Progress Report on
Enhancing the Asset Management Business 2021

Financial Services Agency, Japan (JFSA)

June 2021

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Ⅰ. Asset Managers' Initiatives and Challenges for Advancement

1. Dialogue with asset managers to enhance asset management capabilities

- In Progress Report 2020, the JFSA proposed that Japanese asset management companies should promote the following initiatives to help their customers to build up personal assets by providing customer-oriented products with robust and consistent mid- to long-term performance so that Japanese asset managers can establish a revenue base by gaining trust and support from their customers.

(1) **"Organizational governance"** – Develop and implement a governance structure to prioritize customers' interests.

(2) **"Managerial/Operational Structure"** – Establish a management structure that enables customers'-interests-first and long-term-investment-value-oriented business conduct.

(3) **"Corporate vision and core competence"** – Clarify the corporate vision and core competence, and take resolute actions toward implementing them.

(4) **"Business operations"** – Establish and improve business operations to achieve product governance, including product development, offering, portfolio management and administration of the customer-needs-oriented products, and to realize enhancement of the asset management capability.

- During the fiscal year under review, the JFSA engaged in a series of dialogues with domestic asset managers, and their parent companies, when the asset managers belong to a financial conglomerate group, about their initiatives to enhance their asset management capabilities. Every asset management company is gradually raising awareness of the necessity to enhance the asset management business such as enhancing the governance, clarifying their distinction with competitors and strengthening their core-competence and so forth. Furthermore, each financial group has started to enhance the entire asset management capabilities through ensuring independency, enhancing the asset management capabilities and increasing operational efficiency.
- For example, subsidiary asset management firms and their parent companies in the same financial conglomerate groups make collaborative efforts to refrain from the conventional HR practices of intra-conglomerate-group job rotation, enhance global and/or alternative investment, introduce a new remuneration system and refine the profitability of individual funds.
- It is important for asset managers to achieve the delivery of service which is trusted and supported by customers by expanding these initiatives and enabling them to be more effective.

1．Dialogue with asset managers to enhance asset management capabilities：
（1）Governance－Establishing the governance of prioritizing customers' interests

① Governance of business operation and portfolio management from the viewpoint of customers' interests

- The following approaches have been taken by asset management companies to enhance the governance which stresses customers' interests and asset management capabilities.

  – One of the major asset management firms has hired several experts with managerial experience gained at asset management firms outside of its financial group as outside directors, and designates one of them as a chair of the board of directors, aiming for better governance focusing on portfolio management expertise.

  – An asset management company has increased the number of outside directors from one to three in order to enhance the product development which can fulfill customer needs. In addition, the management company is planning to shift from a committee consisting of in-house members to outside directors as the main members so as to improve the check-and balance system for the product and investment divisions from the fiduciary duty perspective.

  – An asset management company established a fund governance committee consisting of only outside directors to check the individual fund's marketability and the quality of the appropriateness to customers based on the awareness that it is the asset management company that bears the obligation of fiduciary duty to clients for Japan's contract-type investment trusts so that the firm can supplement the check-and-balance function of the asset management company's board of directors.

  – One of the major asset management firms established two new types of meetings, one is for discussions among all executives and the other is for discussions among outside directors so that the asset manager can examine the fiduciary duty initiatives.

- It is necessary for each asset management company to expand its efforts to enhance governance focusing on customer interests and to appropriately examine whether management and business operations are conducted with the highest priority on customer interests, such as understanding the performance and costs of managed funds, and to continuously take measures to prevent these efforts from becoming formal.

- Asset management firms are also expected to make efforts to deepen discussions in the conference body, e.g., information provision to outside directors so as to ensure that examinations including third parties (outside directors) are conducted appropriately.

1． Dialogue with asset managers to enhance asset management capabilities：

（1）Governance－Establishing the governance of prioritizing customers’ interests

② Mutual understanding and cooperation among the parent companies and their asset management subsidiaries regarding the asset management business

- The following measures appear to have started to be taken to ensure the independence of investment subsidiaries within the financial group and to enhance and improve the efficiency of the group's investment capabilities.

(Securing of independence of asset management subsidiaries)

－The president of an asset management subsidiary within the financial group no longer serves as an officer empowered to handle business execution at its parent company. Within the financial group, which also holds a distribution function, the asset management subsidiary maintains a certain degree of independence so as to direct business operations prioritizing portfolio management expertise.

－An asset management subsidiary voted against the articles of electing directors at its parent company in accordance with internal criteria.

(Enhancement of asset management capabilities as a financial group)

－In order to respond as a group to a wide range of customer needs including alternative investment, a financial conglomerate group has consolidated several asset management subsidiaries, handling alternative assets including PEs, in different divisions into one unit as the asset management business division, and enhance cooperation within the group in product development and so forth.

－A financial conglomerate integrated the group's alternative investment functions into its investment subsidiary.

(Operational efficiency through collaboration within a financial group)

－Several asset management subsidiaries within the group have promoted product collaboration and consolidation of middle and back office operations.

－The group had enhanced sales cooperation for high-quality products to expand the group's assets under management.

- It is indispensable for the group parent company to ensure the independence of its asset management subsidiary and the leadership to direct further collaboration and functional aggregation within the group, resulting in enhancement of the asset management capabilities through their investment expertise, a cost reduction strategy and so forth.

1． Dialogue with asset managers to enhance asset management capabilities：

（1）Governance－Establishing the governance of prioritizing customers' interests

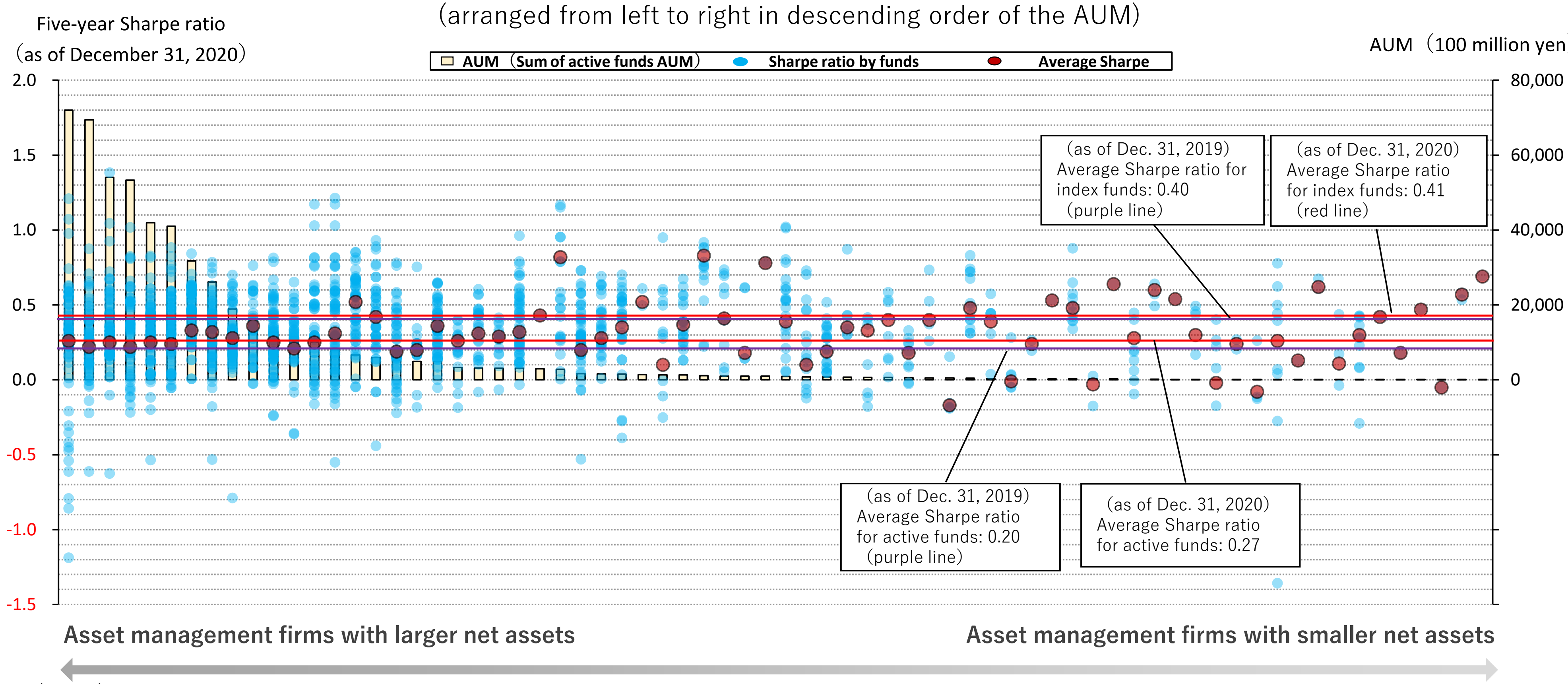
③ Grasping of fund performance

i) Sharpe ratio of publicly offered active funds

- In terms of the Sharpe ratios of publicly offered active funds, some asset management companies with a limited number of funds and small total AUM have achieved relatively better performance with the thorough corporate analysis, and thus resulted in a higher Sharpe ratio in average. On the other hand, some other asset management companies with a large number of funds and large AUM have many funds with Sharpe ratios lower than the average of index funds. These asset managers are expected to improve the fund performance by enhancing a governance structure prioritizing customers' interests.

AUM and fund performance by asset management companies

(arranged from left to right in descending order of the AUM)

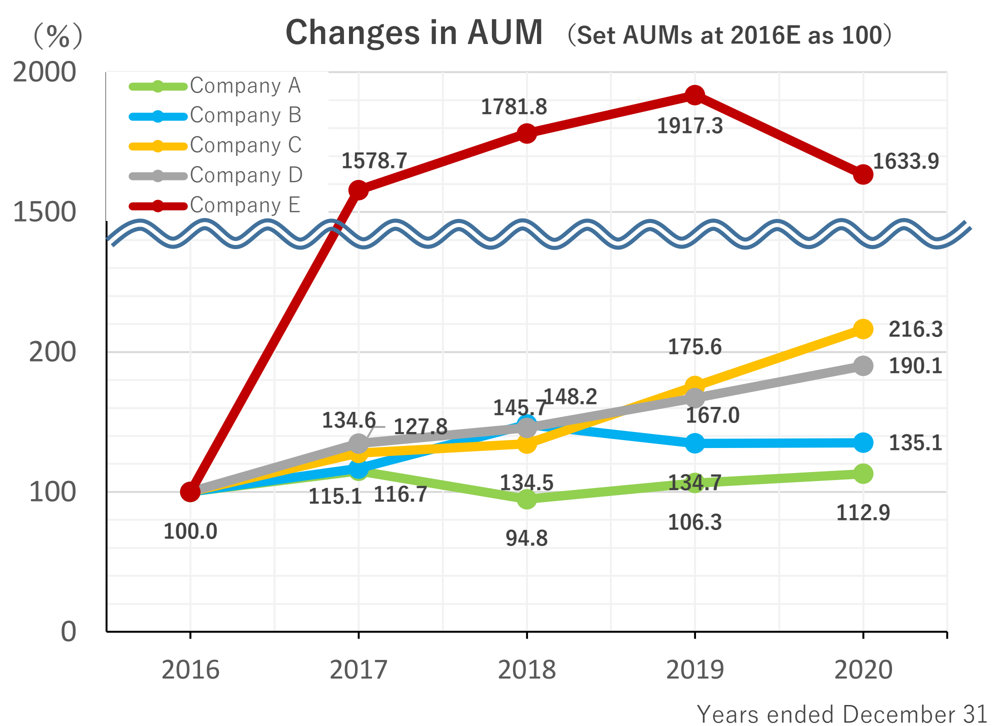


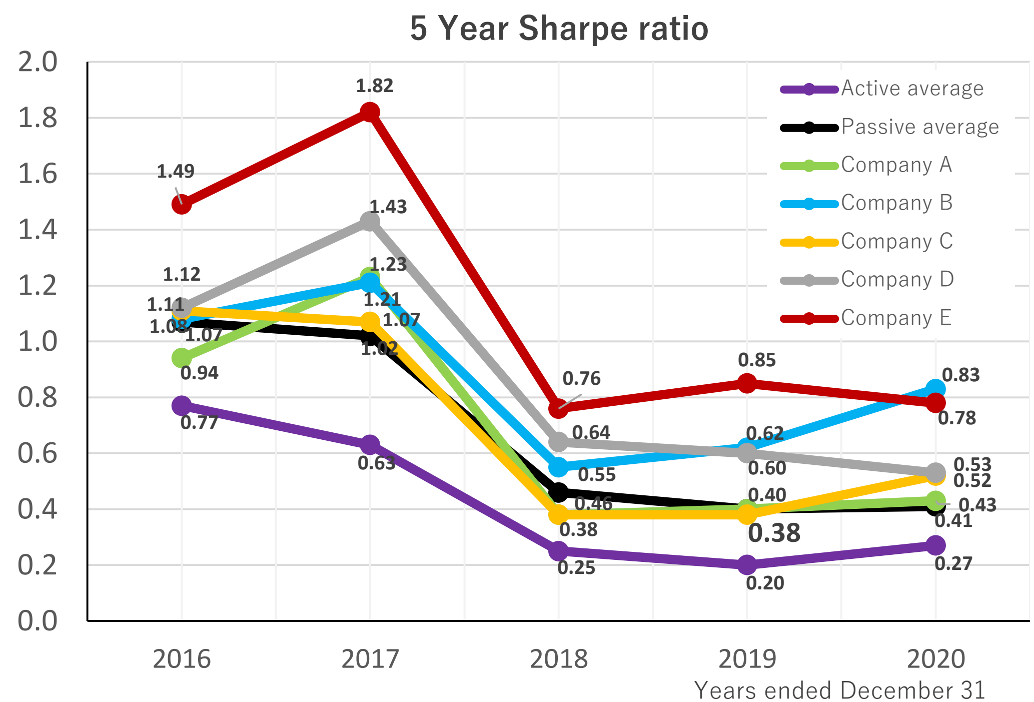
(Source) Prepared by JFSA based on QUICK data

【Column ①】Independent and other distinctive asset managers

- Independent and other distinctive asset managers that do not belong to any major financial groups are making efforts to build a relationship of trust with investee companies and customers by clarifying corporate vision and conducting thorough corporate analysis stressing dialogue with investee companies and providing customers with detailed explanations of their corporate philosophy and fund management status, as well as selling funds by themselves (direct sales).
- Some independent and other distinctive asset managers have stably achieved better performance than the active average.
- Most asset management firms focusing on direct sales face a set of challenges in terms of AUM expansion, a talent pool and human development of fund managers and analysts who can invest from a long-term perspective, and the fostering of an executive for business succession.
- In order to provide stable investment returns to customers, it is expected that, through several efforts aiming at stable business operation and asset management, more distinctive domestic and foreign asset managers with conspicuous investment capabilities will create a competitive environment, refurbishing the entire asset management business.

AUM and performance of five independent and other distinctive asset managers





(Source) Prepared by JFSA based on QUICK data

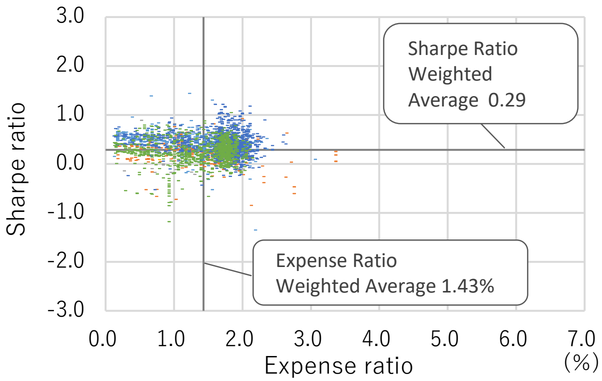
1．Dialogue with asset managers to enhance asset management capabilities：
（1）Governance－Establishing the governance of prioritizing customers’ interests

③ Grasping of fund performance　ii) International comparison of Sharpe ratios and expense ratios

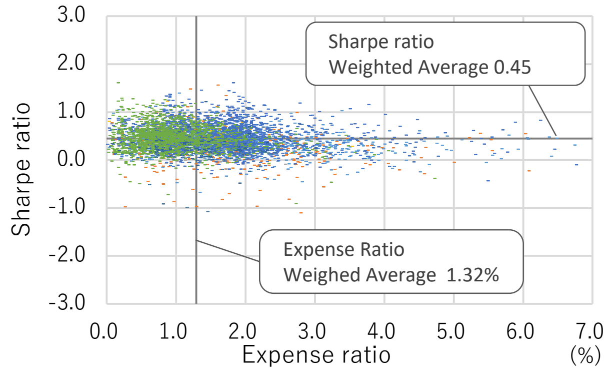
- In international comparison, US mutual funds have an advantage in both the Sharpe ratio and the expense ratio (Figure A).
- A comparison between passive and active funds shows that the Sharpe ratio for active funds is higher than that for passive funds in Japan and the United States as well as Luxembourg. The expense ratio in U.S. is the lowest for both passive and active funds among the three (Figure B).

