractual type investment trusts are classified into two categories - Investment Trusts Managed by Investment Trust Management Company and Investment Trusts Managed by Trustee.

Generally speaking, an investment trust managed by the investment trust management company comprises three entities: the trustor (investment trust management company), the trustee (trust company or bank concurrently engaging in trust business = hereinafter referred to as trust bank) and the beneficiary. The investment trust management company and the trustee enter into a trust agreement in accordance with a trust deed filed with the Prime Minister. The beneficiary rights accruing from trusts established under the agreements are evenly distributed among, and acquired by, a plural number of investors. Investors acquiring them are called the beneficiaries, whose rights are exercised by virtue of a beneficiary certificate. The investment trust management company manages the trust properties, while trust bank acts only as a trustee.



※ Trust banks or securities companies sell the trustee managed type as distributing companies.

In the case of investment trusts managed by trustee, trust bank manages the trust properties and acts concurrently as a trustee. (Investment trust management company is not involved in this case.) The trust agreement of trustee-managed type is concluded between the trust bank (trustee) and each investor (trustor) in accordance with a single trust deed.

E. “Securities Investment Trusts” and “Investment Trusts Other Than Securities Investment Trusts”

Contractual type investment trusts are classified according to their investment objectives into two categories – Securities Investment Trusts and Investment Trusts Other Than Securities Investment Trusts.

“Securities Investment Trusts” mean those investment trusts managed by investment trust management company that invest mainly (more than 50% of the fund’s assets) in securities. In Japan, only the securities investment trusts were permitted in the past for a long time and are still currently dominant in Japan.

The term of “Investment Trusts Other Than Securities Investment Trusts” is not defined by the Law for Investment Trusts and Investment Companies and is used only for convenience sake. The amendment to the Law in 2000 made it possible to establish this type of investment trusts by expanding their main investment objectives from securities to Specified Assets as defined by the Cabinet Order under the Law.

Securities investment trusts are permitted only for investment trust management company-managed type, while investment trusts other than securities investment trusts are permitted for both trustee-managed type and investment trust management company-managed type.

F. “Securities Investment Companies” and “Investment Companies Other than Securities Investment Companies”

Investment Companies are classified according to their investment objectives into two categories – Securities Investment Companies and Investment Companies Other than Securities Investment Companies.

The amendment to the Law in 1998 made it possible to establish the investment trust of corporate type (investment company). However, the Law limited its main investment objectives only to securities at that time. As a result, the Law permitted to establish only the securities investment company, which was defined as follows: “Securities Investment Company” means any company, which is established in accordance with the Law, and the purpose of which is to manage its own assets by investing them mainly in securities.

As the further amendment to the Law in 2000 expanded the main investment objectives, the definition of “Investment Company” replaced the definition of “Securities Investment Company.” Investment companies investing in securities are still called “Securities Investment Company” for convenience sake. There are presently those securities investment companies investing mainly in stocks of venture firms.

The term of “Investment Companies Other Than Securities Investment Trusts” is not defined by the Law and used only for convenience sake. The amendment to the Law in 2000 made possible to establish this type of investment companies by expanding their main investment objectives from securities to Specified Assets. The mainstream of investment companies other than securities investment companies are those investment companies that invest in real estates, rights to lease real estates and rights of superficies.

CHAPTER FOUR

Management Structure of Investment Trusts Managed by Investment Trust Management Company

Operation of investment trusts managed by investment trust management company is generally divided into three entities. Giving direction for investment management of the trust properties is the responsibility of the investment trust management company (trustor). Administration and safekeeping of trust properties are the responsibilities of a trust company or a bank concurrently engaging in the trust business (trustee). Investors (beneficiaries) receive profits and losses accruing from the investment management. In practice, however, distributing companies also play certain roles in the management of investment trusts by handling subscriptions and sales, by paying profit distributions and money paid at redemption as well as by dealing with redemptions and repurchases under the subscriptions and sales agreement with redemptions and repurchases under the subscriptions and sales agreement with investment trust management company. So, it is reasonable to state that four parties actually involve in the management of investment trusts.

Those who engage in subscriptions and sales had been only securities companies (type 1 financial instrument business operators under the Financial Instruments and Exchange Law, the same applies hereinafter.) for a long time. Since December 1998, registered financial institutions have been also permitted to do so. The Japan Post (present Japan Post Bank) began to distribute investment trusts in October 2005 too.

I. Investment Trust Management Companies

A. From Authorization System to Registration System

Formerly, any company desiring to act as an investment trust management company had to obtain the authorization under the Law for Investment Trusts and Investment Companies. The business such as giving direction for investment management of investment trusts managed by investment trust management company is positioned as the “investment management business,” which is one of the financial instrument businesses, under the financial Instruments and Exchange Law which enacted in 2006. To engage in financial instrument and exchange business, they must register to Prime Minister under article 29 of the Law.

Therefore, the company who willing to engage in investment management business, they must file the application for registration to be a financial instrument business operator. The application must be filed with the Prime Minister and accompanied by the articles of incorporation and documents prescribing ways and means of doing business. The applicant must indicate the “investment management business” as the type of the financial instrument business on the application form.

The Law for Investment Trusts and Investment Companies defined the financial instrument business operator who is a trustor of investment trusts managed by investment trust management company as “an investment trust management company.”

Main registration rejection requirements for investment management business

1. Applicant’s registration was revoked within past five years.
2. Applicant was imposed a criminal penalty for violating specific laws within past five years.
3. Other business activities of applicant are considered to be against public interests.
4. Applicant does not have sufficient human resources to conduct the financial instrument business properly.
5. Directors of applicant lack the suitability.
6. Applicant is not a joint stock company.
7. Applicant’s capital is less than amount prescribed in the Cabinet Order.
8. Applicant’s total net assets is less than amount prescribed in the Cabinet Order.
9. Difficulty for risk management of losses arising from other business activities of applicant is considered to detrimental to investor protection.
10. Main shareholders of applicant fall into specific rejection requirements.

B. Main Business of Investment Trust Management Companies

Main businesses which are conducted by investment trust management companies are stipulated in “Act on Investment trusts and investment Corporations.”

They are as follows:

- a. Preparing, filing and delivering trust deeds;
- b. Preparing and filing securities registration statements and prospectuses;
- c. Concluding investment trust agreements with trustees and establishing trust funds;
- d. Issuing beneficiary certificates;
- e. Giving directions for investment management of trust funds;
- f. Outsourcing the whole or the part of investment management;
- g. Giving directions for exercising voting rights of securities held in trust properties;
- h. Paying dividends as well as money at redemption;

- i. Calculation of the value of trust property
- j. Redeeming trust funds;
- k. Preparing and filing securities reports regarding trust funds;
- l. Preparing and delivering financial reports;
- m. Entrusting to the third parties the survey of the prices and other matters related to the Specified Assets excluding listed securities etc.;
- n. Delivering documents to beneficiaries etc. in the case of fear for conflict of interests.

C. Trust Agreement and Trust Deed

Prior to the establishment of an investment trust managed by investment trust management company, investment trust management company (trustor) must conclude the trust agreement with the trust bank (trustee) in accordance with the trust deed. In advance of its conclusion, it must file the content of the trust deed with the regulatory authority. Formerly, the trust deed had to be approved by the Minister of Finance. The amendment to the Law in 1998 changed the approval system to the filing system.

The trust deed must set forth the following stipulations.

- a. The manager and the trustee;
- b. Matters related to the beneficiary;
- c. Matters related to the business for which the manager and trustee are responsible;
- d. Matters related to the amount of the principal of the trust;
- e. Matters related to the beneficiary certificates;
- f. Matters related to the management and operation of the principal placed in trust and of the income therefrom (including kinds of assets in which funds invest);
- g. Matters related to valuation method, valuation criteria and valuation date of investment trust properties;

- h. Matters related to the redemption of the principal of the trust and distribution of income;
- i. Matters related to the effective period of the trust agreement, its extension and cancellation of the contract during its effective period;
- j. Matters related to the accounting period of the trust;
- k. Matters related to the method of computation, as well as the means and time of payment, of remunerations and other charges payable to the trustee and manager;
- l. Distinction of public offer, qualified institutional investor private placement or professional investor private placement or general investor private placement;
- m. Maximum borrowing amount, if the trustee is permitted to borrow money necessary for the trust;
- n. In case the investment trust management company outsources the fund management to the outside company, the name and address of the given company;
- o. Expenses of outsourcing the fund management;
- p. Matters related to the amendment of the trust deed;
- q. Method of public announcement;
- r. Any other matters to be prescribed by Ordinance of Cabinet Office.

The amendment to the Law In 1998 also required investment trust management company to deliver the trust deed to investors, unless its prospectus includes the trust deed.

When investment trust management company amends the important provisions of trust deed prescribed in the Cabinet Office Ordinance, it must conduct the “resolution in writing” in principle. To conduct the resolution in writing, it must deliver the written notice before two weeks of the resolution to beneficiaries whose addresses are known. The trust deed may stipulate that those beneficiaries, whose addresses are known but who did not exercise their voting rights, are considered to vote for the resolution. The resolution must be adopted by two-third or more of votes of beneficiaries.

II. Conduct Rules for Investment Trust Management Companies

The Financial Instruments and Exchange Law stipulated various conduct rules for investment management business. Among them, key conduct rules applied to investment trust management companies are as follows.

A. Duty of Sincerity to Customers

An investment trust management company, its officers and employees must conduct their business activities in a sincere and fair manner to customers.

B. Duty of Loyalty and Duty to Exercise Reasonable Care

When conducting business activities, an investment trust management company must be loyal to beneficiaries and must exercise reasonable care.

C. Prohibited Activities

An investment trust management company is prohibited from engaging in, for instance, following activities.