A. Sharpe ratio and expense ratio

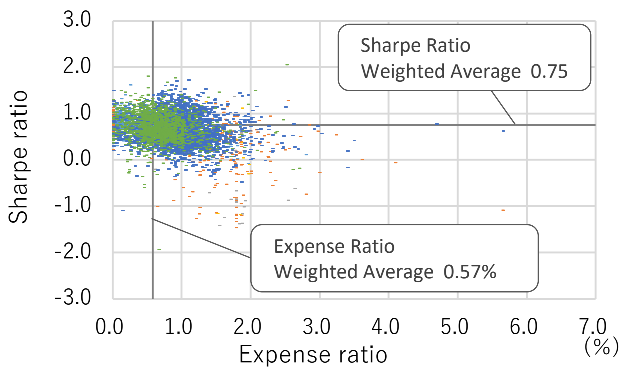
・Japanese publicly offered investment trusts

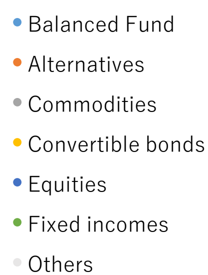


・Luxembourg open-end funds



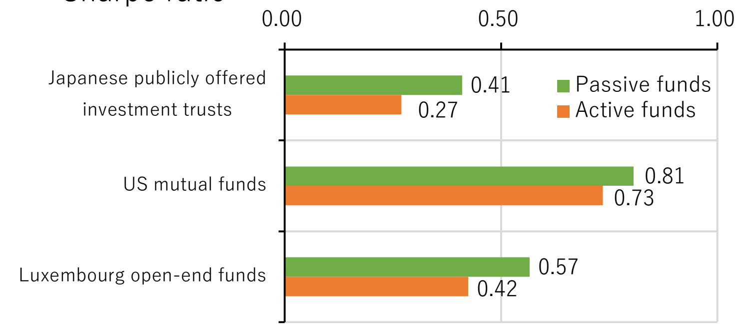
・US mutual funds



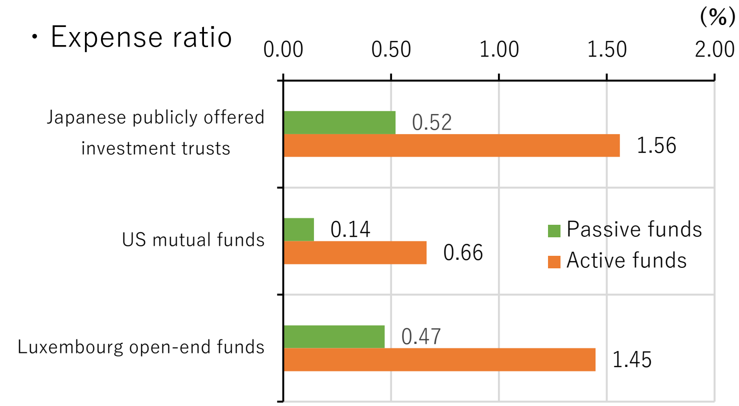


B. Comparison between passive and active funds

・Sharpe ratio



・Expense ratio

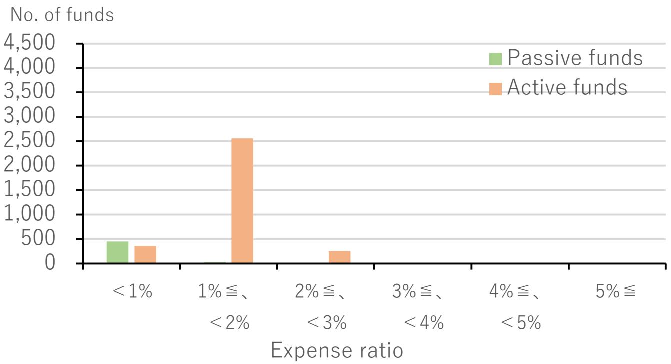


(Note)Data based on funds with a five year performance track record as of the end of 2020 among domestic publicly offered investment trusts in Japan, mutual funds in the US, and open-end funds in Luxembourg. The five year Sharpe ratio and the expense ratio of each fund are measured as asset-weighted averages based on the AUM at the end of 2015. Expense ratio is the ratio of management fees and other expenses to the asset balance of the fund. The Japanese expense ratio includes real(actual) trust fees, while the expense ratio for US mutual funds and Luxembourg open-end funds includes real(actual) trust fees, audit fees, and transfer agent fees for back-office operations.
(Source) Prepared by JFSA based on data provided by QUICK and Ibbotson Associates Japan

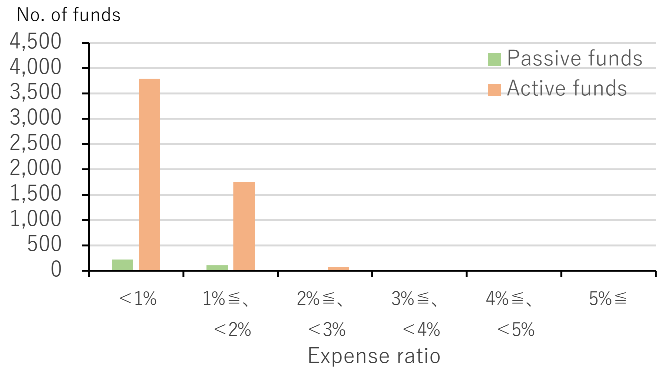
1． Dialogue with asset managers to enhance asset management capabilities：
（1）Governance－Establishing the governance of prioritizing customers' interests

- The expense ratio for most US mutual funds accounts for less than 1% in terms of the number of funds and the size of AUM, while the expense ratio for a large number of Japanese investment trusts is distributed between 1% and 2%.（Figures A and B).
- The Luxembourg open-end funds show a wider distribution of expense ratios than those in the US and Japan because of different fee structures in various regions. (Figure C).
- From the perspective of prioritizing customers' interests, it is essential for asset managers to examine performances and costs of their own funds by comparing them with those of other funds that both domestic and foreign competitors provide, and to make constant efforts to establish product governance and improve performance costs.

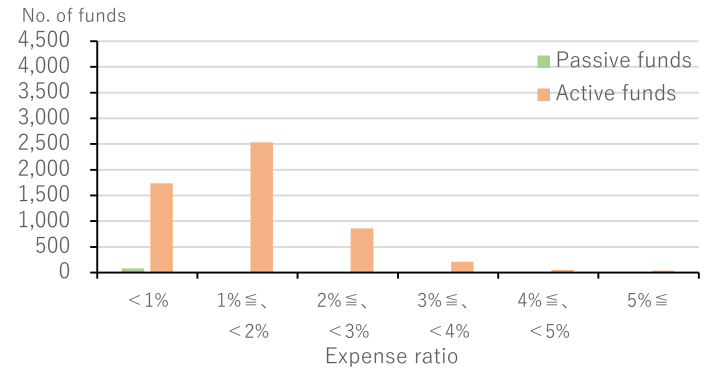
A. Japanese publicly offered investment trusts



B. US mutual funds



C. Luxembourg open-end funds



Expense ratio	＜1%	1%≦、＜2%	2%≦、＜3%	3%≦、＜4%	4%≦、＜5%	5%≦
Active funds						
Number of funds	362	2,560	255	7	0	0
Ratio	11.4%	80.4%	8.0%	0.2%	0.0%	0.0%
AUM（trillion yen)	4.5	44.4	4.6	0.0	0.0	0.0
Ratio	8.4%	83.0%	8.6%	0.0%	0.0%	0.0%
Passive funds						
Number of funds	450	32	0	0	0	0
Ratio	93.4%	6.6%	0.0%	0.0%	0.0%	0.0%
AUM（trillion yen)	7.2	0.4	0.0	0.0	0.0	0.0
Ratio	94.3%	5.7%	0.0%	0.0%	0.0%	0.0%

Expense ratio	＜1%	1%≦、＜2%	2%≦、＜3%	3%≦、＜4%	4%≦、＜5%	5%≦
Active funds						
Number of funds	3,788	1,753	76	6	2	4
Ratio	67.3%	31.1%	1.4%	0.1%	0.0%	0.1%
AUM (10billions of USD)	864.5	165.6	2.6	0.1	0.0	1.3
Ratio	83.6%	16.0%	0.2%	0.0%	0.0%	0.1%
Passive funds						
Number of funds	221	108	4	0	0	0
Ratio	66.4%	32.4%	1.2%	0.0%	0.0%	0.0%
AUM (10billions of USD)	237.6	1.0	0.0	0.0	0.0	0.0
Ratio	99.6%	0.4%	0.0%	0.0%	0.0%	0.0%

Expense ratio	＜1%	1%≦、＜2%	2%≦、＜3%	3%≦、＜4%	4%≦、＜5%	5%≦
Active funds						
Number of funds	1,739	2,536	857	214	52	38
Ratio	32.0%	46.6%	15.8%	3.9%	1.0%	0.7%
AUM (10billions of USD)	88.3	114.0	37.3	6.2	1.5	3.0
Ratio	35.3%	45.5%	14.9%	2.5%	0.6%	1.2%
Passive funds						
Number of funds	81	11	0	0	0	0
Ratio	88.0%	12.0%	0.0%	0.0%	0.0%	0.0%
AUM (10billions of USD)	3.9	0.4	0.0	0.0	0.0	0.0
Ratio	91.1%	8.9%	0.0%	0.0%	0.0%	0.0%

(Note)Data based on funds with a five year performance track record as of the end of 2020 among domestic publicly offered investment trusts in Japan, mutual funds in the US, and open-end funds in Luxembourg. The five year Sharpe ratio and the expense ratio of each fund are measured as asset-weighted averages based on the AUM at the end of 2015. Expense ratio is the ratio of management fees and other expenses to the asset balance of the fund. The Japanese expense ratio includes real(actual) trust fees, while the expense ratio for US mutual funds and Luxembourg open-end funds includes real(actual) trust fees, audit fees, and transfer agent fees for back-office operations.
(Source) Prepared by JFSA based on data provided by QUICK and Ibbotson Associates Japan

【Column ②】 Insight of Information ratio for publicly offered investment trusts in Japan

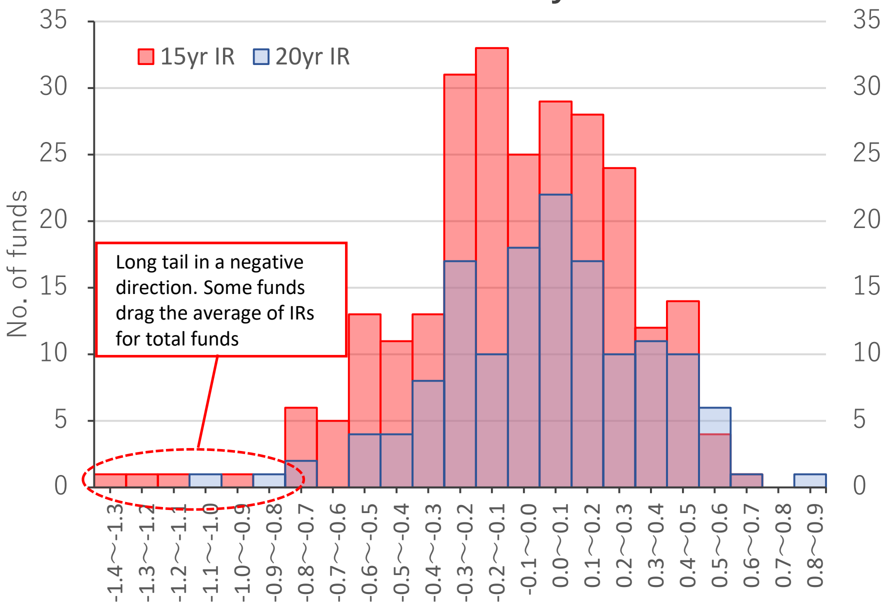
- For active equity investment trusts, the information ratio (IR), calculated using the TOPIX total return index (including dividends) as a benchmark and fund returns after deducting costs, shows a simple average of almost zero (-0.07 for 15 years and + 0.01 for 20 years). The distribution of IR shows a long tail trend in a negative direction, where some funds may have lowered the average IR(Figure A).

  * Information ratio : An excess return over the benchmark return, i.e., active return, divided by a tracking error i.e., standard deviation of active return.

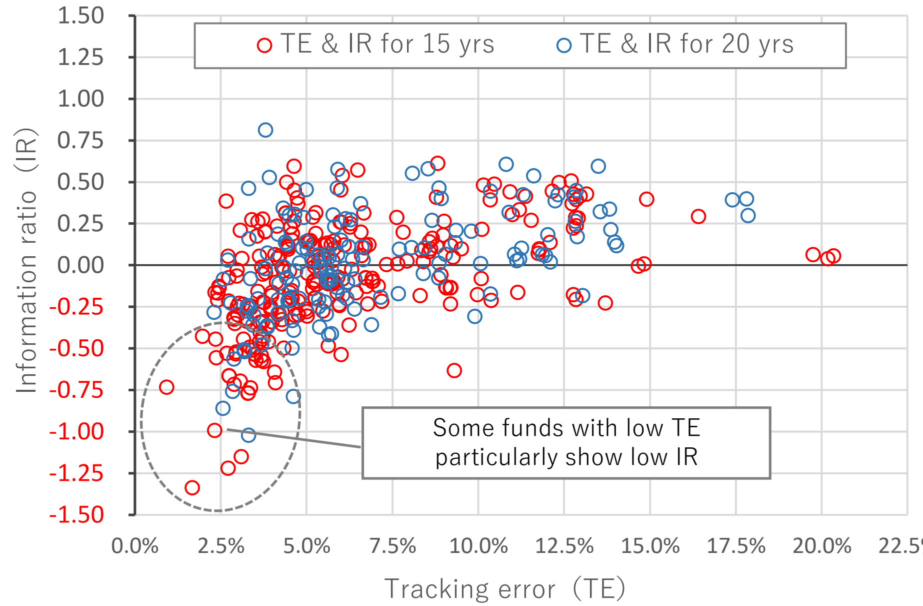
- Looking at the distribution of the tracking error (TE) and the information ratio (IR), while the TE tends to be relatively high for funds with positive IR, the IR tends to be extremely low for some funds with low TE. It appears that these funds are likely to be managed in a passive manner and do not provide returns commensurate with fees and other costs (Figure B).

  * Of 711 funds that existed 20 years ago, 568 funds have been already redeemed and are not included in this analysis.

A. Information Ratio for 15 and 20 years



B. Tracking Errors and Information Ratios



(Note) Information ratio (IR) and tracking error (TE) for active investment trusts (253 funds) with a 15-year track record and active investment trusts (143 funds) with a 20-year track record, using the TOPIX Dividend Index as a benchmark, as of the end of March 2021.
(Source) Created by Idea Fund Consulting based on fund data provided by Mitsubishi Asset Brains Company, Limited

1. Dialogue with asset managers to enhance asset management capabilities：
(2) Managerial/operational structure－Prioritizing customers' interests and long-term fund management

- While there are several approaches to reviewing the existing managerial/operational structure in order to realize "customers'-interests-first and long-term-investment-value-oriented" business conduct, top management at some other asset managers still have a short tenure and also some asset management firms have not made any progress in initiatives associated with diversity.

(**Long-term investment centric managerial/operational structure**)

－ The composition of the board of directors, which had mainly consisted of the parent company's personnel, has been changed through partial replacement with a full-time employee, who has long career experience at the asset management subsidiary of the financial group, being promoted to the position of director.

－ An investment expert, who has been hired by the parent company of a financial conglomerate but has long working experience at its asset management subsidiary, has been designated as a president of the subsidiary.

－ Talented resources who are familiar with the practical operations of asset management within or outside the financial group play a key role as the top management to enhance product governance by refining the managerial accounting of individual funds, carefully selecting product managers and so forth.

(**Tenure of top management**)

－ There are several cases in which the top executives of overseas asset management companies have been working for more than 20 years, meanwhile the tenure of the top executives of major Japanese asset management firms, like managing directors and so forth, is two to five years. The latest average tenure of top executives is approximately one year and seven months, and as reference the average tenure of their predecessors in each company was approximately three years.