1. Transactions between managing assets and investment trust management company or its directors (except for those transactions prescribed in the Cabinet Office Ordinance).
2. Transactions among managing assets (except for those transactions prescribed in the Cabinet Office Ordinance)
3. Transactions for the purpose of its own benefit or the benefit of other parties by taking advantage of changes in prices of specific financial instruments resulting from such transactions.
4. Transactions, terms of which are different from those of ordinary transactions, and terms of which affect adversely the benefit of beneficiaries.
5. Transactions of securities or other transactions for its own account by using the information obtained through transactions for investment management.
6. An investment trust management company or the third party provides with beneficiaries or third party for compensating the loss or increasing the profit.

D. Measures for Preventing Harmful Influence

In addition to above mentioned prohibited activities, an investment trust management company, its officers and employees are prohibited from engaging in, for instance, following activities.

1. Transactions, for the benefit of other own business, that are considered unnecessary in the light of investment policy or total amount of assets under management and the market condition.
2. Transactions, for the benefit of parent company or subsidiaries, that are considered unnecessary in the light of investment policy or total amount of assets under management and the market condition.

III. Distributing Companies, etc.

Distribution channel of investment trusts has been expanded since 1990s. There are various distribution channels at present such as first type of financial instruments business firms, investment trust management companies engaging in direct marketing, registered financial institutions and financial instruments business introducing brokerage firms.

A. Type I of Financial Instruments Business Firms

Type I of financial instruments business firms correspond to securities companies under the former Securities and Exchange Law. These firms are able to engage in such business as dealing, brokerage and underwriting of securities by registering for first type of financial instruments business with the regulatory authority.

B. Investment Trust Management Companies Engaging in Direct Marketing

Under the direct marketing, investment trust management companies handle by themselves subscriptions and redemptions of their own beneficiary certificates they issued. The direct marketing is positioned as a second type of financial instruments business under the Financial Instruments and Exchange Law. Therefore, to engage in the direct marketing, investment trust management companies must register for second type of financial instruments business.

C. Registered Financial Institutions

The amendment to the then Securities and Exchange Law in December 1998 made it possible for financial institutions such as banks and insurance companies to distribute investment trusts. The regulatory framework remained the same under the Financial Instruments and Exchange Law. Therefore, such financial institutions are able to distribute investment trusts by registering as a registered financial institution pursuant to Article 33-2 of the Law. The Law imposes on the registered financial institutions the sales and subscription rules same as those imposed on financial instruments business firms.

More recently, as the Law for permitting the Japan Post to distribute investment trusts passed the Diet in December 2004, the Japan Post (present Japan Post Bank) began to distribute them in October 2005.

D. Financial Instruments Intermediary Service Firms

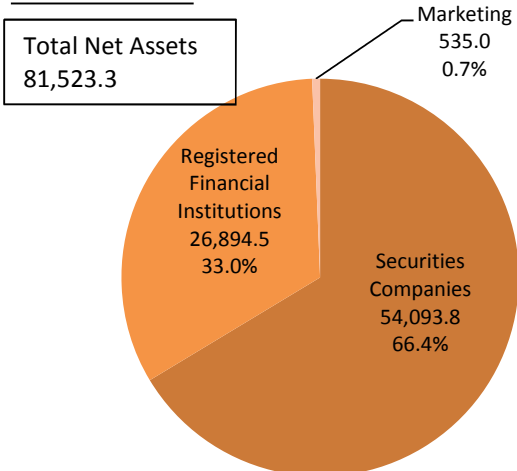
Financial instruments intermediary service is defined as the business to inter-mediate the transactions between customers and financial instruments business firms. This business corresponds to securities brokerage business under the former Securities and Exchange Law. The financial instrument includes additionally such business as acting as an intermediary for conclusion of investment advisory contract and discretionary investment advisory contract. The engage in the business, persons must register pursuant to Article 66 of the Financial Instruments and Exchange Law.

E. The Sales Representatives Registration System

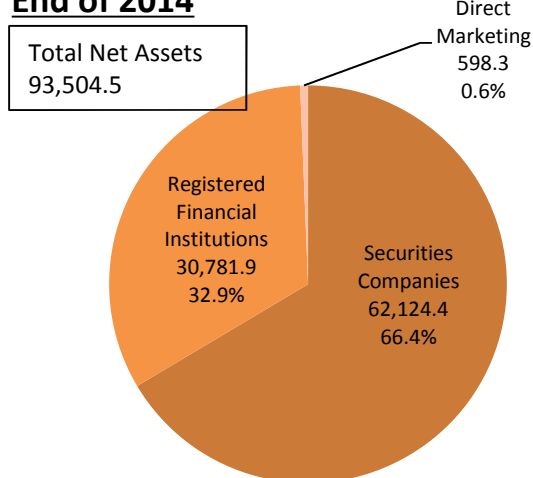
Those individuals, who engage in soliciting the trade of securities, must be registered as sales representatives with the Register of Sales Representatives of the Japan Securities Dealers Association (JSDA). Therefore, those officers and employees of distributing companies, who engage in subscriptions or sales of investment trusts, must be registered as sales representatives with the Register. In order to register, they must pass the qualifying examination of the JASD.

Total Net Assets of Publicly Offered Securities Investment Trusts by Distribution Channel (in ¥billion)

End of 2013

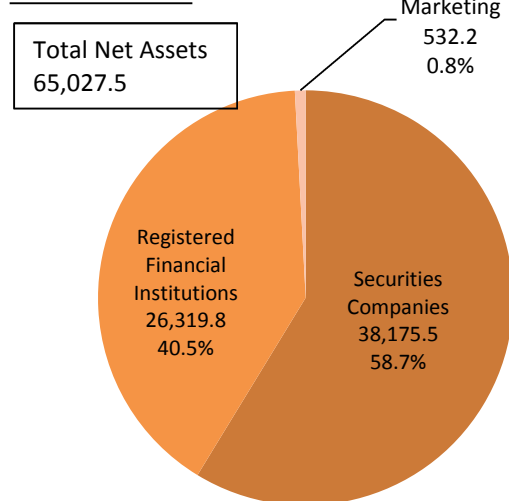


End of 2014

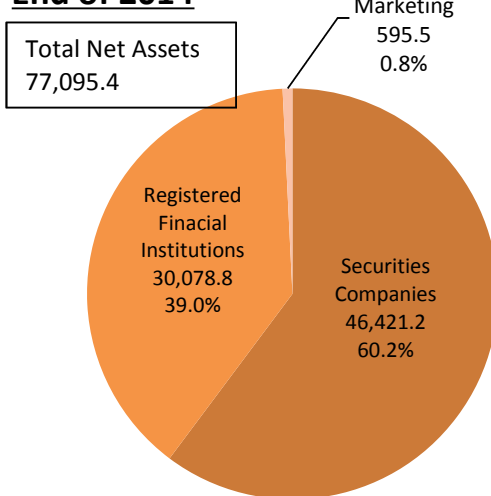


Total Net Assets of Publicly Offered Stock Investment Trusts by Distribution Channel (in ¥billion)

End of 2013



End of 2014



IV. Trustee Companies

The Law for Investment Trusts and Investment Companies stipulates that no trust agreement of the investment trust managed by investment trust management company shall be concluded unless the trustor is a financial instrument business firm engaging in investment management business, and unless the trustee is a trust company or financial institution concurrently engaging in the trust business.

In the case of investment trusts managed by investment trust management company, investment trust management companies give directions for the management of trust property in accordance with the trust agreement concluded with the trustee. The trustee conducts mainly the following business:

- a. Safekeeping and administration of trust property
- b. Calculation of the value of trust property
- c. Execution of management of trust property based on the trustor's direction
- d. Conclusion of depositary contracts with foreign custodians for safekeeping of foreign securities

Since investment trusts were authorized in April 1970 to hold foreign securities in their portfolios, these trustee companies decided, in consultation with investment trust management companies, to appoint custodians of assets located outside Japan.

CHAPTER FIVE

Classification of Publicly Offered Investment Trusts

Under the current investment trust system in Japan, investment trusts have a wide range of choice: for example, contractual type or corporate type, investment trust management company managed type or trustee managed type, public offering or private placement. This chapter explains the classification of the publicly offered investment trusts. The Investment Trusts Association, Japan, introduced the new fund classification in January 2009 for the front page of prospectus. So, explanations in this chapter are based on the new fund classification.

Under the new fund classification, publicly offered investment trusts are broadly classified according to (I) unit type or open type, (II) the investment country and (III) investment assets.

I. Classification by Unit Type or Open Type

In the case of the unit type, investors are able to purchase this type only during the subscription period at the initial establishment (no continuing inflow of money into this type after subscription period). Since there is no continuing inflow of money, as the time goes by, the total net assets of the unit type decrease by redemptions by investors. The unit type sets forth the trust period in its trust deed, and when the trust period expires, the unit type is liquidated.

In the case of the open type, investors are able to purchase this type not only during the subscription period but also after the subscription period. The total net assets of the open type are expected to grow due to continuing inflow of money. Therefore, the trust period of many open-type investment trusts is longer than that of the unit type, and the trust period of some open-type investment trusts is for an indefinite time.

II. Classification by Investment Country

- A. Domestic.....Main investment profits derives substantially from domestic assets, as set forth by the prospectus or trust deed,
- B. Foreign.....Main investment profits derives substantially from foreign assets, as set forth by the prospectus or trust deed,
- C. International.....Investment profits derive substantially from both domestic and foreign assets, as set forth by the prospectus or trust deed.