(**Diversity initiatives**)

－ The average percentage of female employees at major asset management companies headquartered in Japan is approximately 36%, showing no significant differences among companies. On the other hand, the average percentage of female managers is approximately 12%, and the highest percentage is 16-19%, showing a significant difference among companies. Asset managers with many overseas offices tend to work on diversity initiatives proactively, but the average percentage of foreign employees at the Japan offices remains low, approximately 4%, in the aggregate.

cf. The average percentage of women in managerial positions in the overall financial industry in 2020 was 11.2%.

(Source : Teikoku Databank, "Survey of Corporate Attitudes Towards Promotion of Women (2020)")

- It is essential for asset management firms to establish a managerial/operational structure which enables them to thoroughly implement long-term-investment-value-oriented business conduct and see an increase in the number of funds contributing to their customers' asset accumulation, e.g., through a more appropriate tenure of top management and selection of experts with practical operation experience in asset management. Especially, for asset managers which accept employees from their parent companies as top management, it is indispensable to pay particular attention not to take any sales-oriented approaches to making a short-sighted profit only for the group. At the same time, it is necessary for them to implement the business conduct of prioritizing customers' interests through product development which enables delivery of stable mid- to long-term returns to their customers.
- As active participation of women is stated in Japan's Corporate Governance Code, asset management firms are expected to promote diversity so as to enhance asset management capabilities by utilizing diverse human resources.

1． Dialogue with asset managers to enhance asset management capabilities：
(3) Vision and competences－Clarifying vision and competences and their concrete implementations

① **Efforts by asset managers during the administrative year of 2020(starting from July 2020 to June 2021)**

- The following efforts were made by each asset manager to clarify the corporate vision and core competence

（**Enhancing capabilities of managing global assets/ product offering to overseas customers**）

－As an initiative to enhance the in-house investment capabilities of managing overseas assets, one of the major Japanese asset management firms has established an Asian equity long-short strategy team by hiring external expertise with an excellent track records at its Asia base and launched a new fund. Another asset manager has established an overseas base so that the firm can improve research qualifications and also launch in-house products by effectively utilizing data science capabilities.

－An asset management company aiming to become a global asset manager has obtained new and additional mandates from outside institutional investors by enhancing overseas sales and marketing functions in cooperation through information sharing among overseas branches.

（**Collaboration with strategic partners**）

－One of the asset management companies provides domestic investors with infrastructure equity related investment products which its overseas investment management subsidiary has competitive advantages.

－Aiming to establish an active fund management structure with multiple distinctive investment teams, a financial conglomerate has promoted an "Inorganic" strategy in some areas requiring reinforcement such as sustainable investment, alternatives and so forth.

（**Differentiation by distinctive products**）

－An asset manger is strengthening its operational structure by investing in alternative assets, which is required for the firm to provide effective solutions to meet customers’ needs, as well as by collaborating with outside specialists.

－One of the asset management firms has commenced a demonstration experimentally to utilize the analysis of alternative data for asset management, aspiring to improve fund performance.

－Through alliances with overseas asset managers, e.g., establishing joint ventures, an asset management firm has launched a variety of ETF products to invest in themes with future growth potential.

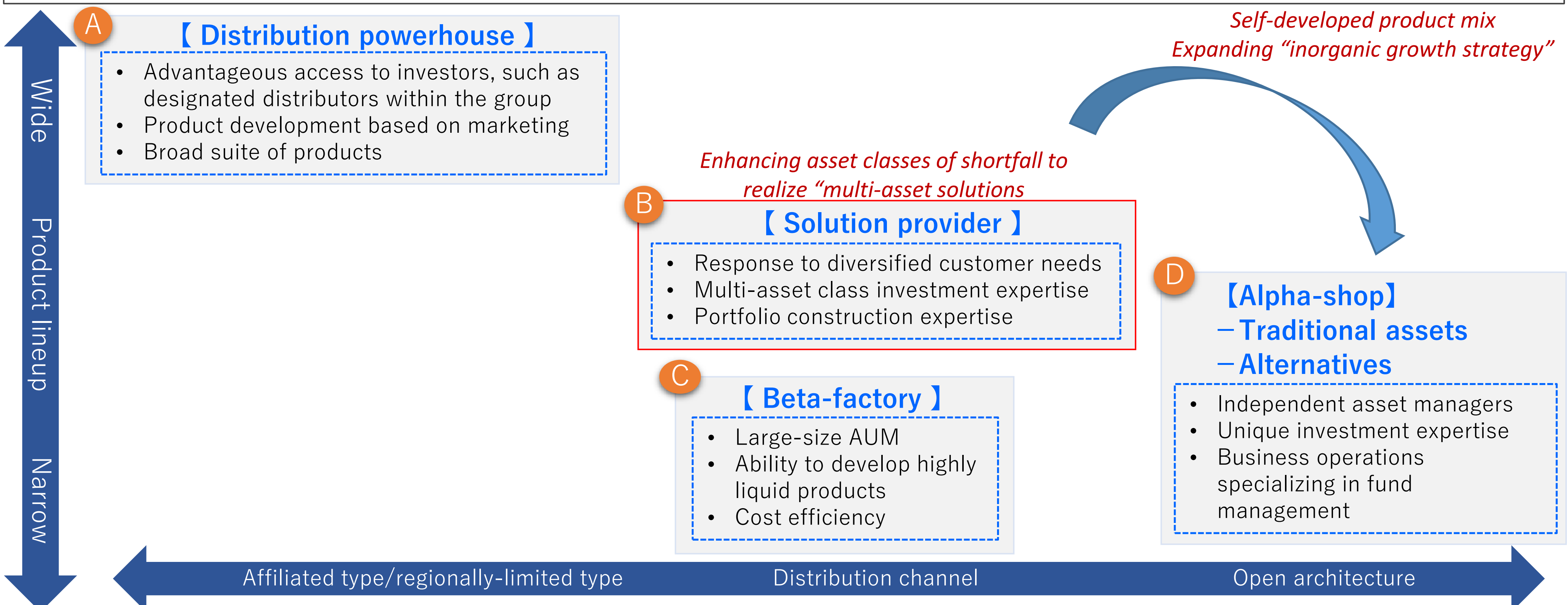
- Asset managers need to differentiate themselves from competitors and enhance core competence in their fields of endeavor to survive harsh competition through realization of product commercialization and better fund performance, thus reaching their corporate vision.
- In terms of AUMs, more than half of the active funds, which are provided through major asset management firms in Japan, are actually managed by overseas asset managers. Amid the intensifying competition, it is required for Japanese asset management firms to commit themselves to clarifying their fields of endeavor in which to enhance their in-house asset management and specific strategies from a mid-to long-term perspective.
- Creation and provision of a wide variety of investment products through outsourcing to competent asset managers should be an effective means to meet various customer needs. However, it is more important for asset managers to enhance their expertise to assess the investment opportunities, to monitor the status of portfolios and total assets outsourced to outside managers and to provide products by which individual investors can accumulate their assets with credibility.

1．Dialogue with asset managers to enhance asset management management capabilities：

(3) Vision and competences－Clarifying vision and competences and their concrete implementations

② Major asset management firms' corporate vision (Typical business models)

- Progress Report 2020, officially released in June 2020, pointed that major asset management firms in Japan had moved toward (B) becoming "solution providers" that respond to various needs of their customers. In dialogue with asset managers during the administrative years of 2020 starting from July 2020 to June 2021, some asset managers have been making progress in their internal arguments on how to strengthen their business fields required for further improvement, in which they need to strengthen going forward, e.g., alternatives or global assets, so that they can target their positioning in the industry as a solution provider.
- Some asset managers are working hard to enhance the function as (D) Alpha shops through distinctive product development, founding of the in-house asset management team and so forth.
- Asset managers are expected to develop their own business models, e.g., by providing various types of investment products as distribution powerhouses(A) making it possible to meet customers' needs, expanding the investment scale with more index funds like Beta-factory(C), and so forth.



(Source) Prepared by JFSA based on the analysis by Boston Consulting Group

1. Dialogue with asset managers to enhance asset management capabilities：

(4) Business operations – Viewpoint of prioritizing customers' interests and enhancing asset management capabilities / Business operations to realize the corporate vision and core competence

① Enhancement of product governance

i) Customer-oriented product governance

- The following measures were taken by several asset management companies to ensure product governance.
  - Asset managers' own approach to developing customer-needs-oriented-products works to curb a launch of new investment trusts, e.g., by prohibiting the creation of similar types of funds.
  - Reorganization has clarified the function of the product management team to be mainly in charge of developing new products and managing/administrating existing funds.
  - Enhancing the product development by assigning a product manager in each product and letting her/him collaborate with the fund management team and sales division.
  - Further progress to monitor profitability in each individual fund by thorough management accounting at most major asset management firms.
  - Sharing information on target customers, or target markets, with their distributors in creating new products.
- On the other hand, the following problems on product governance may cause disadvantages to customers.
  - Since 2018, the number of already terminated publicly offered investment trusts has exceeded the number of newly launched funds, and thus the total number of funds has been on a downward trend. However, the number seems to be still high, as there are a bunch of small AUM funds because of a lack of product lineups which can realize stable profits over the mid- to long-term.
  - It has been pointed out that there are several publicly offered investment trusts that do not meet the customers' investment objectives and needs, nevertheless charging higher trust fees (cf. p17 ii . Closet tracker problem)
  - It seems to be very difficult to justify the cost structure of some index funds which link to the same benchmark.

    (cf. p19-20 iii. Issues on the cost structure of some index funds which link to the same benchmark).
  - Regarding fees for publicly offered investment trusts, the expense item categorized as "other expenses" differs from fund to fund, making it difficult for customers to review it in disclosure materials because of inconsistency among funds.

    (cf. p21 iv. Problems with product cost disclosure)
- It is essential to penetrate the concept of product governance among the investment division, sales division, and administrative division, and realize product development to prioritize customers' interests, and provide an easy-to-understand explanation on fund management concepts and the latest investment status to customers as well as various follow-ups including performance evaluation, initiatives of the cost reduction and elaboration of profitability and decision making to terminate the small AUM funds and so forth.

【Column ③】Small-sized fund liquidation initiatives in Korea

1． Problems with small-sized funds pointed out by the Financial Services Commission of Korea

- Difficult to manage a portfolio in a standard way: Small AUM typically causes some difficulties in managing a portfolio in line with its investment objective and in diversifying the constituents of the portfolio.
- Insufficient monitoring of fund profitability : Too many funds per fund manager makes it difficult to monitor each fund's profitability.
- Operational inefficiency : The higher costs, the smaller the AUMs because of the fixed costs charged regardless of the fund size.
- Causing a negative effect on clients' investment decisions : The proliferation of small-sized funds with similar investment strategies potentially hampers clients' rational product selection, thus reducing the reliability of the funds.

※A small-sized fund refers to a fund whose principal amount is less than 5 billion won (approximately 500 million yen).

cf. In Japan, the number of publicly offered investment trusts (open-end funds) is approximately 1,300 (at the end of December, 2020, based on the funds managed more than one year since inception.

2． Introduction of "the model standard for small-sized fund liquidation and suppression of occurrence"

- The regulation went into effect in February 2016. Although it was a tentative measure valid for only one year, it has been extended and is currently still valid.
- Under the current standard, asset managers are restricted from launching new funds if they have already registered more than three small-sized funds, or if the proportion of their small-sized funds out of their outstanding publicly offered funds (open-end funds) exceeds 5%.

※ It is allowed to launch new funds when new feeder funds are created under the existing master funds, or in case of substantiating that the funding value is more than 5 billion won.

The percentage of small-sized funds fell sharply after enforcement of the standard.

Month/Year	The number of publicly offered funds (open type)	The number of small-sized funds	Percent
Jun 2015	2,247	815	36.3
Mar 2016	2,004	459	22.9
Jun 2016	1,883	294	15.6
Sep 2016	1,820	217	11.9
Dec 2016	1,757	126	7.2
May 2017	1,540	121	7.9
Sep 2017	1,579	106	6.7
Dec 2017	**1,601**	**102**	**6.4**

(Source) Financial Services Commissions of Korea , as of February 5, 2020

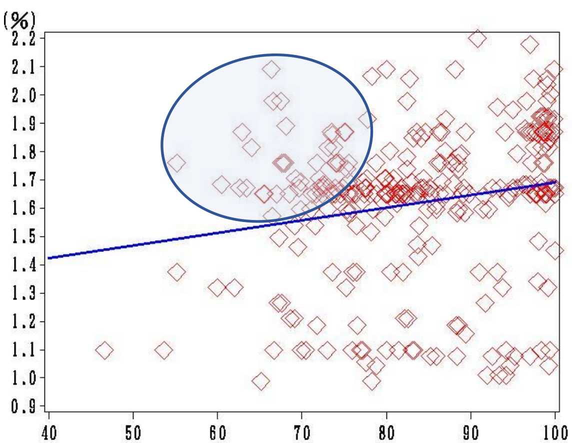
1． Dialogue with asset managers to enhance asset management capabilities：

(4) Business operations－Viewpoint of prioritizing customers' interests and enhancing asset management capabilities / Business operations to realize the corporate vision and core competence

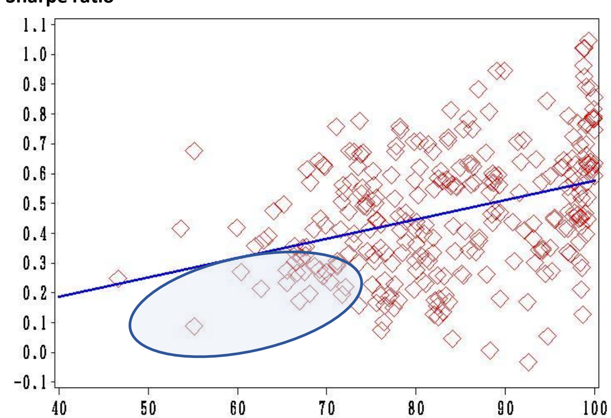
① Enhancement of product governance ii) Closet tracker issues – a discrepancy between investment policy and actual portfolio management

- It has been pointed out that there are problems with some active funds which are likely to be managed as index funds, closet trackers. Although acquiring an excess return is set as an investment policy and thus charging higher management fees, they are likely to be managed in the same manner as index funds.
- As shown in the following chart, trust fees are high for the funds with low active shares and there are some funds with relatively low Sharpe ratios (please see the ovals highlighted in blue in figure A and B). ※ Active share refers to a numerical value that quantitatively shows the difference between actively managed funds and their benchmarks. Active share can take a value from 0% to 100%, 0% means completely consistent with the index, and 100% is completely different from the index.
- It is essential to periodically check the consistency between the investment policy and the actual portfolio management, to promptly respond if any discrepancy is found and to set appropriate trust fees as well as to provide an accurate and clear explanation of the risk return characteristics and trust fee levels in selling funds so as not to harm the customers' interests by making false or misleading explanations.

A. Active share and trust fees



B. Active share and 5 year Sharpe ratio



（Note） Data based on funds with a five year performance track record as of the end of 2020 among domestic publicly offered investment trusts investing in Japanese equities (275 funds in total). Benchmark: TOPIX

cf. The following is the result of running a simple regression model: Objective variable = Regression coefficient x Explanatory variable + Constant term

Explanatory variable	Objective variable	Regression coefficient		No. of funds
Active share	5 year Sharpe ratio	＋0.006	significance level:1%	275
	Real(actual) trust fees	＋0.004	significance level:1%	275

（Source） QUICK

【Column ④】Closet tracker analysis in the ESMA report

- In September 2020, the European Securities and Markets Regulatory Agency (ESMA) published a report investigating how the Closet Index(CI) indicator is associated with fund costs and performance.

- CI refers to the situation where an asset manager claims to be actively managing a fund but is actually following or approaching a benchmark index. It is synonymous with a closet tracker.

- A panel regression analysis using annual data (*) from 2010 to 2018 showed the following results.
  - CI's expected returns are lower than those of funds that are managed in a truly active manner.
  - The costs of CIs are just slightly lower than those of pure active funds ; overall, the net performance of CIs is worse than that of pure active funds.

※ The sample data consist of UCITS equity active funds (approximately 3,200 funds) in the EU, which are observed from 2010 to 2018 and are not included in the Index Tracker. This is the first CI-related analysis of all European equity funds, according to the report.

- The report pointed out the following possible adverse effects of CI.
  - Investors may invest in CIs based on false expectation that the funds are managed with more actively judged investment decisions than in reality.
  - Investors are exposed to a risk-return profile different from their expectation.
  - Investors are paying higher fees than passive funds, explicitly stating to track a benchmark index.

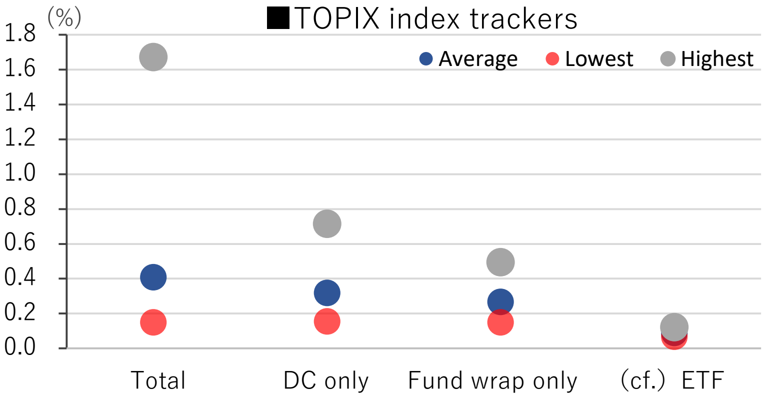
(Source) ESMA Report on Trends, Risks and Vulnerabilities, September, 2020

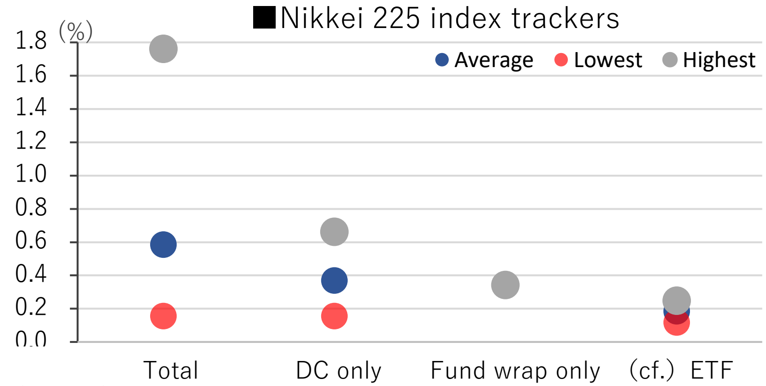
(4) Business operations－Viewpoint of prioritizing customers' interests and enhancing asset management capabilities / Business operations to realize the corporate vision and core competence

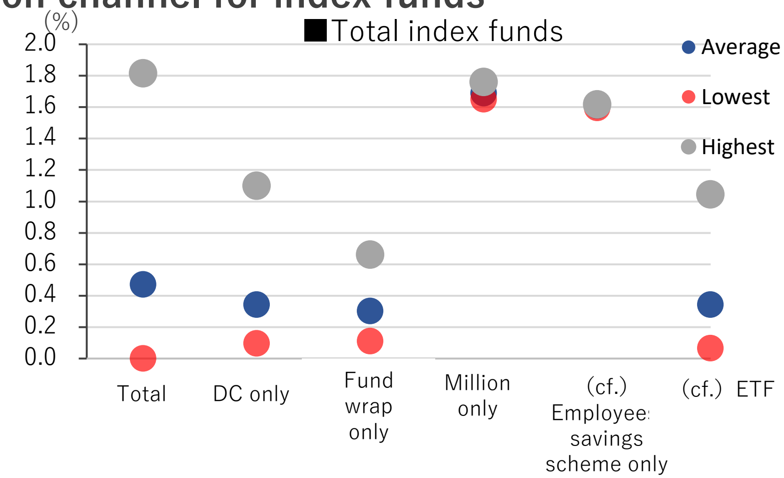
① Product governance enhancement iii) Issues on involved in the cost structure of specific index funds aiming to link the same benchmark

- For index funds to link the same benchmark, trust fees vary even in the same sales channels. In particular, trust fees tend to be higher as the number of years since establishment increases (Figures A and B).
- Differences in the level of trust fees can be seen among distributors and also among asset management companies (Figures C and D on p.20).
- Some asset management companies have started discussions with distributors to lower fees charged in specific investment trusts exclusively launched for accumulative investments and the investment amounts are deducted from every salary(called "Million"). It is expected to strengthen product governance and establish appropriate fee levels according to the customers' needs, objectives, and the status of portfolios.

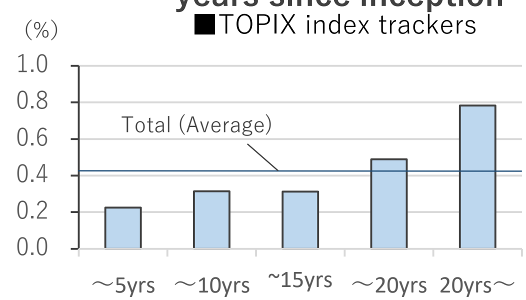
A. Average and lowest trust fees per distribution channel for index funds

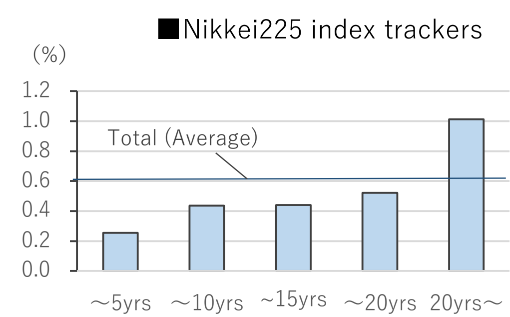






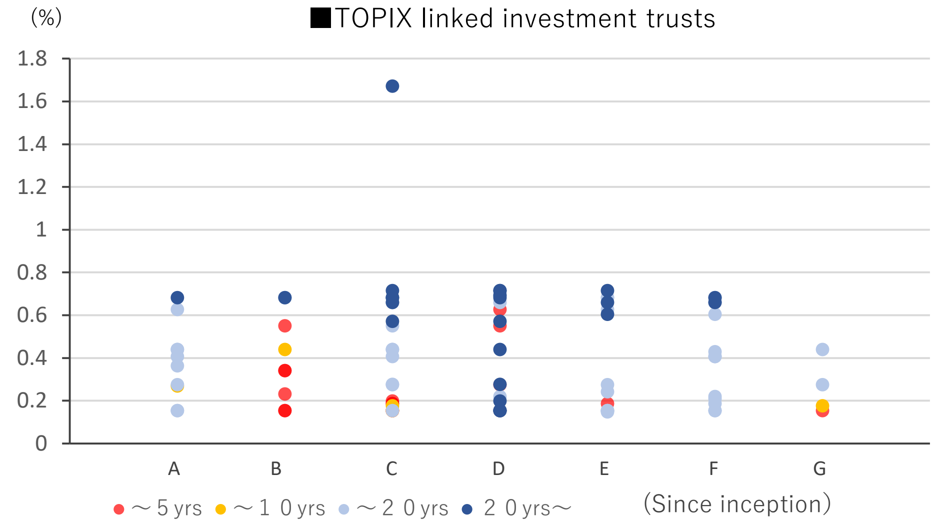
B. Average trust fees for funds with different number of years since inception

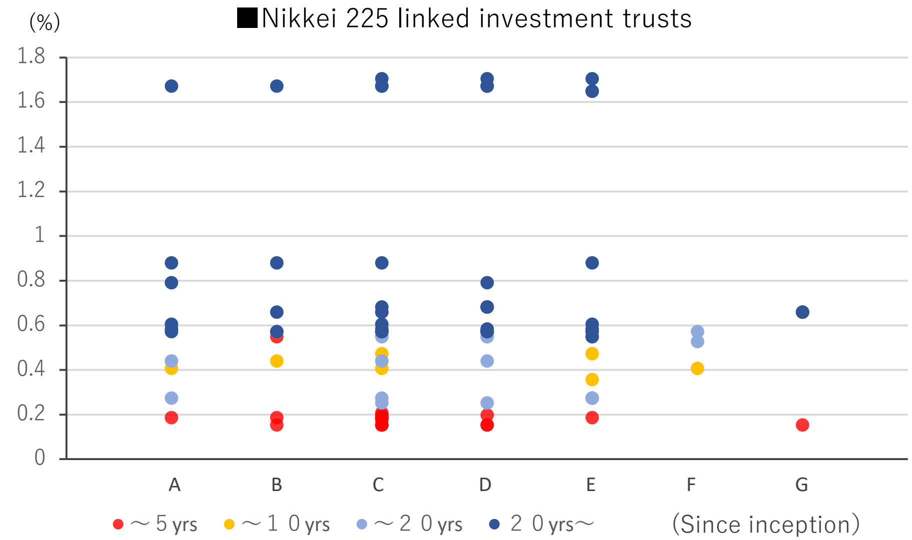




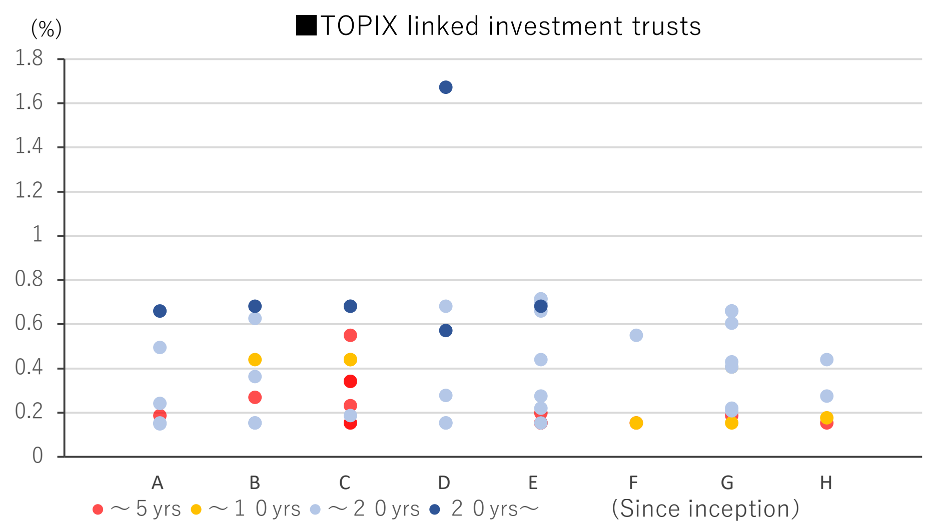
(Source) Prepared by the JFSA based on Quick data
(Note) Index funds extracted from publicly offered open-ended investment trusts investing in Japanese stocks (as of October 2020, excluding ETFs). The expense ratio is measured as simple average.

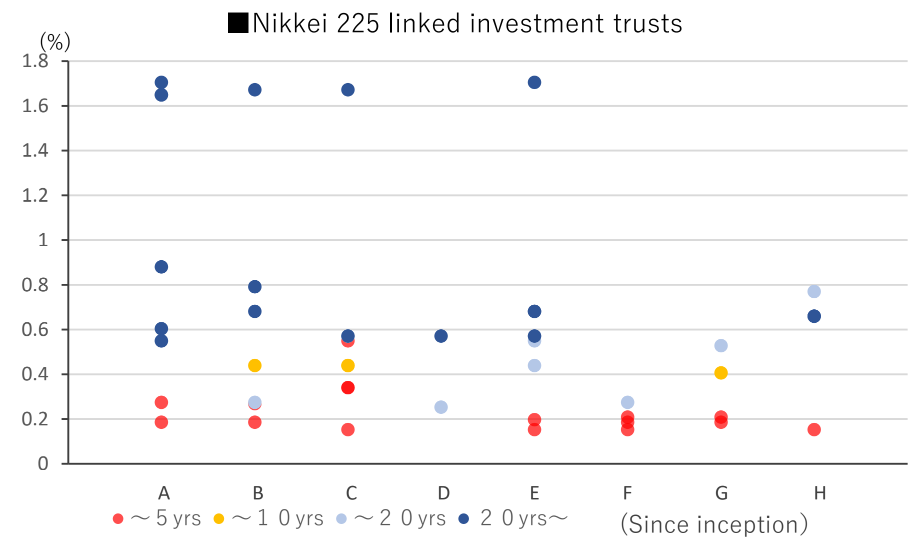
C. Trust fees for index funds provided through major distributors





D. Management fees for index funds managed by major asset management firms





(Note) Index funds extracted from publicly offered open-ended investment trusts investing in Japanese stocks (as of October 2020, excluding ETFs).

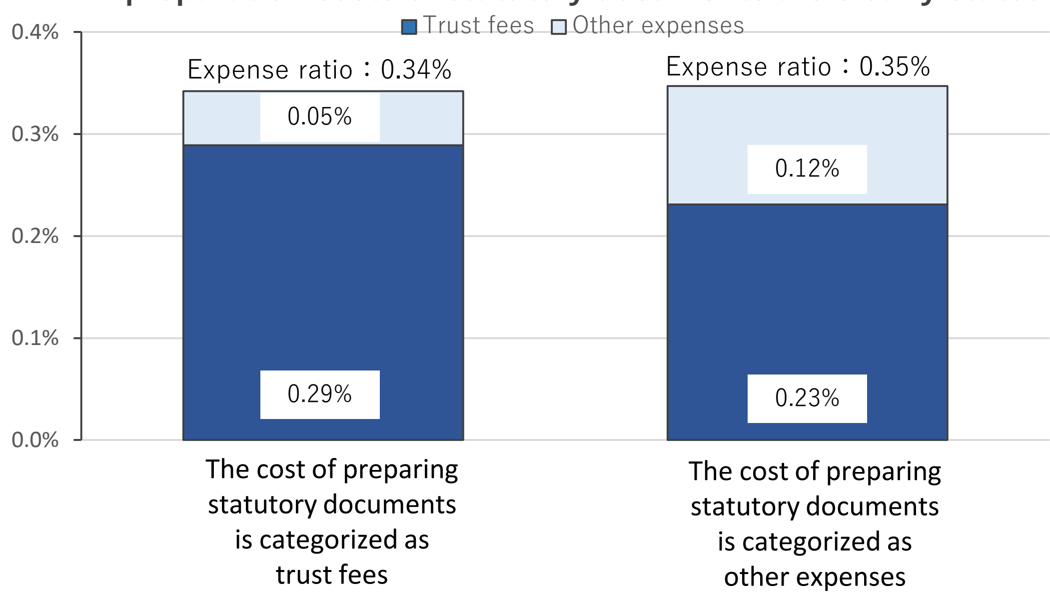
(Source) Prepared by the JFSA based on Quick data

1．Dialogue with asset managers to enhance asset management capabilities：
(4) Business operations－Viewpoint of prioritizing customers' interests and enhancing asset management capabilities / Business operations to realize the corporate vision and core competence

① Enhancing product governance iv) Issues on disclosure of product costs

- It has been pointed out that among trust fees, the treatment of the expenses categorized as "other expenses" vary from fund to fund. For example, while the expenses related to the preparation of statutory documents, e.g., prospectuses, are included in the fund management fees for some investment trusts, the expense is categorized as "other expenses" in other investment trusts.
- The same issue is found in the index funds which are selected as investment vehicles for the Tsumitate NISA, dollar-cost averaging NISA, one of Japan's new tax exemption schemes for mid-to-long term investment by individuals, in which several thresholds for fund management fees are strictly set. Although the cost to prepare the statutory documents are included in the trust fees for most index funds, the cost is categorized as "other expenses" in others. While these funds have relatively low levels of management fees, the proportion of the other expenses out of the total expenses becomes relatively high. (see the figure below). There are some funds that do not clearly classify the legal document preparation expenses in either fund management fees or other expenses. Transparency in expenses is required so that customers can easily understand the cost structure.
- There are some cases in which asset management firms received an administrative disposition since the treatment of some expenses unreasonably categorized them as "other expenses" and caused unreasonable burdens on beneficiaries.

Cost structure of index funds exclusively distributed for Tsumitate NISA in which details of preparation costs of statutory documents are clearly stated



(Note) Index funds exclusively distributed for Tsumitate NISA (excluding ETFs). Prepared by JFSA based on the latest investment report or prospectus in each fund(as of January 2021).
The expenses including management fees for underlying funds outsourced are not included. Other expenses include trading costs and so forth. The numbers(%) are rounded.

1． Dialogue with asset managers to enhance asset management capabilities：

(4) Business operations－Viewpoint of prioritizing customers' interests and enhancing asset management capabilities / Business operations to realize the corporate vision and core competence

② Employee retention and remuneration system

- Each asset management firm has implemented the following measures to secure and develop human resources with asset management expertise, e.g., introducing a self-developed remuneration system which mainly evaluates the employees' fund performance.
  - －An asset manager has started recruitment in each investment specialist course independently to obtain investment specialists.
  - －One of the asset management firms has renewed their personnel remuneration system by stretching the evaluation period from three to five years and making a difference in incentives for fund managers based on their fund performances.
  - －An asset management firm has expanded the coverage of the target employees for its own appraisal system which had been established to evaluate investment professionals but limited coverage so far.
  - －An asset manager with professional experience at another asset management firm was hired as a team leader in order to enhance the asset management capabilities of investing in Japanese equities.
- Each asset management company has introduced a new system independent from the Group's HR compensation system. However, each company needs to verify and improve the impact on rewards paid to fund managers, thus directly impacting fund performance.
- As it is considered indispensable to secure diverse human resources, such as alternative investments and the promotion of digital transformation (DX), it is necessary to establish the asset management company's own personnel system, which is different from the group personnel system.