III. Classification by Investment Assets

- A. Equity.....Main investment profits derives substantially from equities, as set forth by the prospectus or trust deed,
- B. Bond.....Main investment profits derives substantially from bonds, as set forth by the prospectus or trust deed,
- C. Real Estate.....Main investment profits derives substantially from real estate investment trusts, as set forth by the prospectus or trust deed,
- D. Other Assets.....Main investment profits derives substantially from the assets other than equities, bonds and real estate investment trusts, as set forth by the prospectus or trust deed,
- E. Asset Mix.....Investment profits derives substantially from the multiple assets mentioned above A to D, as set forth by the prospectus or trust deed,

If the publicly offered investment trusts are Money Management Fund, Money Reserve Fund, Exchange Traded Fund, Index Fund and Special Type Fund, such type must be indicated on the front page of the prospectus in addition to I, II and III mentioned above.

CHAPTER SIX

Investment Management of Publicly Offered Securities Investment Trusts

I. Investment Objectives

A. Securities

Main investment objectives of securities investment trusts are “securities” as defined by the Financial Instruments and Exchange Law (except for those rights regarded as securities by each Item of Paragraph 2 of Article 2 of the Law, but including the securities-related derivative transactions as prescribed by Item 6 of Paragraph 8 of Article 28, the same applies hereinafter). The Investment Trusts Association’s self-regulatory rules set forth the scope of permissible investment objectives and the restrictions on their investments. For example, stocks as permissible investment are stocks listed on exchanges or registered for trading on OTC markets. Publicly offered securities investment trusts may also invest in unlisted or unregistered stocks, if these stocks fulfill such requirements that the price information is available from brokers or other sources, and that the issuing companies of these stocks disclose periodically the business operation results and other information set forth by the law.

B. Financial Instruments and so on

In addition to these securities as main investment objectives, securities investment trusts may incidentally deposit cash in domestic and foreign banks, or may incidentally invest in domestic certificates of deposit, call loans and discounted bills. Furthermore, securities investment trusts have been able to invest incidentally in the real estates and commodities as a result of the amendments to the Law for Investment Trusts and Investment Companies. However, the total amount of investments in these financial instruments and assets may not exceed 50% of the total net assets of a securities investment trust.

< Investment Objectives Other than Securities >

1. Rights regarded as securities by each Item of Paragraph 2 of Article 2 of the Financial Instruments and Exchange Law
2. Financial instruments such as deposits, call loan and discounted bills
3. Real estates
4. Rights to lease real estates

5. Right of superficies
6. Promissory notes
7. Money claims
8. Interests in anonymous associations
9. Commodities as defined by Paragraph 4 of Article 2 of the Commodity Exchange Law
10. Commodity futures and other derivatives (Rights in commodity investment transactions as defined by the Paragraph 10 of Article 3 of the Cabinet Order for the Law for Investment Trusts and Investment Companies)

II. Transactions Related to Investment Management of Securities

A. Use of Derivatives such as Futures / Options Transactions, etc.

Related to investment management of securities, securities investment trusts can use derivative transactions as defined by Paragraph 20 of Article 2 of the Financial Instruments and Exchange Law. However, the risk amount of these derivative transactions (including the rights in commodity investment transactions) calculated by the reasonable method predetermined by the investment trust management company may not exceed the total asset amount of the securities investment trust.

B. Use of Margin Transactions

Securities investment trusts are permitted to sell stocks on margin. However, total market values of stocks sold on margin may not exceed the total net assets of a fund.

C. Borrowing of Stocks

Securities investment trusts are permitted to borrow stocks for the purposes of their sales. However, total market values of borrowed stocks may not exceed a fund's total net assets.

D. Securities Lending

Securities investment trusts may lend securities (stocks and bonds) held by a fund in order to efficiently manage trust properties.

E. Bond Repurchase Transactions

Securities investment trusts are permitted to engage in bond repurchase transactions. However, total market values of bond repurchase transactions may not exceed a fund's total net assets.

F. Borrowing and Short Sales of Bonds

Securities investment trusts are permitted to borrow bonds or to engage in short sales of bonds (except convertible bonds, exchangeable bonds and warrant bonds). However, total market values of borrowed bonds or total market values of bonds sold short may not exceed the total net assets of a fund.

G. So-Called "Bond Gensaki Transactions"

Securities investment trusts are permitted to engage in so-called Gensaki transactions of bonds, CD and CP. However, total market values of Gensaki transactions for selling bonds may not exceed a fund's total net assets.

H. Cash Lending

Securities investment trusts are permitted to engage in cash lending whose market prices are available (Due considerations should be paid to their liquidities).

I. Borrowing Money

Securities investment trusts are permitted to borrow money within a certain limit for the purposes of meeting redemptions requests by investors and paying the profits distributions that are reinvested into funds.

J. Foreign Currency Forward Contracts

Formerly, conclusions of foreign currency forward contracts had been restricted to only hedge purposes. Since April 1996, securities investment trusts have been permitted to conclude foreign currency forward contracts also for other than hedge purposes. However, total amounts of those foreign currency forward contracts may not exceed the total net assets of a fund.

K. When-Issued Transactions

Securities investment trusts are permitted to engage in when-issued transactions for selling the stocks they hold.

III. Investment Limits for Securities

Following quantitative restrictions are imposed on the investments in securities by securities investment trusts.

A. Stocks Issued by the Same Company

An investment trust management company may not give instructions to acquire stocks of the same issuing company, when the number of stocks held by all investment trusts managed by the given investment trust management company exceeds 50% of the total number of outstanding stocks of that same issuing company.

B. Securities of Investment Trusts (Except for the fund of funds)

The holding of investment trusts may not exceed 5% of a fund's total net assets in principle.

In addition, the combined net assets of the single acquired investment trust held by all funds which are managed by the same investment trust management company may not exceed 50% of the total net assets of the acquired investment trust in principle.

C. Investment Restriction to Disperse the Credit Risk

Exposure of single issuer must not exceed 10% of the total net assets of an investment trust for each asset class (stocks, bonds and derivatives). Combined exposure of single issuer must not exceed 20% for each asset class.

D. Investment Restriction for Derivative Transaction, etc.

The amount of risk related to derivative transactions must be managed to be not exceed a certain percentage of the total net assets of an investment trust. The level refers to be within the total net assets of investment trust by the compendium method, and to be less than 80% by the standard method and VaR method. When the purpose of derivative transaction is not for hedge of risk, the use of compendium method is not permitted on the calculation.

IV. Investment Limits of the Fund of Funds (FOF)

1. In principle, FOF must invest in two funds or more.
2. Except for investments in other funds, FOF may invest only in commercial papers, short-term corporate bonds as defined by the Law for Transfer of Bonds etc., certificates of deposit, designated money trusts, call loans, discounted bills and deposits etc.

3. The combined net assets of the single acquired fund held by all ordinary funds and FOF which are managed by the same investment trust management company may not exceed 50% of the total net assets of that acquired fund.

V. Calculation of Net-Asset Value Per Share

Investment results of securities investment trusts are calculated every day to arrive at net-asset value per share, and these results are made public daily. The net-asset value per share equals the total market value of the trust property per beneficiary certificate, and is determined by dividing the total net assets by the outstanding number of beneficiary certificates.

When calculating the net-asset value per share, portfolio securities and other financial instruments held by a fund are valued in accordance with proper and reasonable values. The Investment Trusts Association sets forth the rules for the method of valuation related to portfolio securities. For example, listed securities are valued, in principle, in terms of the closing price on the securities exchange on the day of calculation (in the case of foreign currency-denominated securities, the latest closing price which is available on the day of calculation), and unlisted securities are valued by market values, in principle. The Investment Trusts Association also sets forth similar rules for derivatives such as the futures / options transactions, etc.

<Association's Main Valuation Rules for Securities>

1. Listed Stocks

a. Stocks Listed on Domestic Exchanges

Closing prices on exchanges on the day of calculation in principle,

b. Stocks Listed on Foreign Exchanges

Latest closing prices available on the day of calculation

2. Bonds

One of the following prices in principle:

a. Trading Reference Statistic Values made public by the Japan Securities Dealers Association

b. Bid prices supplied by securities firms or banks, etc.

c. Prices supplied by pricing service providers

3. Bonds with One Year or Less Maturity

These bonds are valued at the fund's acquisition cost as adjusted every day for amortization of premium or accretion of discount.

Conversion into Japanese yen of foreign currency-denominated assets is made on the basis of the average price of the telegraphic transfer selling and buying rate for customers on the day of calculation, in principle.

The amendment to the Law in 2000 requires investment trust management companies to have the third parties survey the prices of the Specified Assets, when the Specified Assets whose market values are not readily available are acquired or transferred.

CHAPTER SEVEN

Sale and Repurchase of Publicly Offered Securities Investment Trusts

I. Subscription and Sale of Beneficiary Certificates

A. Method of Subscription and Sale

Subscriptions and sales of beneficiary certificates issued by investment trust management companies are mainly handled by securities companies and registered financial institutions (hereinafter referred to as distributing companies).

Furthermore, investment trust management companies may directly handle by themselves subscriptions of their own beneficiary certificates they have issued (direct marketing). The direct marketing is positioned as a second type of financial instruments business under the Financial Instruments and Exchange Act. Therefore, to engage in the direct marketing, investment trust management companies must register for type II of financial instruments business with the regulatory authority.

When distributing companies (in the case of the direct marketing, investment trust management companies) engage in subscriptions and sales of beneficiary certificates, the Financial Instruments and Exchange Act requires them to provide customers pre-contract documents that explain the net asset value per share might fall below the principal value, etc.

B. Disclosure System

The disclosures of securities investment trusts consist of the issuance disclosure at the time of subscriptions and sales (securities registration statement and prospectus) and the periodic disclosure at the end of each accounting period (securities report and financial report).

Under the Financial Instruments and Exchange Act, as the disclosure at the time of issuance, investment trust management companies must file the securities registration statement with the regulatory authority before 15 days of the commencement of the subscription and sales and must offer it for the public inspection.

A prospectus has been divided into a “summary prospectus” that must be delivered to all investors and a “detailed prospectus” that must be delivered to investors on their request from December 2004. By the revision of the Act in July 2010, the summary prospectus has to include only information of particular important to investors to make the prospectus more easily readable and understandable for investors. The main contents of the improved summary prospectus include such information as the investment objectives &

features of funds, investment risks, historical performance and procedures & fees. They must be described in this order. The information excluded from the improved summary prospectus is included in the new detailed prospectus.

As the periodic disclosure, investment trust management companies must file the securities report with the regulatory authority at the end of each accounting period and must offer it for the public inspection. They must also file the interim report on the semi-annual business for those investment trusts whose accounting periods are one year. In addition, the Law for Investment Trusts and Investment Companies requires investment trust management companies to prepare the financial report and deliver it to investors as described already in Chapter Six.

The investment trust management company must prepare a financial report at the end of each accounting period in principle and must deliver it to beneficiaries whose addresses are available. The financial report must contain the correct information on the progress of operations during the current period, a statement of securities transactions, a statement of futures / options transactions, a statement of transactions between the fund and the affiliated parties, a profit and loss statement and so on.

Periodic investment reports, which update investors on a fund's operation and performance, are sometime too long, too detailed, and too technical to understand by average individual investors.

The revised Law (amended in June 2013) requires that investment management companies must produce a simple report containing key information, and it should be delivered to each investor of the fund, and to post the current report on the asset management company's website so that the investors who would like to know the details can access it at their convenience.

C. Sales and Subscription Rules

The Financial Instruments and Exchange Law stipulates that distributing companies (including investment trusts management companies when they engage in direct marketing) must comply with following sales and subscription rules, when they engage in the sales and subscription of securities investment trusts.

1. Duty of Sincerity to Customers

A distributing company, its officers and employees must conduct their business activities in a sincere and fair manner to customers.

2. Regulation on Advertisement

☆ An advertisement must include the company name, registration number and so on

- ☆ Any representations of profit prospects that differ considerably from the fact or that are considerably misleading are prohibited.

3. Duty to Deliver Document before Concluding Contract

- ☆ A document must include the registration number, the effect that distributing company is a financial instruments business firm and so on.
- ☆ A document must include the outline of contract and fees.
- ☆ A document must include the effect that investor might suffer loss, if any loss would be possible.

4. Duty to Deliver Document at Time of Concluding Contract

5. Various Prohibited Activities

- ☆ Making false statement is prohibited.
- ☆ Solicitation by providing conclusive judgment about uncertain matters is prohibited.

6. Prohibition of Compensating Customers for Their Loss

A distributing company may not promise any customer that the distributing company or third party delivers benefits to the customer in order to compensate any loss or shortage in the predetermined amount of profits.

7. Suitability Rule

A distributing company may not undermine the investor protection by engaging financial instruments transaction contract in inappropriate solicitation activities in the light of customer's knowledge, experience, assets or investment purpose.

8. Duties to Explain

A distributing company must explain the fund's outline, fees and charges, risks and so on to the customer in advance in the manner and to the extent necessary for understanding the product in the light of customer's knowledge, experiences, assets and investment purposes.

Those rules that aim at eliminating information gap between an investor and a distributing company (for example, regulation on advertisement or duty to deliver document) do not apply to professional investors.

II. Repurchase and Redemption of Beneficiary Certificates

Two alternatives are available for investors in liquidating or cashing a beneficiary certificate before its maturity. One way is to ask distributing companies to repurchase (buy back) a certificate at the net-asset value per share. The other way is to ask investment trust management companies to redeem a certificate at the net-asset value per share.

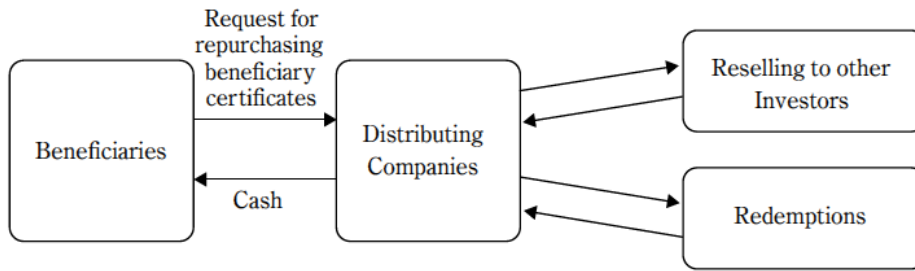
A. Repurchase

Distributing companies hold the beneficiary certificates they repurchased from investors on their own account. This means that they take the risks arising from holding of such beneficiary certificates until they redeem them or resell them to other investors. On the other hand, there is no difference for investors between the repurchase and the redemption as investors receive the same amount of proceeds by liquidating the beneficiary certificates in either way. In addition, as a result of the taxation change in the fiscal year 2008, gains from redemptions of stock investment trusts are regarded as the capital gains after January 2009 for individual investors. So, the tax treatment of the redemptions becomes same as the tax treatment of the repurchases.

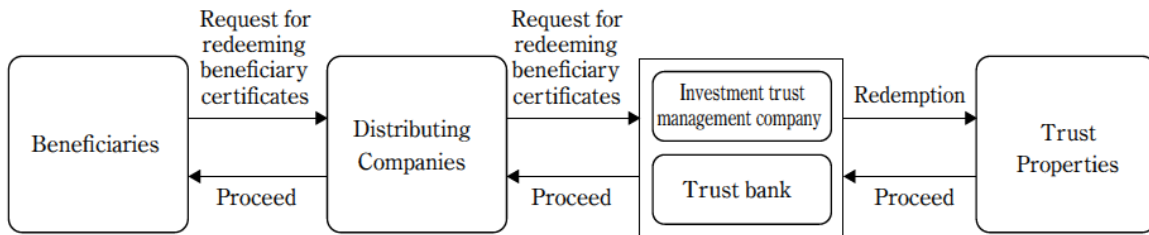
B. Redemption

Distributing companies notify the investment trust management company of the number of units to redeem based upon the investors' redemption requests. Then, the investment trust management company gives the trust bank the direction to redeem that number of units. Most part of the trust properties is invested in securities and financial instruments, but a certain part is normally invested in call loans and other liquid assets to meet the redemption requests. If call loans and other liquid assets are not sufficient to meet the redemption requests, the trust bank sells securities or financial instrument according to the direction by the investment trust management company. The trust bank forwards the money at the redemption through the investment trust management company to the distributing company, which pays it to investors.

<Repurchase>



<Redemption>



III. Trading of ETF

Beneficiary certificates of ETF are listed on the exchanges on which investors trade them. Like listed stocks, investors are able to trade them at any time during the business hour of exchanges. Investors are able to trade them by the market order or the limited order and engage in the margin and loan transactions.

Investors trade ETF at the market-determined prices on exchange, not at its net asset values, even though its net asset values are calculated.

Contractual type investment trusts are normally distributed by securities firms and registered financial institutions or marketed directly by investment trust management companies. However, investors are presently able to trade ETF only through securities firms that are members of the exchanges, because those securities firms have the computer system necessary for processing the ETF orders that is the same system for processing the stock orders.

In the case of ETF, its beneficiary certificates are issued by depositing a certain number of portfolio securities as decided by investment trust management companies according to component ratio of the index. The redemption works in reverse, and a certain number of its beneficiary certificates are converted into the portfolio securities held by trust properties. However, investors must prepare all portfolio securities of the given index to request to issue the ETF beneficiary certificates or they must own the ETF equivalent to several 100 million yen at least to request to redeem the ETF beneficiary certificates. Therefore, the ETF beneficiary certificates are normally issued or redeemed for institutional investors, and ordinary investors trade them on exchanges through securities firms.

CHAPTER EIGHT

Fees and Expenses of Publicly Offered Securities Investment Trusts

The fees and expenses that investors pay for the purchase and the holding of investment trusts are broadly classified into two categories:

- a. Fees paid directly by investors such as sales charges
- b. Fees bore by the fund and deducted from its assets such as trust remunerations

Sales charges are paid to distributing companies as compensation for the professional advice they provide in selecting a fund.

Trust remunerations are grouped into the remuneration for the trustor (management fee), the remuneration for the trustee and the agent fee paid to distributing companies.

I. Fees Paid Directly by Investors

A. Sales Charges

The sales charges are those fees that investors pay to distributing companies when they purchase investment trusts. Because the sales charges are compensations for the explanations, etc. upon the distributions of investment trusts, the rates of them are set by each distributor. The rates of sales charges vary from one fund to another. When multiple distributing companies distribute the same fund, the rates of the sales charges of the same fund may vary depending on the distributing companies.

In general, many stock investment trusts levy sales charges, while many bond investment trusts do not levy them (no load funds). However, in the case of no load funds, corresponding amount to sales charge is paid to distributing companies as the agent fee out of the trust remunerations.

There are some funds that charge no front-end load at the time of purchase, but charge the back-end load at the time of redemption.

B. Redemption Fees

Redemption fees are also the cost that is paid by investors. Not all fund charges redemption fees which are charged to the departing inventors.

In order to meet the investor's redemption request, funds sell portfolio securities or other assets, even though many funds have liquid assets such as call loans to meet the investor's redemption request. Redemption fees are intended that departing investors bear the costs incurred by the sales of portfolio securities caused by redemptions. Redemption fees are calculated by multiplying the net asset value per share on the day of redemption by a certain percentage. Unlike the sales charges, redemption fees go to funds (neither distributing companies nor investment trust management companies). The redemption fees benefit remaining investors as they are retained in the trust properties and taken into the consideration for the calculation of net asset value per share.