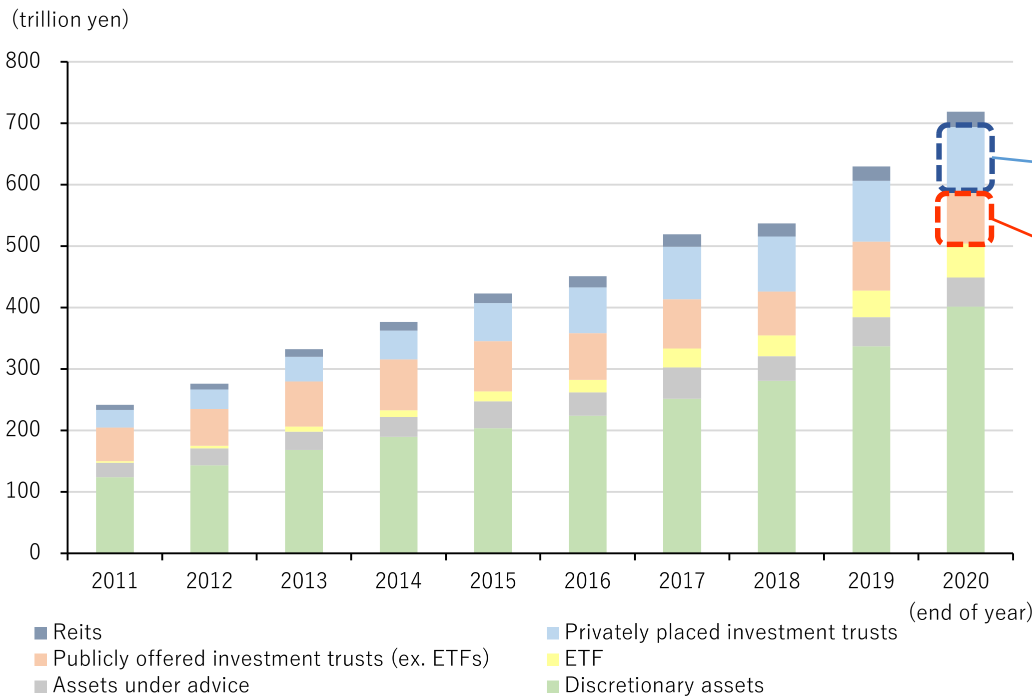
③ Business efficiency

- Some asset managers have taken the following initiatives to make business operation more efficient.
  - － A system has been established to enable fund managers to concentrate on asset management roles, such as making investment decisions, by reorganizing administrations and support tasks within the asset management division.
  - －Integration of mother funds among several index portfolios, data maintenance and automation of trading operations has led to the suppression of an increase in personnel that normally accompanies an AUM increase.
  - －In response to the COVID-19 situation, asset management firms have improved the efficiency of sales support, such as seminars for distributors, through digitalization on the condition of non-face-to-face meetings.
- It is necessary to pursue both asset management capability enhancement and cost reduction through the efficient utilization of artificial intelligence (AI) and mass data as well as digitalization.

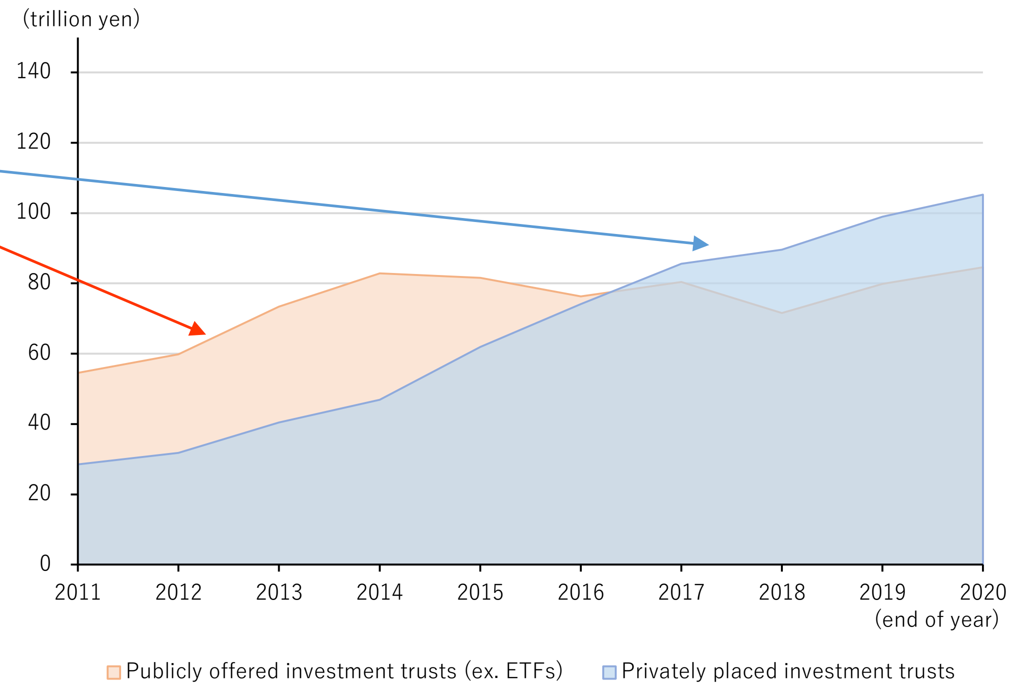
2. Privately placed investment trusts： (1) Market expansion and drivers

- The amount of entrusted investment by Japanese asset management companies has been increasing mainly in privately placed investment trusts and discretionary assets for institutional investors, and has exceeded 700 trillion yen in total including publicly offered investment trusts (Chart A).
- Among them, the balance of privately placed investment trust increased from about 30 trillion yen in 2011 to about 100 trillion yen at present (at the end of December 2020: 105.2 trillion yen). In terms of AUM, privately placed investment trusts have exceeded publicly offered investment trusts excluding ETFs (Chart B).
- It has been pointed out that the increase in privately placed investment trusts is attributable to the fact that some major financial institutions and regional financial institutions are utilizing them to invest in foreign bonds, etc., which are difficult to deal with on their own, on the back of lower domestic interest rates.

A. AUM trend



B. AUM trend of privately placed investment trusts and publicly offered investment trusts



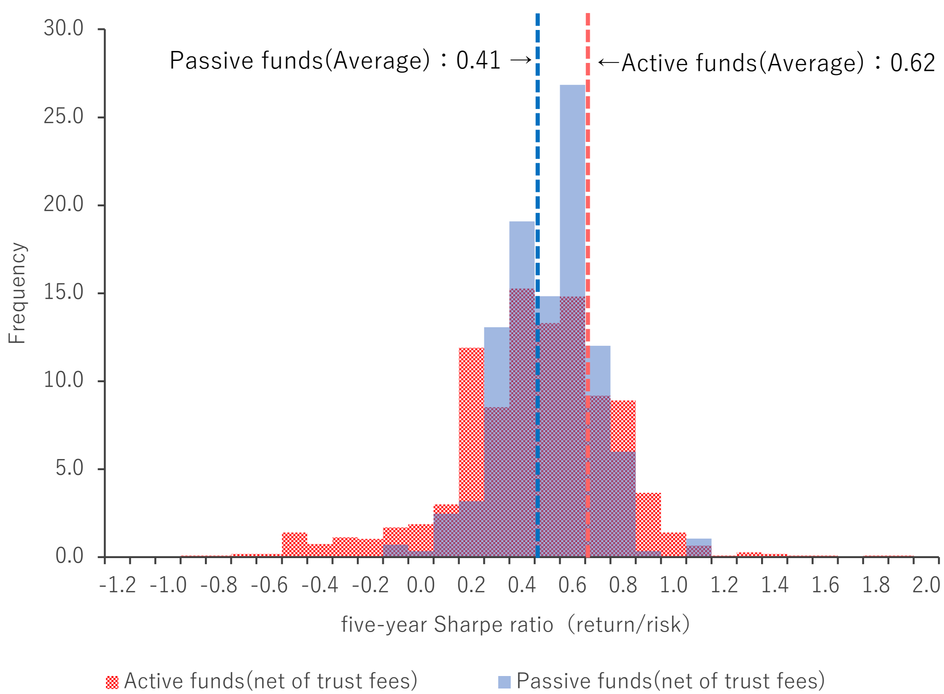
(Source) The investment Trusts Association, Japan(JITA) and the Japan Investment Advisors Association (JIAA)

2． Privately placed investment trusts ：（2）Costs and performance

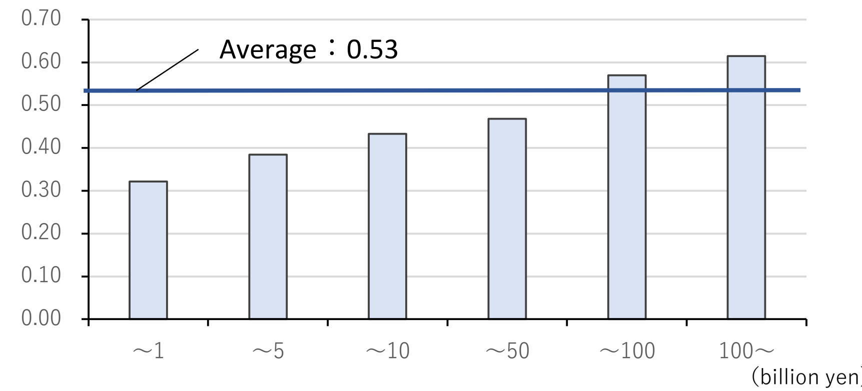
① Performance of privately placed investment trusts

- As to fund performance of privately placed investment trusts over the past five years on a total fund basis, the Sharpe ratio (average : 0.62) of active funds after deducting trust fees exceeds the ratio of passive funds (average : 0.41) (Figure A).
- The five year Sharpe ratio by asset size shows that the relation between the size and the Sharpe ratio tend to be directly proportional (Figure B), while the relation between the size and the trust fees tend to be inversely proportional (Figure C).

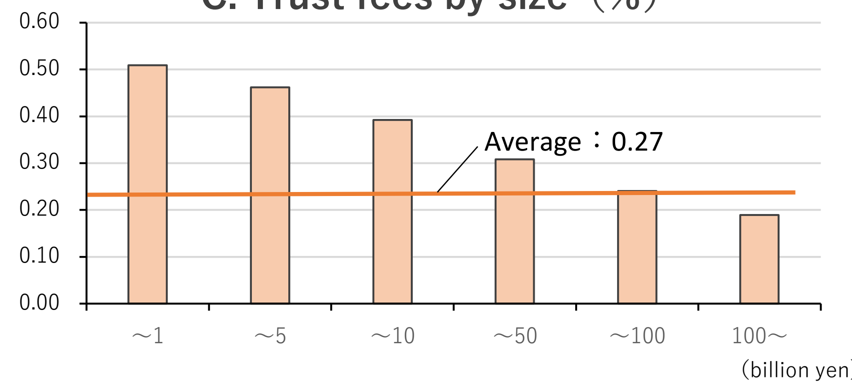
A. Sharpe ratio for private placements



B. Sharpe ratio by size



C. Trust fees by size（%）

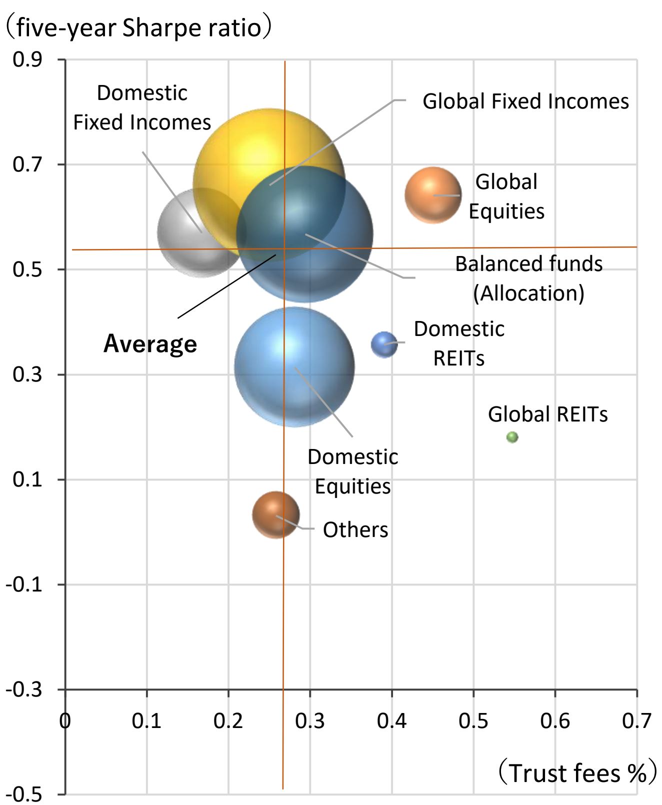


(Source) Prepared by JFSA based on documents submitted by major asset management companies with larger AUMs of private placement investment trusts.
(Note)Based on privately placed investment trusts as of December 31, 2020. Calculated as a weighted average of the five-year Sharpe ratio of each fund based on the AUMs at the beginning of the term, i.e., the end of December 2015.

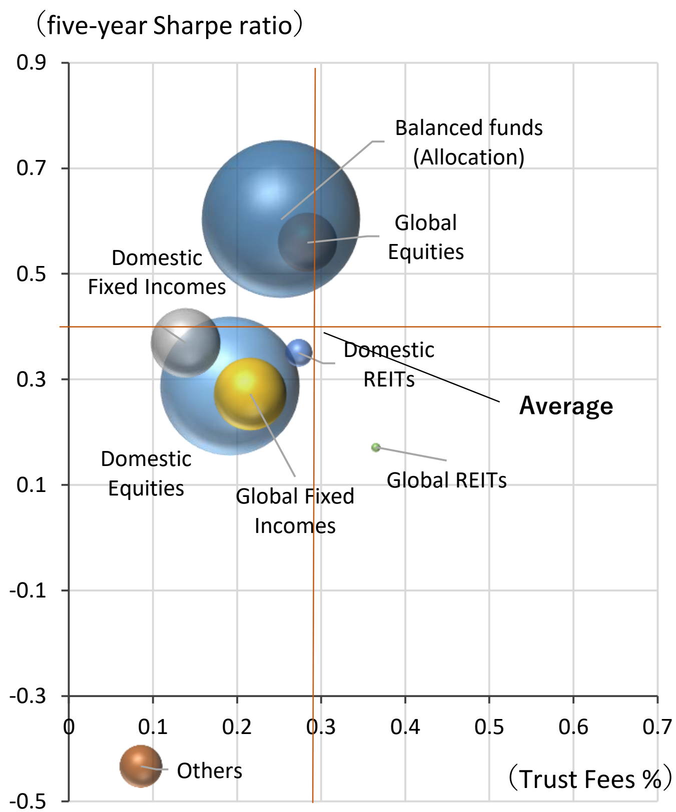
② Asset classes and cost/performance of privately placed investment trusts

- "Balanced funds (Allocation)" and "Domestic equities" account for a large percentage of the passive funds (Figure B), meanwhile "Global Fixed Incomes" occupy the highest proportion among active funds (Figure C).
- Among active funds, "Global Fixed Incomes" with lower trust fees account for a large percentage. The low volatility of these funds during the past five years mainly causes the higher Sharpe ratio than that of passive funds.