II. Fees Bore by Funds and Deducted from Their Assets

A. Trust Remunerations

Investment trust management companies receive the "trust remuneration for the trustor" (management fee) each accounting period as the compensation for the directions given for management of trust properties. Trust banks receive the "trust remuneration for the trustee" each accounting period as the compensation for the safekeeping and administration of trust properties. Distributing companies receive the "agent fee" from the investment trust management company out of his trust remuneration for the trustor to cover these costs such as the expenses for paying profit distributions and money at redemptions as well as the postages for delivering financial reports.

The annual rate of a trust remuneration is predetermined as a percentage of a fund's total net assets, and the trust remuneration is deducted daily from a fund's assets when calculating the net asset value per share.

B. Transaction Costs

Transaction costs such as brokerage fees incurred by transactions of portfolio securities are also deducted from a fund's assets each time they occur.

C. Others

Other fees bore by fund and deducted from its assets include tax on a fund's assets, various expenses for handling trust business, interests arising from payments by a trustee instead of a fund and audit fees for a fund's financial statements.

Some funds deduct also preparation costs for disclosure materials such as prospectuses and financial reports from a fund's assets.

<Fees Paid Directly by Investors >

Payment Time	Item	Contents
Purchase of Funds	Sales Charge	Rates determined as a percentage of fund's assets. Some funds levy no sales charges, others levy back-end load. Consumption tax is levied on sales charge.
Redemption of Funds	Redemption Fee	Some funds levy redemption fee, but others levy no redemption fee.

<Fees Bore by Funds and Deducted from Their Assets>

Payment Time	Item		Contents
Daily	Trust remuneration	Trustor	Compensation for managing funds
		Trustee	Compensation for safekeeping and administration of fund's assets
		Distributing companies	Costs such as expenses for paying profit distributions and money at redemptions as well as the postages for delivering financial reports.
	Audit fee, etc.		Audit fees for fund's financial statements and other expenses
Transaction of portfolio securities	Brokerage commission		Brokerage commission depends on frequency and volume of transactions

CHAPTER NINE

Investment Companies (Corporate Type Investment Trusts)

Since the enactment of the Securities Investment Trust Law in 1951, only contractual-type investment trusts (the legal form of trust) have been permitted in Japan for nearly 40 years. On the contrary, major countries already permitted the corporate type investment trusts or made efforts to provide the diversified options of the fund structure in the late 1990s. In the United Kingdom, in addition to the open-end unit trusts of contractual type and closed-end investment trusts of corporate type, the open-end investment companies (OEIC) of corporate type were introduced in 1997. In Germany where only contractual-type investment trusts were permitted like Japan, the establishment of closed-end investment trusts of corporate type was also permitted. Considering the situations in foreign countries and the merits of corporate type, the Securities and Exchange Council (an advisory board of the Ministry of Finance) recommended in 1997 to “examine the introduction of corporate type investment trusts for the purpose of enhancing the functions of investments trusts and promoting the diversification of products.” The Law to Amend Laws Related to Financial System Reform, which included amendment to the Securities Investment Trust Law, was enacted in June 1998 and become effective in November 1998. Corporate-type investment trusts, thus legally permitted, are called “investment companies” in Japan. Both open-end and closed-end investment companies were legally permitted.

After the main investment objectives were expanded, the venture funds and the real estate investment companies that invest mainly in unlisted stocks or real estates respectively were launched.

	Contractual type		Corporate type	
	Open-end	Closed-end	Open-end	Closed-end
Japan	Investment trusts	—	Investment companies	Investment companies
U.S.A		—	Mutual funds	Closed-end investment companies
U.K.	Unit trusts	—	OEICs	Investment trusts
France	FCP	—	SICAV	—

I. Management Structure

A. Incorporation of Investment Companies

Investment companies are regarded as a juridical person. They must entrust their business such as the asset management, the custody of the fund’s assets, the general business administration and the subscription of investment units to the outside companies, and they may not hire any employee. The promoter of an investment company must prepare the articles of incorporation in order to incorporate it. He may be either a natural person or a juridical person, but must be one of the following entities:

- a. Financial instrument business firms (limited to those firms that engage in the Investment management business, the same applies hereinafter)
- b. Trust company
- c. Officers or employees of a. and b. as well as former officers or employees of a. and b. served for more than five years.
- d. Qualified institutional investors
- e. Officers or employees of companies with the capital of more than ¥ 10 billion that file the securities report with the Commissioner of the Financial Services Agency as well as former officers or employees of those companies served for more than five years

If the number of promoter is two or more, one promoter must be one of those persons.

The total contribution (capital) amount of the investment company at the time of its incorporation must be more than ¥ 100 million. The minimum total net assets, which the investment company must maintain at any time, is more than ¥ 50 million. It must be registered by filing the articles of incorporation and other documents with the Prime Minister in advance. After the incorporation registration, the investment company may begin to solicit the offer to its investment unit (the equally divided position of the partner of the investment company). The articles of incorporation take effect when the Prime Minister receives the filing for the registration. The articles of incorporation, which are equivalent to the trust deed of contractual-type investment trust, include, among others, following matters:

- a. Object,
- b. Company name,
- c. Statement as to whether or not the investment units are redeemed upon the request of investors
- d. Total number of the investment units to be issued,
- e. Issuing price and the number of investment units at the time of its incorporation,
- f. Minimum total net assets which the investment company must maintain at any time,
- g. Investment objectives and investment policy,

- h. Method, standard and date of asset valuation,
- i. Dividend distribution policy,
- j. Period for settlement of accounts,
- k. Address of the principal office,
- l. Remunerations of the executive director, the supervisory director and the auditor,
- m. Asset management fee for investment adviser for investment company,
- n. Name and address of the administration service provider, the investment adviser for investment company and the asset custody company, and the outline of each contract to be concluded with these companies,
- o. Maximum amounts for borrowing money and issuing investment company bonds,
- p. Name and address of the promoter,
- q. Statement as to whether the promoter receives any compensation and, if any, the amount of the compensation,
- r. Statement as to whether the incorporation costs occurs and, if any, the amount of the incorporation costs and its contents.

Those who agree to purchase investment unit must sign and stamp on the application form for the investment unit prepared by the promoter. The application form contains following matters:

- a. Date of registration,
- b. Matters described in articles of incorporation,
- c. Duration of investment company
- d. Allocation method of investment unit,
- e. Financial institutions dealing with payment of investment unit,

f. Name and address of candidates for executive directors, supervisory directors and auditors,

g. Statement as to whether there is any interest between candidate for executive directors and promoters and, if any, the content of interest.

Candidates for executive directors, supervisory directors and auditors indicated on the application form are regarded as appointed, when the allocation of investment units are completed. Then, the executive directors and supervisory directors inspect such matters as any violations against laws and articles of incorporation, and full payment of investment units. If they find any problem on inspected matters, the executive directors convene the general meeting for the incorporation and report it. If they do not find any problem, the executive directors do not need to convene the meeting. The provisions in the Company Law are applied to the operation of the general meeting for the incorporation.

The investment company comes into existence when registry of incorporation at the registry office takes effect. The registry of incorporation must be done within two weeks after the inspection by the executive directors and supervisory directors is completed. When the executive directors convene the general meeting for incorporation, the registry of incorporation must be done within two weeks after the last day of the meeting.

B. Investment Unit and Investment Certificate

The investment unit is the equally divided position of the partner of the investment company. It is issued in the form of non-par value by the investment company and is represented by the investment certificate (share). The liability of investors is limited to the values of investment units they have purchased. The investment company must issue investment certificates (shares) without delay after it has come into existence. The articles of incorporation prepared by the promoter may stipulate that the investment company does not issue investment certificates (shares) until investors request to issue them.

C. General Meeting of Investors

The executive directors usually convene the general meeting of investors. However, the supervisory directors may demand the convening of the meeting if necessary. The Law for Investment Trusts and Investment Companies does not stipulate any specific date or frequency of the meeting. However, the Law stipulates that the term of office of executive directors may not exceed two years. Therefore, the meeting must be held at least once in every two years to elect them. In convening the meeting, the public notice must be given before two months of the meeting, and notice must be delivered to each investor before two weeks of the meeting.

Investors who do not attend the meeting may exercise the voting right in writing. When exercising voting rights in writing, investors fill out necessary matters on the paper attached to the notice of the meeting and return it to the investment company before one day of the meeting. The number of voting rights exercised by in

writing was added to the number of voting rights exercised by investors attending on the meeting. The articles of incorporation may stipulate that investors, who do not attend it and do not exercise the voting right in writing, are regarded to approve the proposals introduced to that meeting. The meeting may adopt the resolution as to only those matters stipulated by the Law for Investment Trusts and Investment Companies and the articles of incorporation. Matters stipulated by the Law for the resolutions are as follows:

- a. The election and removal of executive directors, supervisory directors and auditors,
- b. Merger and dissolution of investment companies,
- c. Amendment of the articles of incorporation,
- d. Approval of the management contract.

D. Executive Directors and Supervisory Directors

Executive directors and supervisory directors must be appointed at the general meeting of investors except for those directors who are regarded as appointed at the time of incorporation of the investment company. Executive directors represent the investment company. However, they must obtain the approval of board of directors, when executing such important matters as follows:

- a. Convening of the general meeting of investors,
- b. Entrustment of the business such as the asset management, the custody of the fund assets and the subscription of investment units,
- c. Split of investment units and the suspension of the redemptions because of the merger,
- d. Conclusion of the merger contract,
- e. Conclusion of contracts related to the management and custody, and the amendment of these contracts,
- f. Payment of the management fee, the custody fee and other costs related to the management and custody,
- g. Cancellation of the management contract,

The executive directors must report at least once in every three months the progress of the business to the board of directors.

The supervisory directors supervise the execution of duties by executive directors. They may demand at any time of the executive directors, the investment adviser, the asset custody company and the administration service provider the report on the situation related to the business and the assets of the investment company, and may conduct investigations if necessary for performing the duties. In light of the position of supervisory directors, the Law for Investment Trusts and Investment Companies stipulates that the investment company may not conclude the management contract with the investment advisers in which the supervisory directors have interests. The Law also stipulates that the number of supervisory directors must exceed the number of executive directors. Therefore, the investment company must have one executive director and two supervisory directors at least.

The board of directors consists of executive directors and supervisory directors.

E. Investment Adviser for Investment Company

The investment company must entrust its management business to the investment advisers for investment company that are financial instrument business firms who are registered as investment management business under the Financial Instruments and Exchange Law. If their investment objectives include real estates, they are required to obtain the license for real estate trading as well as the authorization for discretionary real estate trading business under the Building Lots and Buildings Transaction Business Act.

The management contract with the investment adviser does not take effect until the general meeting of investors approves it. However, the management contract at the time of incorporation of the investment company takes effect without the approval of the general meeting of investors, because it was described in the articles of incorporation prepared by the promoter. The investment adviser for investment company is able to delegate to the financial instrument business firms the part of powers it granted by the investment company.

F. Asset Custody Company

The investment company must entrust its asset custody business to (a) the trust company or (b) the first type of financial instrument firm that engages in securities administration business or (c) the company appropriate for safeguarding the specific type of assets. This appropriate company must have the certain level of financial resources and the personnel structure to appropriately perform the custody business of assets prescribed in the Cabinet Office Ordinance. The trust company or other companies to which the investment company entrusts its asset custody business is called asset custody company.

Executive directors conclude the asset custody contract with the approval of the board of directors, but the approval of the general meeting of investors is not necessary for the conclusion of the asset custody contract.

G. Administration Service Provider

The investment company must also entrust following business to other persons (referred to as the administration service provider) as the investment company may not hire any employee:

- a. Business related to the subscription of investment units and investment company bonds,
- b. Business related to the transfer of investment units and investment company bonds,
- c. Business related to the issuance of investment certificates (shares) and investment company bonds,
- d. Business related to the accounting,
- e. Business related to the operation of its organization.

Unlike the management company and the asset custody company, the laws do not specify any requirements for the administration service provider. The investment company may entrust these businesses to any person who is able to adequately perform them pursuant to the contract concluded with the investment company.

H. Auditor

The investment company must appoint the auditor (public accountant or accounting firm) at the general meeting of investors and must have him audit its financial statement. But the auditor nominated on the application form for the investment unit is regarded as appointed at the time of incorporation of the investment company. The term of office of the auditor is up to the time of the general meeting of investors which is held after one year of his assumption of office. When any resolution on this matter is not adopted at that general meeting of investors, the auditor is regarded as reappointed.

I. Investment Company Bond

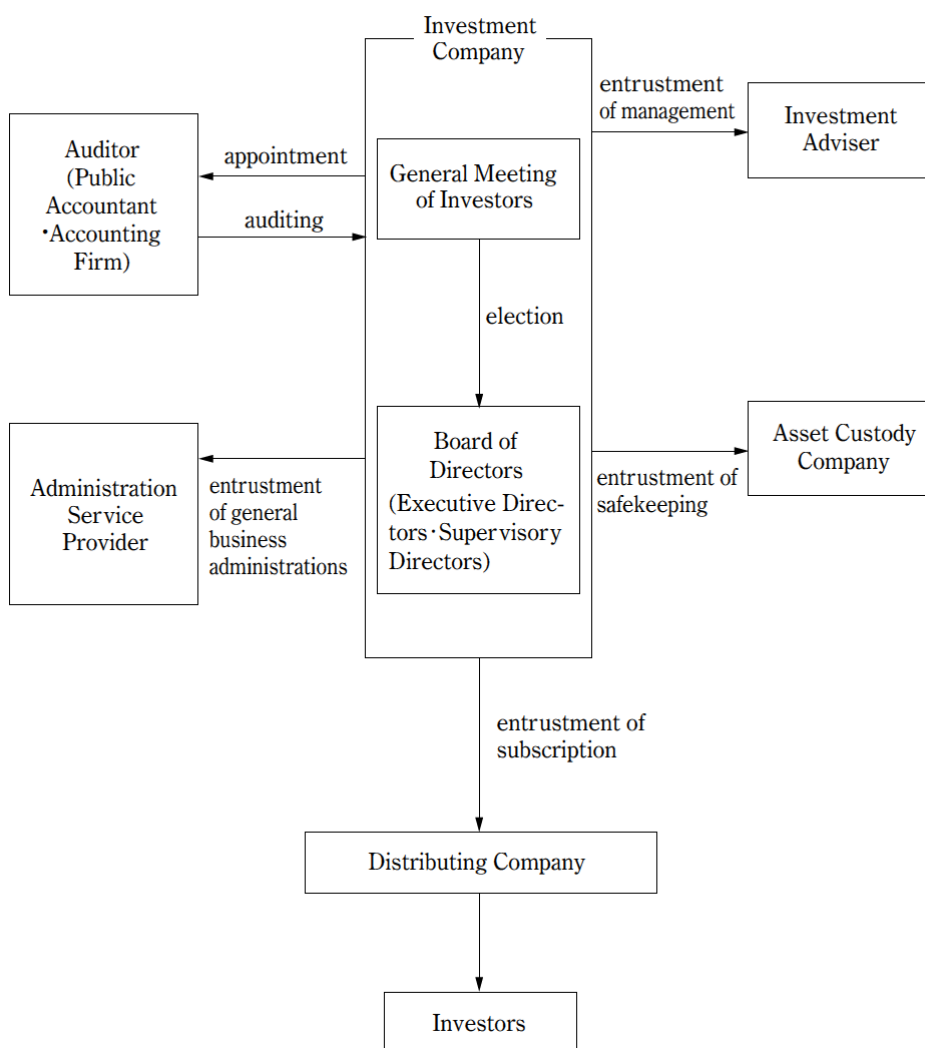
The investment company should respond quickly to the offer for sales of real estate in order to purchase them. Therefore, the investment company is permitted to borrow money or issue the investment company bond for financing timely to purchase them. The issuance of the investment company bond is permissible only for closed-end investment company.

Closed-end investment company is able to issue the investment company bond up to the amount as stipulated by its articles of incorporation. However, the approval of the board of directors is necessary for the issuance of the investment company bond. When issuing the investment company bond whose subscription amount is less than ¥100 million, the investment company must designate the administrator of the

investment company bond, and must entrust to the administrator its related business such as the preservation of bond holder's credit and the receipt of refunded credit.

Further, closed-end investment company may also issue the short-term investment company bond. This bond is defined as the investment company bond, which meets a certain requirements (for instance, its face amount is more than 100 million yen or its principal is repaid less than one year after the payment of total amount). Issuance of short-term investment company bond enjoys some exceptions such as that this bond does not need to prepare the original book for investment company bond.

<The Management Structure of Investment Companies>



II. Real Estate Investment Companies and Venture Funds

All publicly offered investment companies that exist in Japan at present are closed-end type. There are currently two kinds of investment companies, depending on their investment objectives: one is the investment

company that invests mainly in real estates (real estate investment company), another is the investment company that invests mainly in venture firms whose stocks are not listed (venture fund).

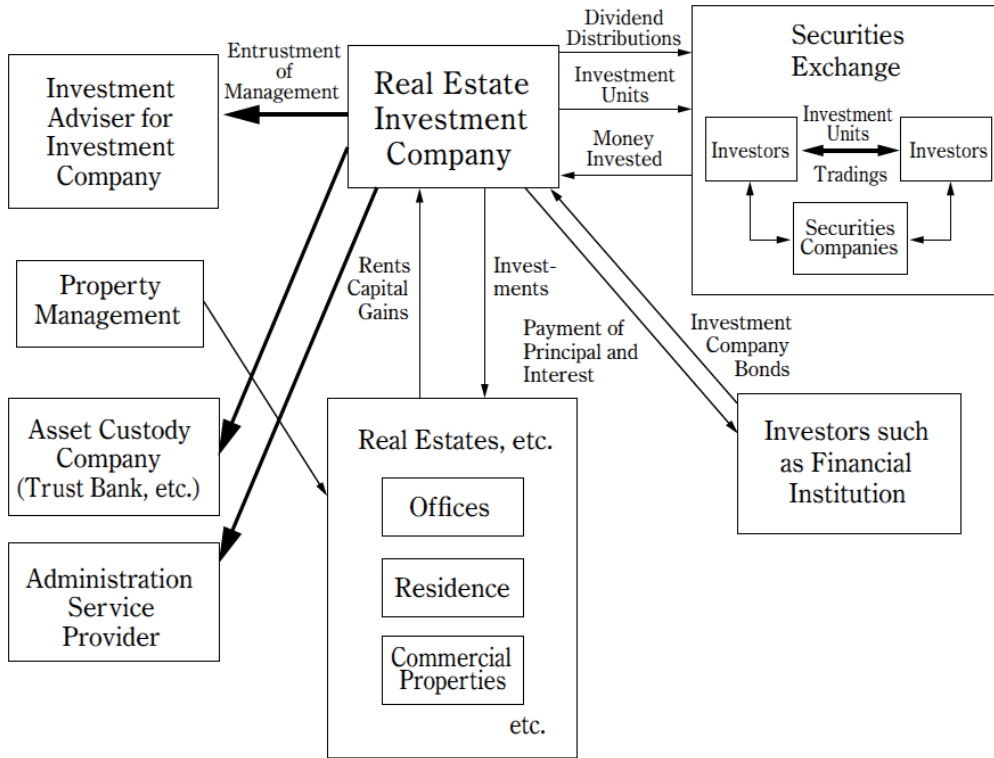
A. Real Estate Investment Companies

Real estate investment companies invest mainly in real estates such as office building, commercial properties and apartment houses, and distribute their rent and capital gains. They made it possible for investors to invest in real estates with the small amount of money by using the investment company structure.