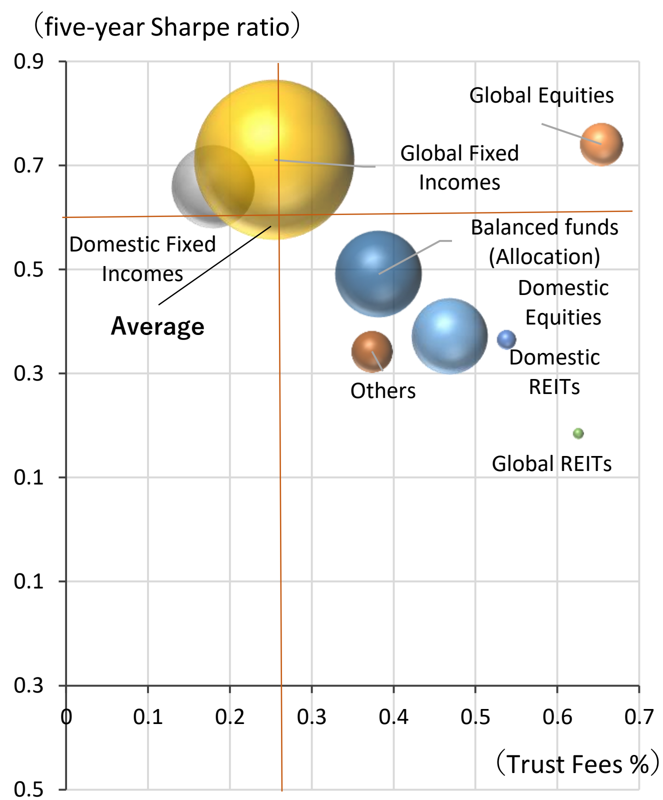
A. Total: privately placed investment trusts



B. Passive funds



C. Active funds

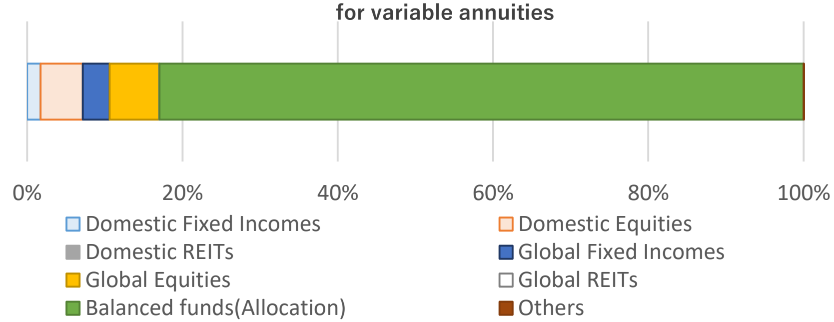


(Source) Prepared by JFSA based on documents submitted by major asset management companies with larger AUMs of private placement investment trusts.
(Note)Based on privately placed investment trusts as of December 31, 2020. Calculated as a weighted average of the five-year Sharpe ratio of each fund based on the AUMs at the end of December 2015. The size of the bubbles in the charts indicates the relative scale of AUM.

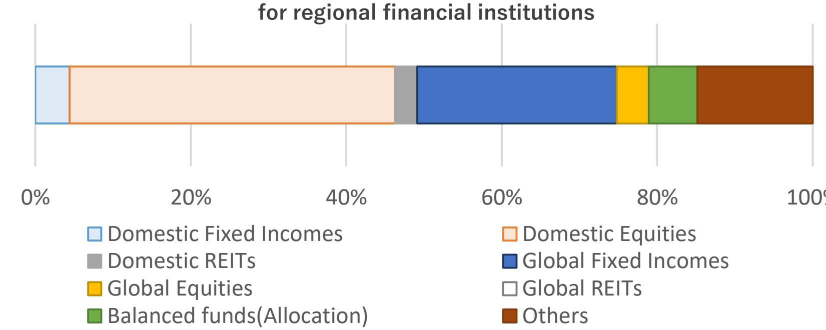
2. Privately placed investment trusts : (3) Investment status of variable annuity insurance and privately placed investment trusts for regional financial institutions

- Balanced funds(Allocation) account for a large proportion of privately placed investment trusts developed for variable annuities, and trust fees for some balanced funds are set more than 1% per annum similar to those of publicly offered investment trusts for individual investors. While passive investment is progressing globally, a fair trust fee level is desirable for privately placed investment trusts developed for variable annuities as well(Figures A and C).
- On the other hand, domestic equities and global fixed incomes occupy the majority of privately placed investment trusts for regional financial institutions, etc., and the level of trust fees has been kept relatively low.(Figures B and D).

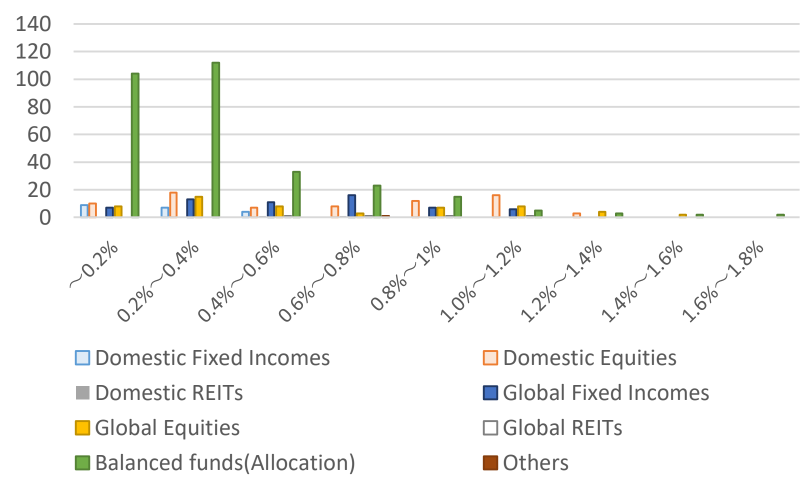
A. Asset class weights of privately placed investment trusts for variable annuities



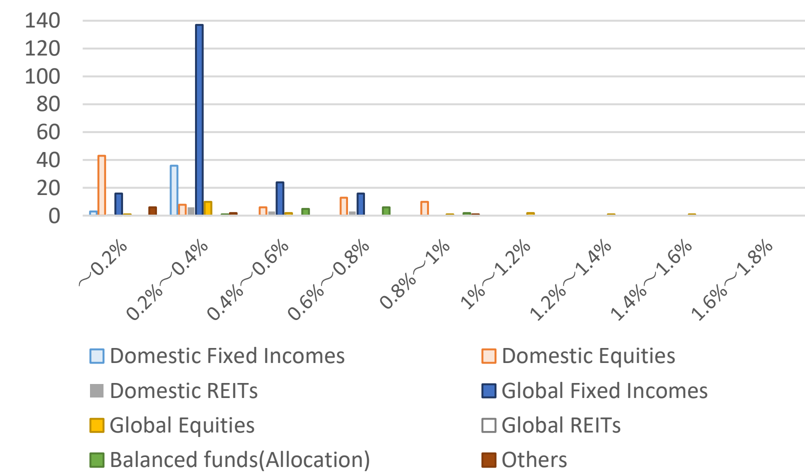
B. Asset class weights of privately placed investment trusts for regional financial institutions



C. Trust fees of privately placed investment trusts for variable annuities



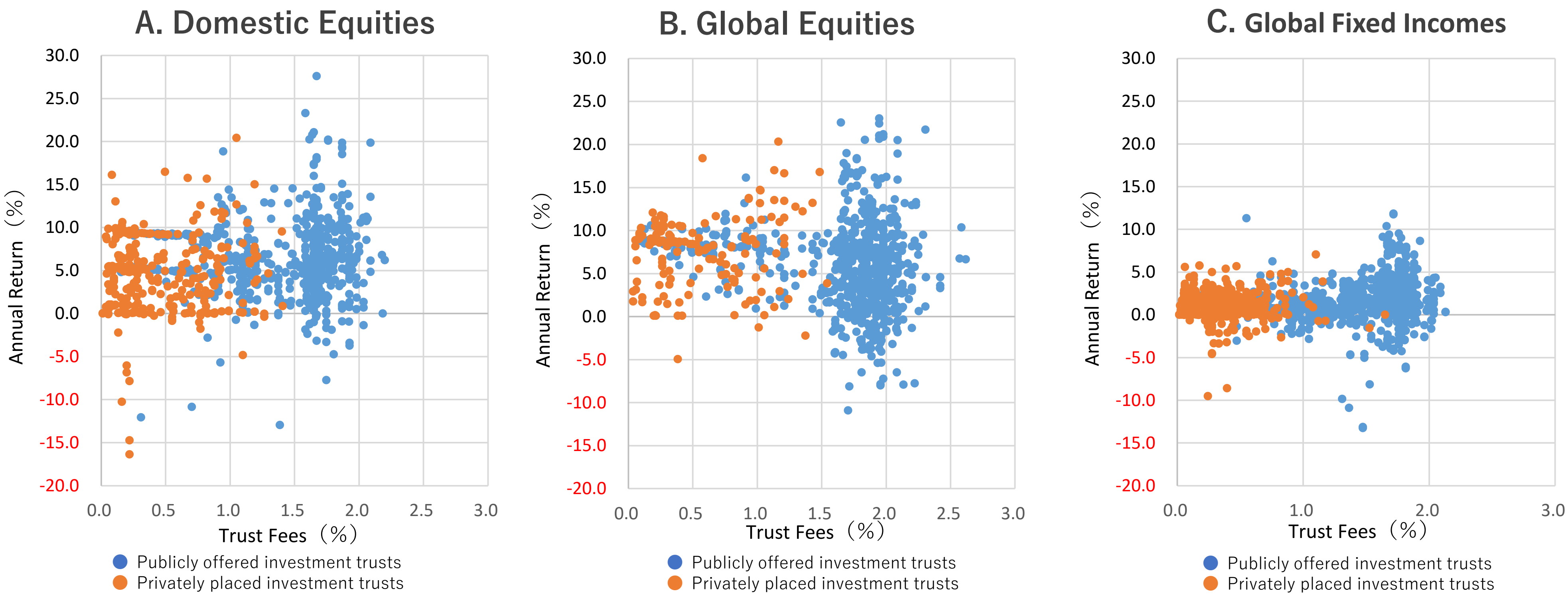
D. Trust fees of privately placed investment trusts for regional financial institutions



(Source) Prepared by JFSA based on documents submitted by major asset management companies with larger AUMs of private placement investment trusts.
(Note)Based on privately placed investment trusts as of December 31, 2020. Calculated as a weighted average of the five-year Sharpe ratio of each fund based on the AUMs at the end of December 2015. The size of the bubbles in the charts indicates the relative scale of AUM.

2. Privately placed investment trusts : (4) Performance comparison between publicly offered investment trusts and privately placed investment trusts

- Per a comparison of publicly offered investment trusts and privately placed investment trusts, the trust fees of privately placed investment trusts are generally lower, and their annual returns vary less than those of publicly offered investment trusts.
- Among domestic and global equities, there are several publicly offered investment trusts with trust fees as low as those of privately placed investment trusts (Figures A and B), meanwhile as for global fixed incomes, the difference in trust fees among them is larger (Figure C).
- In improving fund performance for publicly offered investment trusts, it is considered as a significant factor to improve investment efficiency and control costs by expanding the scale of investment.



- Individual investment trusts are plotted for each asset class according to the level of annual returns and trust fees over the past five years up to the end of 2020. Investment trusts without five year track records are excluded.
- The linear distribution of points for domestic and global equities is considered as passive funds with different trust fee level.
- There are very few privately placed investment trusts with negative returns for domestic and global equities. This can be attributed to the fact that the funds were originally designed to suppress downside risk, and also funds with poor performance tend to be redeemed immediately.

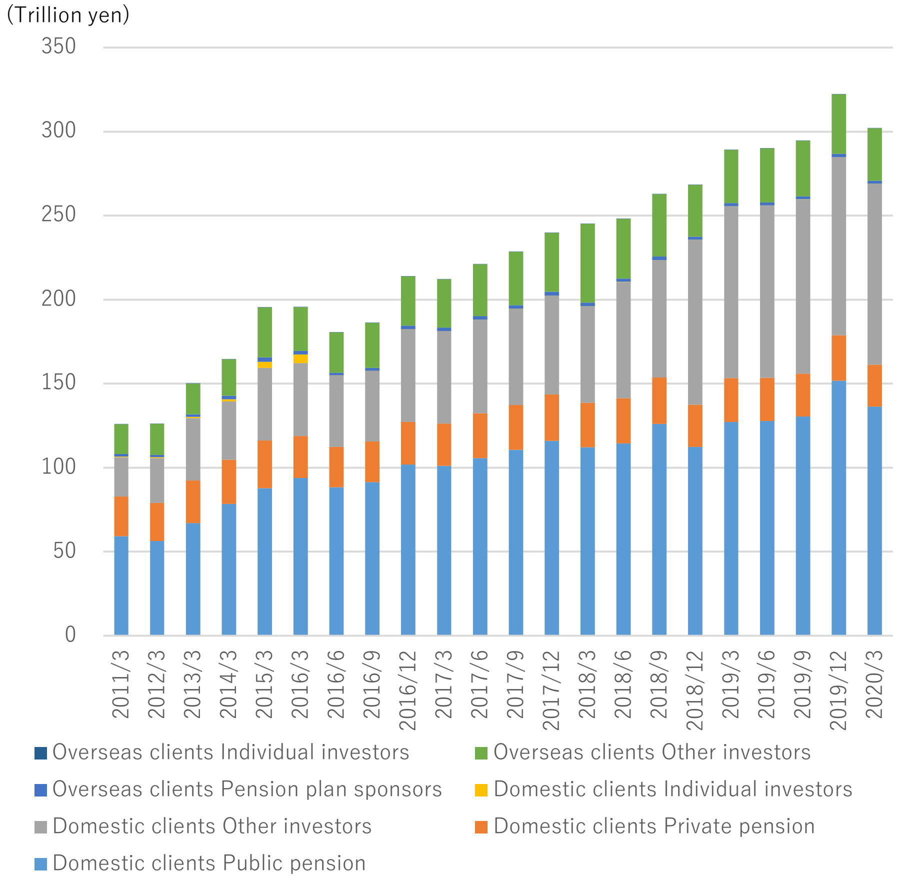
(Source) QUICK, Prepared by the JFSA based on documents submitted by major asset management companies with larger AUMs of private placement investment trusts.

3. Discretionary investment management (1) Expansion of the discretionary investment market

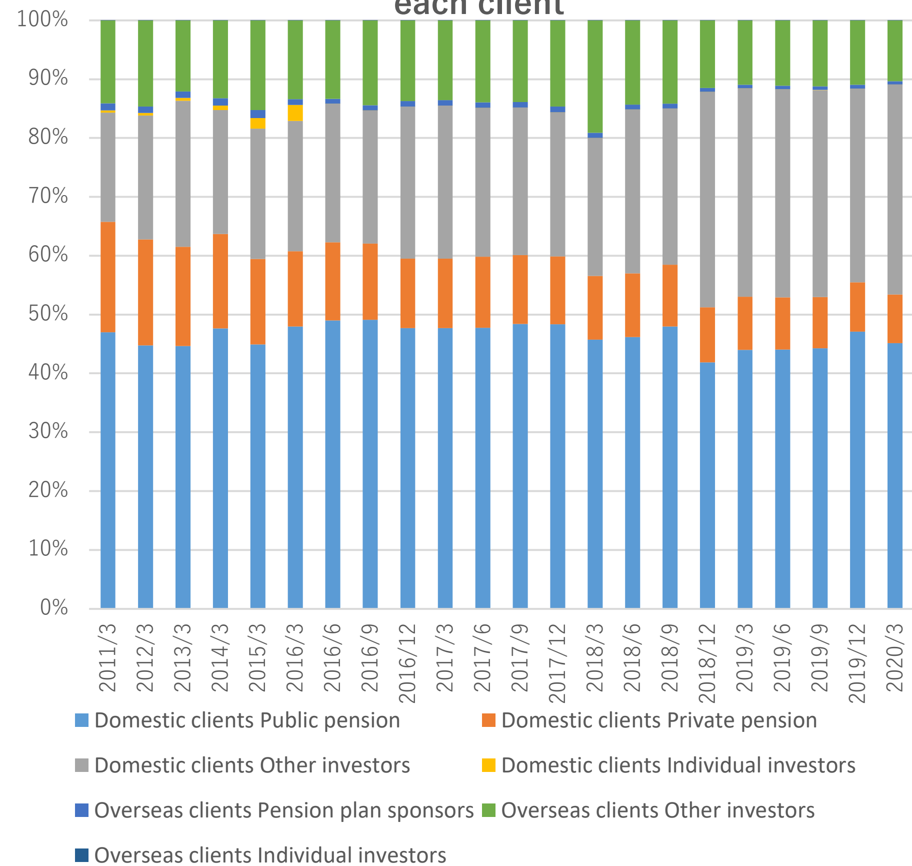
- AUM for discretionary assets has been increasing mainly in "domestic clients (other)" and "domestic clients - public pension plan sponsors" (※)

※ "Domestic clients (other)" include the impact by banks and insurance companies that transfer their investment functions to their asset management subsidiaries within the financial group. In terms of "Domestic clients - public pension plan sponsors", an increase in AUM has resulted from changes in the asset allocation of the clients' portfolios as well as an increase in market value.