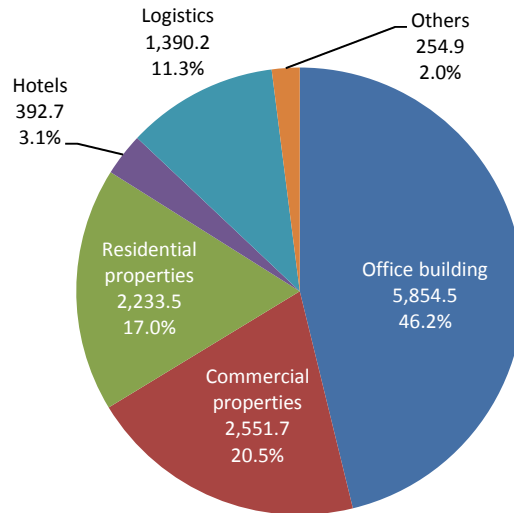
If real estate investment companies would be established as the open-ended type, they would have to sell the portfolio real estates or keep the liquid asset ratio to high in order to meet the investor's redemption request. Therefore, in order to enhance the economic efficiency of the management, they are established as the closed-end type and listed on the exchanges. Like listed stocks, investors trade real estate investment companies on the exchanges through securities firms.

The amendment to the Law for Investment Trusts and Investment Companies in 2000 made it legally possible to establish real estate investment companies. The first real estate investment companies were listed on the Tokyo Stock Exchange in September 2001, and 43 funds were listed on the exchanges as of the end of 2013. The majority of real estates that these real estate investment companies owned was previously office building. Recently, there were some real estate investment companies, which specialized in the investments in commercial properties, residents, or logistics.

<The Management Structure of Real Estate Investment Company>



Type of Real Estates Owned by Real Estate Investment Companies (end of 2014, in disclosed valuation amounts, ¥billion)

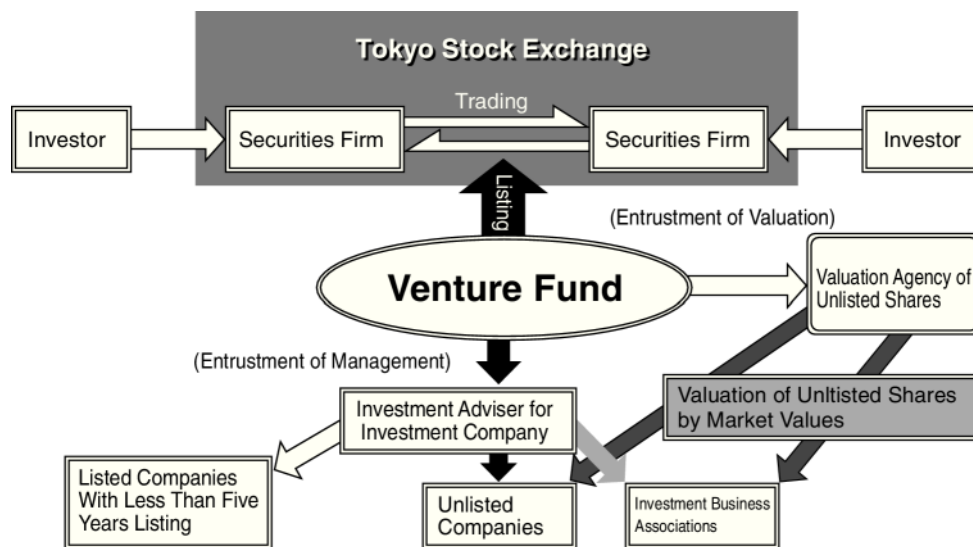


B. Venture Funds

The Law for Securities Investment Trusts and Securities Investment Companies, which took effective in December 1998, made it legally possible to establish the securities investment companies. The Osaka prefecture government began in 2000 to consider the new measures for financing venture firms in Kansai area and concluded that the investment company is the effective scheme for financing them. As a result, it decided to establish the securities investment company, and thus the first securities investment company was established in October 2001 and was listed on the Osaka Securities Exchange. This venture fund facilitated the new measures for financing venture firms and, at the same time, made it possible for retail investors to invest in venture firms with a small amount of money. The structure of the fund is the closed-end type due to following reasons:

- a. It is difficult for such fund to meet the investor's redemption request, as it invests mainly in unlisted stocks.
- b. It is important that the fund has the long-term horizon for its investment management and holds its portfolio securities in longer period.

One venture fund is listed on Tokyo Stock Exchange at the end of 2014.



(source) Tokyo Stock Exchange

CHAPTER TEN

Taxation of Publicly Offered Investment Trusts and Investment Companies

The taxation of investment trusts and investment companies has significantly changed in recent years in order to carry out the government policy that intended to encourage the individuals to actively participate in the stock markets. This chapter explains the taxation of publicly offered investment trusts and investment companies at individual investor level.

I. Securities Investment Trusts

A. Taxation at Investment Trust Level

Earnings accruing on trust properties of securities investment trusts are exempt from income tax pursuant to Article 176 of the Income Tax Law, if the procedures designated by the Law are followed. Since the trust properties are not regarded as a corporate entity, they are not subject to corporate tax.

B. Taxation at Individual Investor Level

The taxation of securities investment trusts depends on whether they are stock investment trusts or bond investment trusts (including MMF). For tax purposes, ETF is treated almost the same as listed stocks, as it is listed and traded on the exchange.

1. Stock Investment Trusts

(1) Profit Distribution

Profit distributions paid to investors by stock investment trusts are subject to the withholding tax as the dividend income, and investors are not required to file a return (Alternatively, investors are able to choose to aggregate profit distributions with other incomes by filing a return or to tax them separately from other incomes by filing a return). The rate of the withholding tax is 20% (not including special income tax for reconstruction).

In the case of unit-type stock investment trusts, the total amount of profit distributions is subject to the tax. In the case of open-type stock investment trusts, the ordinary profit distributions are subject to the tax, while the return of capital (special profit distributions) are not subject to the tax as the repayment (refund) of the investment principal.

Investors are able to purchase the unit-type stock investment trust only during its subscription period at the same price (typically, ¥10,000 per unit) except for the case that investors purchase them from other investors or distributing companies. On the contrary, investors are able to purchase the open-type stock investment trust not only during its subscription period but also after the subscription period at the current net asset value per share. Therefore, the purchase price (net asset value per share) is different from one investor to another. The different purchase price for additional purchases of the open-type by each investor is called as an individual principal. The ordinary profit distribution is calculated on the basis of the individual principal of each investor. When the investor receives the return of capital (special profit distribution), he will have to use the adjusted individual principal which is calculated by deducting the return of capital (special profit distribution) from the individual principal for the tax calculation in the subsequent years.

<Calculation of Tax on Profit Distributions>

a. Basic Rules

- When the net asset value at the end of accounting period after deducting the profit distribution exceeds the individual principal, the total amount of the profit distribution is subject to the tax as the ordinary profit distribution.
- When the individual principal exceeds the net asset value, the part of the profit distribution equivalent to the amount that the individual principal exceeds the net asset value is not subject to the tax as the return of capital (special profit distribution), while the rest of the profit distribution is subject to tax as the ordinary profit distribution.

b. Examples

- Assumptions

Net asset value per share after deducting the profit distribution: ¥11,000

Profit distribution: ¥500

Individual principal of beneficiary A: ¥10,000

Individual principal of beneficiary B: ¥11,300

- Beneficiary A

Net asset value (¥11,000) > Individual principal (¥10,000)

Profit distribution of ¥500 is subject to tax as the ordinary profit distribution. His individual principal remained unchanged.

- Beneficiary B

Net asset value (¥11,000) < Individual principal (¥11,300)

$$¥11,300 - ¥11,000 = ¥300$$

Among profit distribution of ¥500, ¥300 is not subject to the tax as return of capital (special profit distribution), while ¥200 is subject to tax as the ordinary profit distribution. His adjusted individual principal is ¥11,000 (= ¥11,300 - ¥300).

(2) Gains and Losses from Redemptions

Gains from redemptions of the stock investment trusts are regarded as capital gains and are taxed separately from other incomes by filing a return or subject to the withholding tax in the case of the Special Tax Account. The rate of both taxes is 20% (not including special income tax for reconstruction).

<Calculation of Tax on Gains from Redemptions>

a. Unit Type Stock Investment Trusts

- Assumptions

Purchase price: ¥10,000 (Typical price in Japan)

Net asset value per share on the day of redemption: ¥11,000

- Tax on Gains from Redemption

Profit of ¥1,000 (= ¥11,000 - ¥10,000) is regarded as capital gains and subject to the separate tax by filing a return or the withholding tax.

b. Open-Type Stock Investment Trusts

- Assumptions

Individual principal: ¥11,300

Net asset value per share on the day of redemption: ¥12,000

Redemption fee: ¥30

- Tax on Gains from Redemption

Profit of ¥670 (= ¥12,000 - ¥11,300 - ¥30) is regarded as capital gains and subject to the separate tax by filing a return or the withholding tax.

After the taxation change in the fiscal year 2003, losses from redemptions of stock investment trusts have been regarded as the capital losses. So, such losses can be offset against capital gains from repurchase of stock investment trusts and from sales of listed stocks. Losses from redemptions that were not used to offset against capital gains in a previous year can be used to offset against them following three years.

Further, gains from redemptions of stock investment trusts have been also regarded as the capital gains for individual investors after January 2009. So, gains from redemptions of stock investment trusts can be offset against losses from their redemptions. Gains from redemptions of stock investment trusts can be also offset against capital losses from repurchase of stock investment trusts and from sales of listed stocks. In addition, losses from redemptions of stock investment trusts can be offset against dividend income after January 2009.

c. Gains and Losses from Repurchases

One way for liquidating the investment trust is to ask distributing company to repurchase (buy back) it. Gains and losses from repurchases of stock investment trusts are classified as capital gains and losses. Capital gains from repurchases of stock investment trusts are subject to the separate tax by filing a return or the withholding tax in the case of the Special Tax Accounts.

Capital gains from repurchases of stock investment trusts can be offset against capital losses from their repurchases. In addition, capital gains from repurchases of stock investment trusts can be offset against losses from their redemptions. Further, capital gains and losses from repurchases of stock investment trusts can be offset against capital gains and losses from sales of listed stocks. Capital losses that were not used in the previous year can be used to offset against them following three years.

Further, gains from redemptions of stock investment trusts are also regarded as the capital gains after January 2009. So, capital losses from repurchase of stock investment trusts and from sales of listed stocks can be offset against gains from redemption. In addition, capital losses from repurchase of stock investment trusts and from sales of listed stocks can be offset against dividend incomes.

2. Bond Investment Trusts

The Income Tax Law defined the bond investment trusts as those investment trusts whose purpose is to manage the trust property by investing it in bonds but not investing in share certificates and equity securities. The profit distributions and gains from redemptions of bond investment trusts are subject to the separate withholding tax of 20% as the interest income like bank deposits and money trusts (no further tax liabilities).

Capital gains from repurchases of bond investment trusts are exempt from the tax. However, the distributing companies repurchase them at the repurchase price (net asset value per share on the day of repurchase minus Special Deduction). As a result, the proceeds the investors receive by the repurchase equal to the proceeds they receive by the redemption. In practice, investors normally liquidate them by the way of the redemption.

As the capital gains from repurchases of bond investment trusts are exempt from the tax, capital losses from repurchases and losses from redemptions of bond investment trusts are completely neglected for the tax purposes. Further, they are not deductible from the capital gains from sales of stocks etc., and the carryover is not allowed for them.

Unlike the open-type stock investment trust, the open-type bond investment trust may not effect any additional establishment at the current net asset value per share, although it may effect additional establishment at the price at which it is subscribed at the initial establishment. So, if a bond investment trust is subscribed at ¥10,000 per share at its initial establishment, it must effect its additional establishment always at ¥10,000 per share. When its net asset value per share exceeds ¥10,000 on the day of the account settlement, the bond investment trust distributes the difference between its net asset value per share and ¥10,000, and then it effects the additional establishment on that day. However, when the net asset value per share fell below ¥10,000 on the day of the account settlement, the bond investment trust was not able to effect the additional establishment (as the net asset value per share of a bond investment trust is calculated by valuing its portfolio securities by the market values, it is possible that its net asset value per share falls below ¥10,000).

In order to address this issue, following quasi-individual principal method was introduced in open-type bond investment trust in April 2004 (However, the open-type bond investment trusts may not yet effect any additional establishment at the current net assets value per share).

<Quasi-Individual Principal Method for Open-Type Bond Investment Trusts>

- a. If the net asset value exceeds the principal (¥10,000), the open-type bond investment trust effects the additional establishment after it distributes the difference between its net asset value per share and the principal on the day of the account settlement.
- b. The open-type bond investment trust may effect the additional establishment, even if its net asset value per share falls below the principal. However, it may not distribute profits, until its net asset value per share exceeds the principal.
- c. When investors purchase the open-type bond investment trust below the principal and redeem it above the purchase price later, the gain from such redemption is subject to the tax as the interest income.

Each open-type bond investment trust may choose whether it adopts the quasi-individual principal method or not. If it chooses to do so, it must revise its trust deed in advance. If it does not choose to do so, it effects the additional establishment only at the principal (¥10,000) as previously.

C. ETF

ETF is listed and traded on the exchange like listed stocks. Institutional investors acquire ETF also in exchange for the block of stocks composing the specific index and receive the portfolio securities in exchange for a certain amount of ETF. However, individual investors purchase and sell ETF by trading on the exchange through securities firm. Therefore, individual investors purchase and sell ETF not at net asset value but at market-determined price. As a result, for tax purposes, ETF is treated like listed stocks. Profit distributions by ETF are subject to the tax as dividend income, while capital gains from sales of ETF are subject to the tax as capital gains.

II. Listed Investment Companies

The publicly offered investment companies that exist in Japan at present are either the closed-end securities investment companies or the closed-end real estate investment companies. All of them are listed and traded on the exchanges.

A. Taxation at Investment Company Level

In principle, the earnings by the investment company are taxable at the investment company level. However, the investment company may deduct the distributed dividends from its taxable earnings so that it is able to avoid the investment company level tax. In order to do so, the investment company must meet certain requirements. One of the requirements is that the investment company must distribute more than 90% of dividends permissible for distributions.

The acquisitions of real estates are subject to the taxes such as the Registration and License Tax and the Real Estate Acquisition Tax. The reduced tax rates are applied for the acquisitions of real estates by investment companies.

B. Taxation at Individual Investor Level

As the investment companies that exist in Japan at present are listed on the exchanges, they are treated almost same as the listed stocks and ETF for tax purposes. However, real estate investment companies are treated differently from listed stocks and ETF in some points (for example, the tax treatment of dividends).

III. Investment Trusts Other Than Securities Investment Trusts

The Income Tax Law defined the “investment trust investing in bonds etc.,” which is one type of investment trust other than securities investment trust, as any investment trust other than securities investment trust that invests the trust property in bonds etc. as set forth by the Cabinet Order of the Law.

For tax purposes, the “investment trusts investing in bonds etc.” is treated same as the bond investment trust both at the investment trust level and at the investor level, and its profit distributions and gains from redemptions are classified as the interest income.

IV. Others

A. Special Tax Account System

In the Special Tax Account, losses incurred by trading of listed stocks, etc. (including public-offered stock investment trusts, ETFs, REITs) can be deducted from profits or dividends of listed stocks, etc. Through a tax withholding account (a special account for which an investor chooses direct tax withholding), the investor pays tax through the account, therefore, filing by the individual is unnecessary.

The deduction of losses from profits can be done between multiple special tax accounts held by same investor by filing a tax return. If the amount of losses could not be deducted in a year, it can be carried over for up to 3 years by filing.

B. Tax-Exempt System for Individual Investors

1. Tax-Exempt Small-Amount Saving System

Under the Tax-Exempt Small-Amount Saving System, a certain qualified persons such as beneficiaries of the widow’s pension and handicapped persons are able to receive the profit distributions and gains from redemptions of the eligible investment trusts as well as the interests of bank deposits and postal savings tax free, when they invest in the eligible investment trusts, bank deposits and postal savings up to ¥3.5 million in the aggregate principals. The individuals over 65 years old were excluded from the qualified persons for the System after 2006.

Formerly, the eligible investment trusts for the System were the bond investment trusts and stock investment trusts that seek the stable management as set forth in the trust deed. However, as the tax classification for the profit distributions and gains from redemptions of stock investment trusts was changed from the “quasi-interest income” into the “dividend income,” stock investment trusts were excluded from the eligible investment trusts for the System.

2. Employee Assets-Formation Saving System

Government introduced the System in 1972 to encourage the employees’ asset formation purposefully, and the System consists of following measures:

- ◇ Measures to encourage the employees’ savings,

- ◇ Measures for employers to help the employees' asset formation,
- ◇ Measures to finance the employees from the money pooled under the System.

Measures to encourage the employees' savings consist of the Employee Assets-Formation Savings for Pension, the Employee Assets-Formation Savings for Housing and the Employee Assets-Formation Savings for the General Purpose. As only employees are qualified for these Savings, they periodically contribute to eligible products through payroll deductions.

Eligible investment trusts for these Savings are bond investment trusts and stock investment trusts that seek the stable management as set forth in the trust deed. Stock investment trusts continue to be eligible for these Savings, even after the tax classification for the profit distributions and gains from redemptions of stock investment trusts was changed from the "quasi-interest income" into the dividend income." In practice, the Long-Term Bond Investment Trust and the stock investment trusts established specifically for these Savings are used as eligible investment trusts.

Type	Tax-Exempt Maximum Amount	Specific Saving Purpose
Employee Assets-Formation Savings for Pension	Employees are exempt from tax on profit distributions and gains from redemptions of up to total principals of ¥5.5 million (aggregate principals of Savings for Pension and Savings for Housing)	To receive annuity after 60 years old
Employee Assets-Formation Savings for Housing		To cover costs for acquiring housing or rebuilding housing
Employee Assets-Formation Savings for General Purpose	No tax-exempt privilege	No specific saving purpose

3. NISA (Tax Exempt System for Small Investment)

With a termination of preferential tax treatment for capital gain and dividend income, new tax exempt system for small investment will start in 2014. This system, based on Individual Savings Account in UK, is called NISA (Nippon version of ISA.) This system is introduced to support stable asset formation for household and to expand the capital supply which is necessary for economic growth.

In this system, once an individual investor opens a tax-exempt account for small amount investment, all profits derived from the listed stocks or publicly offered stock investment trusts (including REIT and ETF) in the account are exempt from tax for 5 years. The maximum investment amount in this account is limited to ¥1 million per year. This tax exempt ceiling (¥1 million) is given to the investor every year until 2023, for 10 years. So in some period, maximum original principal applicable for this tax exempt treatment will be ¥500 million. However, offsetting profits and losses in this account is not permitted.

C. Special Income Tax for Reconstruction

Special Income Tax for Reconstruction (2.1 %) aimed at recovery and reconstruction is levied on all income tax from 2013 to 2038. So, income tax on investment trusts has changed as follows:

Tax rate on interests of bond investment trusts: 20.315% (income tax 15.315%, inhabitant tax 5%)

Tax rate on dividend & capital gain of stock investment trusts: 20.315% (income tax 15.315%, inhabitant tax 5%)