A. Discretionary assets: AUM by each client



B. Discretionary assets: Proportion of AUM by each client

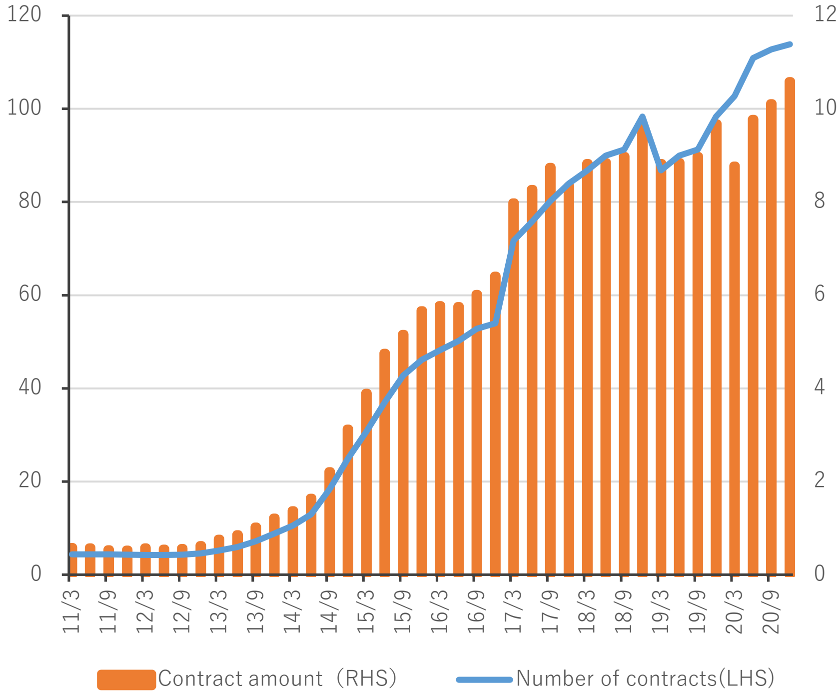


(Source) Japan Investment Advisors Association

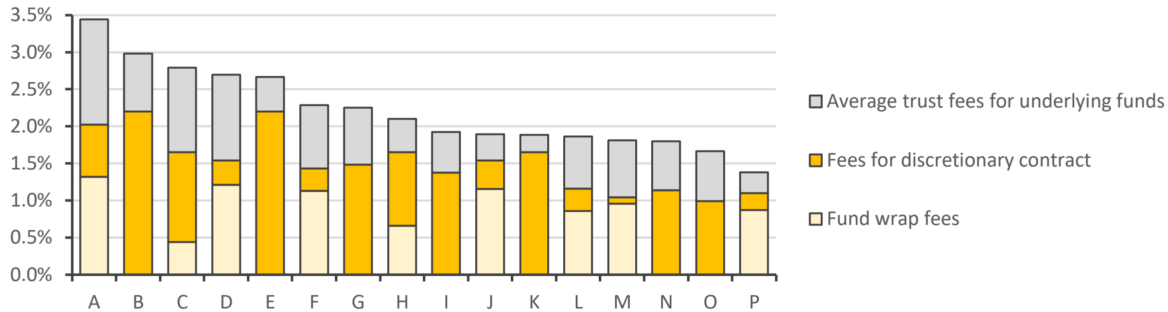
3． Discretionary investment management （2） Fund wrap

- Fund wraps, discretionary contracts for individuals, have been increasing in recent years (Figure A)
- In addition to fund wrap fees, the costs charged to fund wrap customers include the fees for discretionary contracts and also trust fees for underlying investment trusts to invest in (Figure B). Overall, average performance after deducting these fees is inferior to that of balanced funds (Figure C)
- It is expected that distributors aiming at fee-based management reconsider the appropriate approach to providing products and services from the perspective of customers' interests.

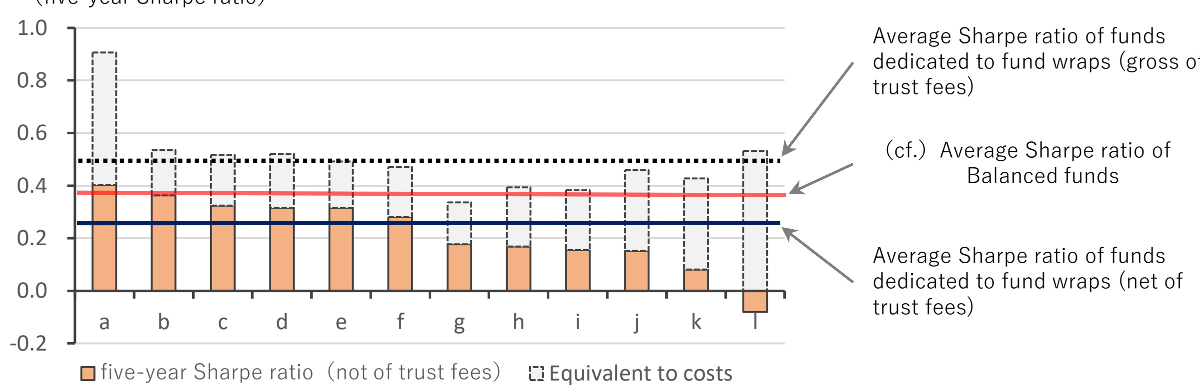
A. Fund wrap （Discretionary assets）



B. Fund wrap - Cost structure （ratio of each fees to AUM、annualized）



C. Five-year Sharpe ratio for funds dedicated to fund wraps



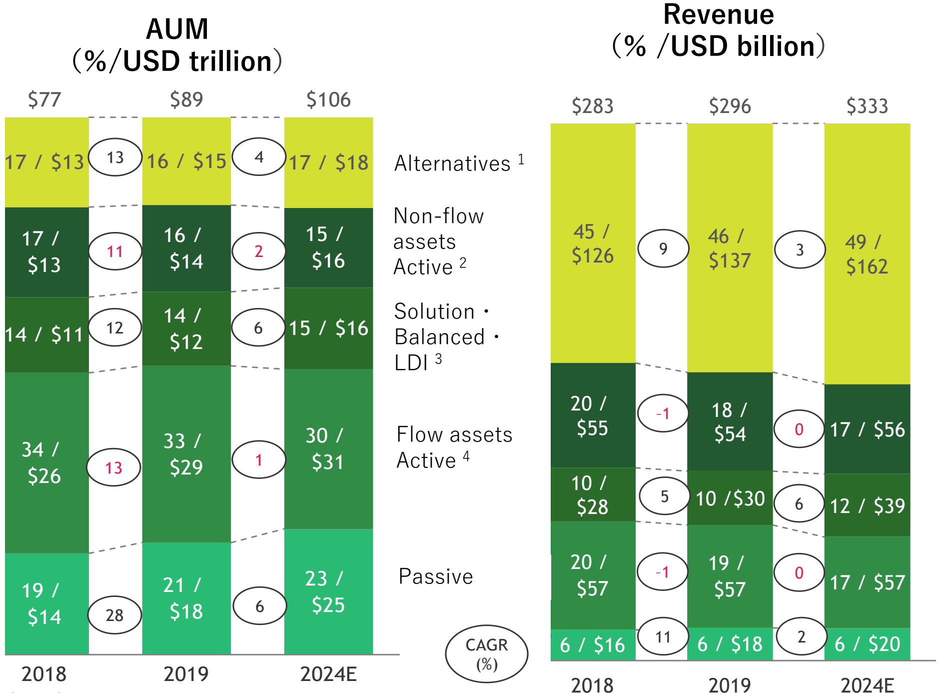
(Note) Data in Figures B and C are as of the end of 2020. Figure C based on funds with a five year performance track record. The funds are wrap accounts, which invest in domestic open-end stock investment trusts and foreign investment trusts sold in Japan, and investment trusts dedicated to fund wraps. Robo-advisors that directly invest in foreign ETFs are not included. For fund wrap fees and discretionary investment management fees (fixed remuneration), the maximum and minimum average values (or flat values) are calculated. If there is no difference between the maximum and minimum, i.e., the flat value, the maximum value (flat value) is adopted. There are fund wrap fees that include fund wrap fees in discretionary investment management fees. Each Sharpe ratio (average) is the net amount of trust fees. The average Sharpe ratio for balanced funds is the gross amount of trust fees.

(Source) Japan Investment Advisors Association , Prepared by JFSA based on QUICK Data

1. Global Asset Management Trends and Domestic current status : (1) Expansion of Alternative investment

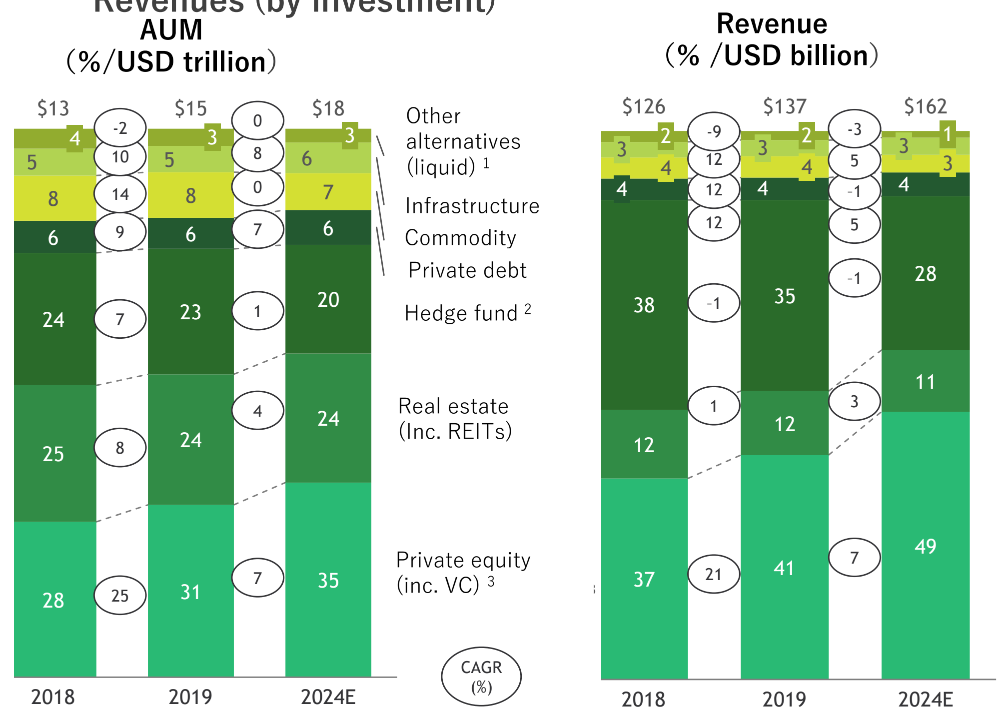
- Alternative investment is expected to continue growing (Figure A). In terms of AUM, alternative investment accounts for over 10%, the income provided by which takes up approximately half of the total income.
- Globally, private equity investment is growing and accounts for a large share of the revenues (Figure B)
- Japanese asset management companies have also been enhancing their business operations for alternative investment by consolidating asset management functions within their financial groups, acquiring overseas asset managers with expertise in managing alternative assets, and strengthening capabilities to discover potential alternative products overseas.

A. Assets under management and revenue by global asset class



(Note)
1. Hedge funds, private equity, real estate, infrastructure, commodities, private debt, etc.
2. Stock specialized types (overseas, global, emerging markets, small and medium-sized stocks, sectors) and bond specialized types (emerging markets, global, high-yield, convertible)
3. Target Dating, Global Asset Allocation, Flexible Income, Liability Driven, Balanced, etc.
4. Actively managed domestic large equities, domestic government / corporate bonds, money markets, and securities markets.

B. Global Alternative Investment Portfolio and Share of Revenues (by investment)



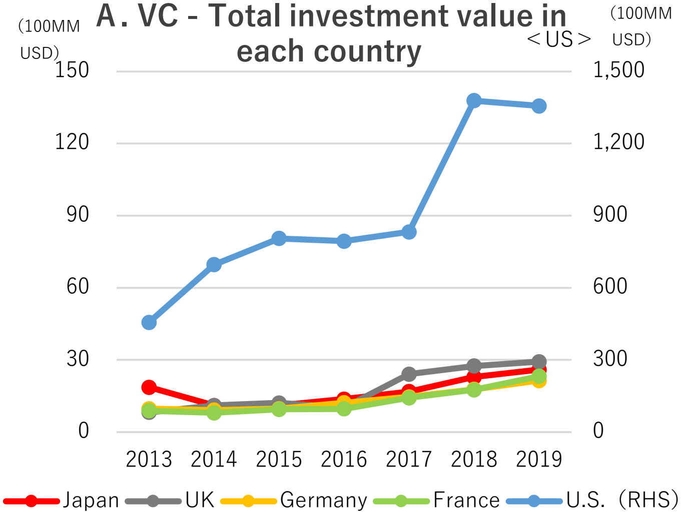
(Note)
1. Absolute returns, Long / Short, Market Neutral, Volatility Transactions, etc.
2. Includes hedge funds and funds of funds but excludes performance-linked fees from revenues.
3. Includes private equity funds of funds and excludes performance-linked fees from revenues.

(Source) Boston Consulting Group

【Column ⑤】Expected roles and issues of alternative investments including VCs and PE funds

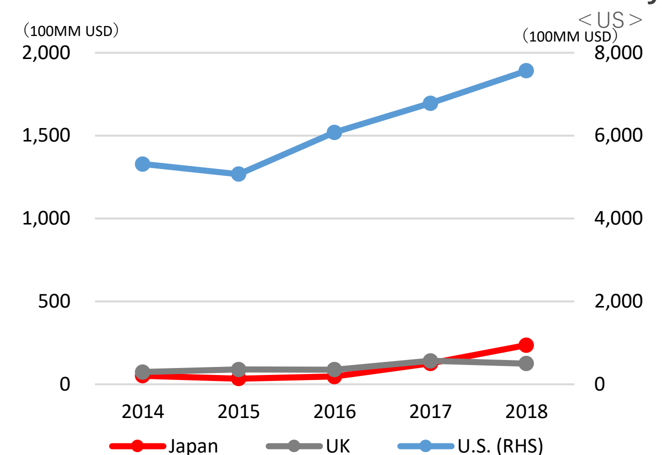
- Although alternative investments such as VCs and PEs are increasing in Japan, there is a significant gap between the U.S. and Japan (Figures A and B). In terms of PEs in Japan, individual transactions are generally small, meanwhile overseas general partners take up a large share of big deals (Figure C).
- In the U.S., PEs are recognized as a general investment by asset owners such as pension funds. Furthermore, some progress with PEs has been made toward ensuring transparency and advancing as an option for investors by introducing necessary regulations and supervision in Europe and the United States (Figure D).

A. VC - Total investment value in each country



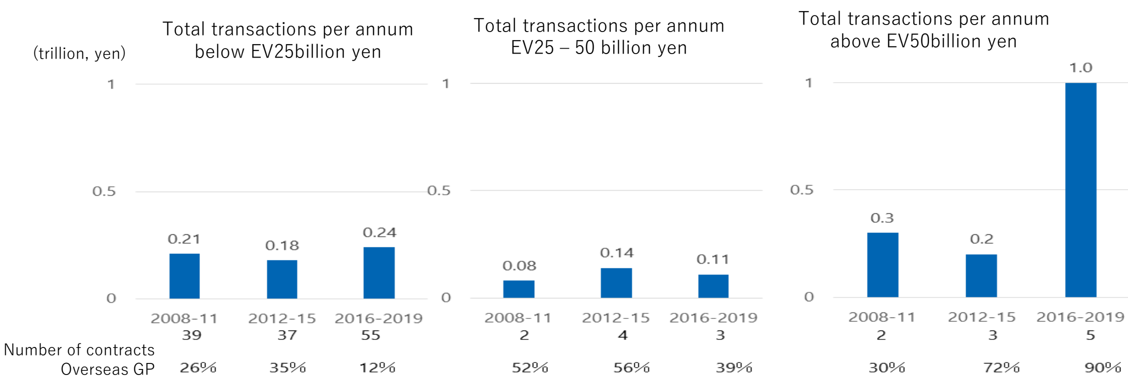
Source : Prepared by the Financial Services Agency based on OECD materials and Venture Enterprise Center materials

B. PE - Total investment value in each country



(Note) Figures for the United States include debt.
Source : Japan Private Equity Association (JPEA) materials, Pitchbook's "US PE Breakdown", prepared by the Financial Services Agency based on materials from British Private Equity & Venture Capital Association

C. Trends in Japan's PE by Size



(Note) EV : Corporate value = Share value + Net interest-bearing debt (Net debt : Interest-bearing debt - Cash and deposits)

(Source) Bain & Company (2019) "Japan Private Equity Report 2019"

D. Trends in PE Regulation and Supervision in US and Europe

○ US

- ✓ Following the global financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the registration of PE funds and stricter regulations.
- ✓ Partial lifting of restrictions on PE investment to improve investment returns for pension funds in 2020.
- ✓ Financial authorities announced that it is not a breach of fiduciary duty if 401k trustees provide PE funds.

○ Europe

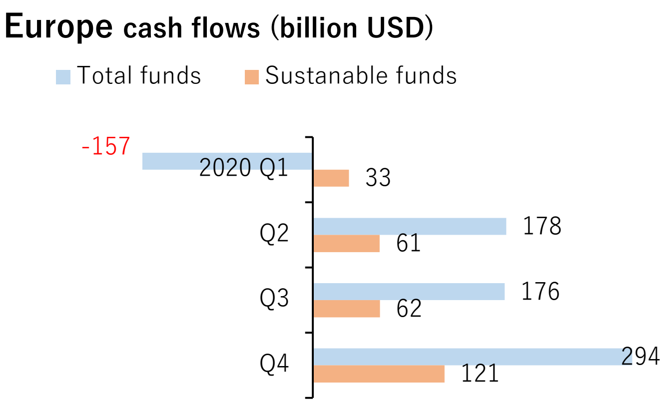
- ✓ Set strong legal requirements for managing and operating PE funds in order to improve transparency, liquidity and so forth.
- ✓ Reflect the Senior Managers Regime (SMCR) in PE funds and require greater responsibility for management

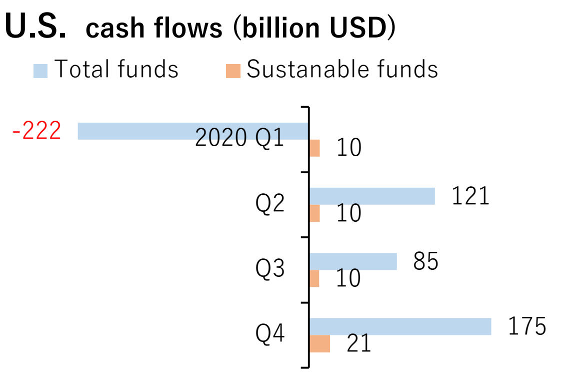
(Source) Boston Consulting Group

1．Global asset management trends and domestic current status :
(2) Expansion of sustainable related investments and approaches to sustainable investments such as diversity

- The AUM of ESG and sustainable related funds has been increasing. In the first quarter of 2020, although most funds faced cash outflow due to the impact of COVID-19, there was a continuous cash inflow into sustainable funds (Figure A).
- At overseas asset management companies, there were some developments to enhance sustainable investments, including diversity, and engagement (Figure B).

A. Trends in Sustainable Funds





(Source) Morningstar
(Note) US： US mutual funds
Europe： Funds domiciled in 27 Europe countries

B. Approaches to sustainable investments such as diversity by overseas asset management companies

- ✓ Clarifying a policy for proxy voting, e.g., requiring investee companies to increase the number of female directors and opposing any appointment of directors if they do not meet criteria.
- ✓ Excluding certain assets from the investment universe from the sustainability risk perspective
- ✓ Requesting investees to disclose business plans pertaining to the response to climate change
- ✓ In stewardship activities, stressing proxy voting pertaining to shareholder proposals on sustainability (in cases where investee companies are not sufficiently responsive, asset managers agree upon shareholder proposals to further counter climate change or to oppose the appointment of directors, and so forth)

【Column ⑥】Diversity initiatives in Japan

- The revised Stewardship Code (as of March 24, 2020) stipulates that consideration of sustainability (medium- to long-term sustainability including ESG factors) consistent with their investment management strategies is included in institutional investors' stewardship responsibilities.
- In the revised Corporate Governance Code (as of June 11, 2021), as an appropriate cooperation with stakeholders other than shareholders of listed companies, it was stipulated that "Companies should present their policies and voluntary and measurable goals for ensuring diversity in the promotion to core human resources, such as the promotion of women, foreign nationals and midcareer hires to middle managerial positions, as well as disclosing their status". [Supplementary Principle 2-4 ①]. The Code also states as the responsibilities of the board that the board should be constituted in a manner to achieve both diversity, including gender, international experience, work experience and age, and appropriate size. [Principle 4-11]
- In addition, the revised Guidelines for Investor and Company Engagement (as of June 11, 2021) stipulates the checking of whether "the board of directors is constituted in a manner such that it is equipped with appropriate knowledge, experience, and skills as a whole and ensures diversity, including gender, international experience, work experience and age" and whether "there are women appointed as directors", in order to generate sustainable growth and increase corporate value over the mid- to long-term. [3-6]
- Listed companies are required to state the visualization of diversity initiatives in the corporate governance reports. It is expected that asset management companies will clarify how to engage in dialogue with investee companies on their diversity initiatives, and how to encourage improvement of enterprise value and sustainable growth through engagement.
- The JFSA will pay close attention to progress of dialogues by asset management companies, and will follow up on the status by utilizing the Advisory Council., etc.

【Examples of Diversity Dialogue at Domestic Asset Management Company】

- ✓ An asset manager clearly states the following points as a policy of stewardship responsibilities pertaining to dialogue with companies: "whether human resource strategies are implemented appropriately, such as diversity initiatives which take into account internationalization and the promotion of women," and "whether the composition of the board of directors reflects diversity from various viewpoints"
- ✓ The criteria for judgement regarding exercise of voting rights at an asset management firm should include: "the composition of the board of directors is expected to pay full attention to diversity (gender, nationality, experience, age, length of service and so forth)," "it is desirable to select at least one female director," and "if a female director or auditor is not elected without rational explanation, vote against the reappointment of directors."
- ✓ Company A has a large percentage of global market shares but no female directors and auditors. In dialogue with Company A, an asset manager explained the necessity of ensuring diversity within the board of directors and expansion of the number of women in managerial and executive posts. As a result, Company A newly appointed a female director.
- ✓ In dialogue with Company B, an asset management firm conveyed that the firm may oppose the appointment of directors if no female director is included in the list, and Company B newly appointed a female director.
- ✓ Company C implemented a personnel measure which enables women to develop their careers without leaving the company in response to women's various life events. An asset manager suggested Company C to enhance non-financial information by publicly announcing such initiatives. In response to the suggestion, Company C has ensured disclosure of non-financial information and has delivered a clear message externally.

1. Global asset management trends and domestic current status :

(3) Movements to strengthen DX initiatives

- Asset management firms have been continuously working on DX initiatives.
- There are several approaches to enhancing DX initiatives, such as the utilization of alternative data in the asset management process, expansion of digital remote channels for customer communications, and effective use of AI to improve operational efficiency and automation.

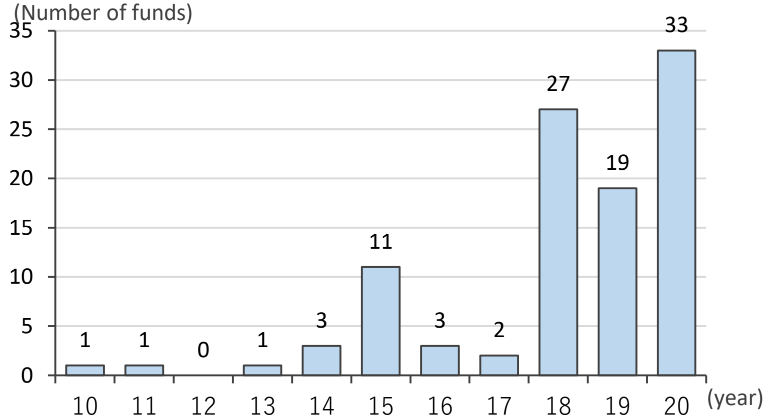
DX Initiatives in Asset Management Operations

- ✓ Supporting existing analysts with corporate research and ESG data analysis conducted by the data scientist team
- ✓ Making the most of analysis of alternative data at major hedge funds
- ✓ Utilization of digital marketing to enable asset management companies to develop their own expertise. e.g., providing product information through applications or advisory services with robot advisors in response to various needs from retail channels such as RIA (Retail Investment Advisory), direct sales and so forth.
- ✓ Use of contents such as videos and social media in order to improve brand images in the Asia region
- ✓ Subcontractors of asset administrations provide asset management firms with services to improve the efficiency of investment research utilizing AI and encourage automation and labor-saving of back-office tasks

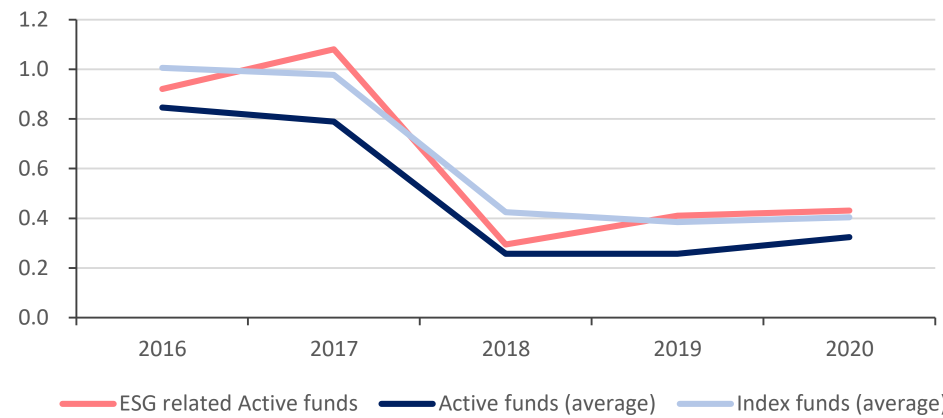
(Source) Nomura Research Institute

- As interests in ESG and SDGs have increased in recent years, the development and sales of active funds related to ESG and SDGs have increased (Figure A). Although the size of these funds is small compared with the overall market size of equity funds, the growth rate of AUM is high (Figure B).
- When the performance of these funds is compared with the overall average of active funds and also the overall average of index funds, the results differ depending on the measurement period (Figure C), making it difficult to evaluate them unconditionally. Meanwhile, the cost (trust fees) level tends to be higher than the average costs of active funds (Figure D).

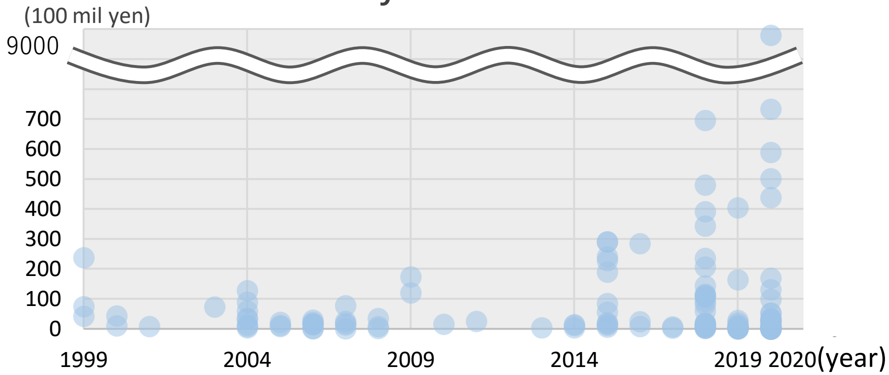
A. Number of ESG-related Funds Newly Established



C. ESG-related Fund Performance (5-year Sharpe Ratio)



B. Establishment year and net assets of ESG-related funds



D. Organizing the Price / Performance of ESG-Related Funds

Classification	Total trust fees (%)	five-year Sharpe ratio	three-year Sharpe ratio	one-year Sharpe ratio
ESG related Active funds (average)	1.44	0.3	0.11	0.32
Active funds (average)	1.23	0.14	0.03	-0.02
Index funds (average)	0.47	0.26	0.17	-0.02

(Note) Domestic publicly offered investment trusts at the end of December 2020, (excluding ETFs, etc., data in Figure D as of the end of October) The Sharpe ratio for each fund category is calculated on a simple average basis. "ESG-related funds" are expediently defined as any funds clearly stating as a investment policy to focus on "ESG, impact investment, SDGs, SRI, CSR, environment, corporate governance, women's empowerment and human resources."

(Source) Prepared by JFSA based on QUICK data

- It is pointed out that criteria for stock selection in ESG-related funds vary among individual funds and are not clear (Figures A and B). In addition, the details of the evaluation method for ESG achievements is not disclosed in prospectuses.
- There are no major differences in ESG scores between ESG-related funds and other funds (Figure C). Basically, it should be noted that there are various types of ESG score, and the calculation methods also differ depending on ESG data providers.

A. Major investment methods for ESG

Investment Method	Description
Negative screening	Excluding stocks in specific industries and themes such as weapons, etc., from a fund/portfolio
Positive/Best-in-class screening	Investing in stocks with higher ESG ratings relative to their industry peers
Norms-based screening	Screening of investments based on international norms such as United Nations Global Compact(UNGC)
ESG integration	ESG considerations in the stock selection process
Sustainability themed investing	Investment in themes related to sustainability such as climate change, renewable energy and so forth
Impact/ Community investing	Investing in businesses aiming to solve social or environmental problems
Corporate engagement and shareholder action	Influencing corporate behavior with the use of shareholder power

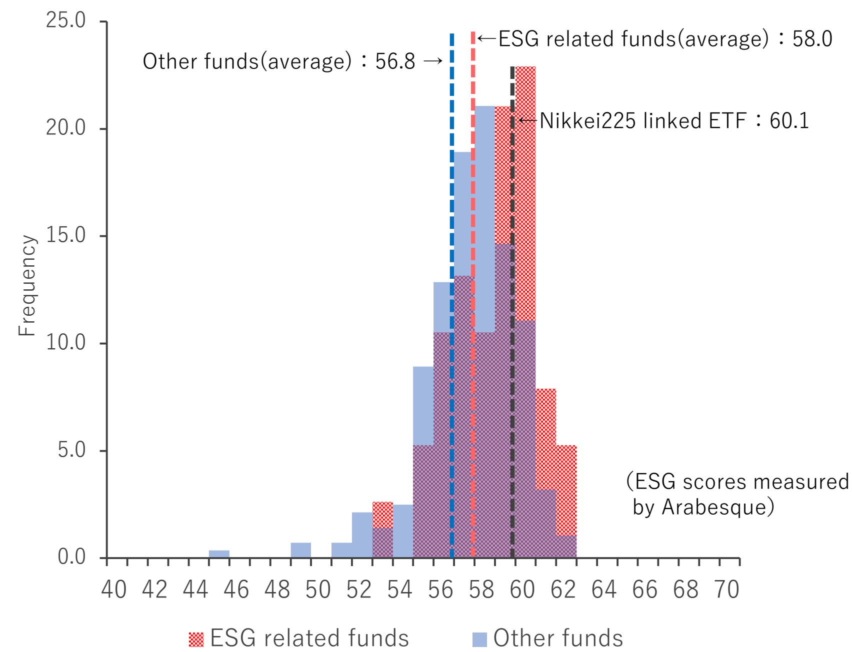
（Source） Global Sustainable Investment Review 2018

B. Actual cases of stock selection criteria for ESG-related funds

① Selecting targets of investment through quantitative analysis from the higher ESG rating stock universe after screening based on the ESG evaluation criteria

② Selecting investments based on multiple evaluation criteria for quantitative analysis including ESG

C. Comparison of ESG scores for domestic equity funds



（Note）
- The ESG scores measured by Arabesque, a German ESG data provider, are given to the stocks consisting of a fund(100 is the highest score). The fund's ESG score is calculated by summing up the individual scores weighted by the investment values of the constituents.
- Funds with a total weighting of 70% or more of stocks with ESG scores in domestic equity funds
- ESG scores are calculated based on stocks included in the "Schedule of Securities" section of the securities report as of the latest closing date.

（Source） Prepared by JFSA based on QUICK data

【Column⑦】Public comment on the fund names rule by the U.S. SEC

- In March 2020, the Securities and Exchange Commission (SEC) of the United States solicited public comments on the Fund Naming Restrictions under the Investment Companies Act of 1940 (Names Rule), which established rules pertaining to fund naming to prevent investors from misunderstanding the asset management status due to misleading fund names. The purpose of this public comment is to seek opinions on the limitations of and possible improvements to the current regulations in light of the various investment methods in recent years.
- One of the SEC's concerns is that, while there is an increase in the number of funds with the "ESG" designation in the US, there should be a qualitative aspect in evaluating what "ESG" refers to, and there are some cases in which it is difficult to determine whether it is in conflict with their fund names or not.
- The received public comments are disclosed on the SEC's website, but no specific schedule concerning, for example, system reform has been publicized.

Overview of the Names Rule

- ✓ Enforced in 2001
- ✓ When a fund name is prefixed with a specific asset class, industry, or country/region, the fund must invest more than 80 percent of AUM in the asset category.
- ✓ Investors must be notified at least 60 days in advance of any changes in the investment policy above.
- ✓ Description of "investment methods" including use of derivatives in the name of the fund, is not subject to the Names Rule.

Current regulatory challenges

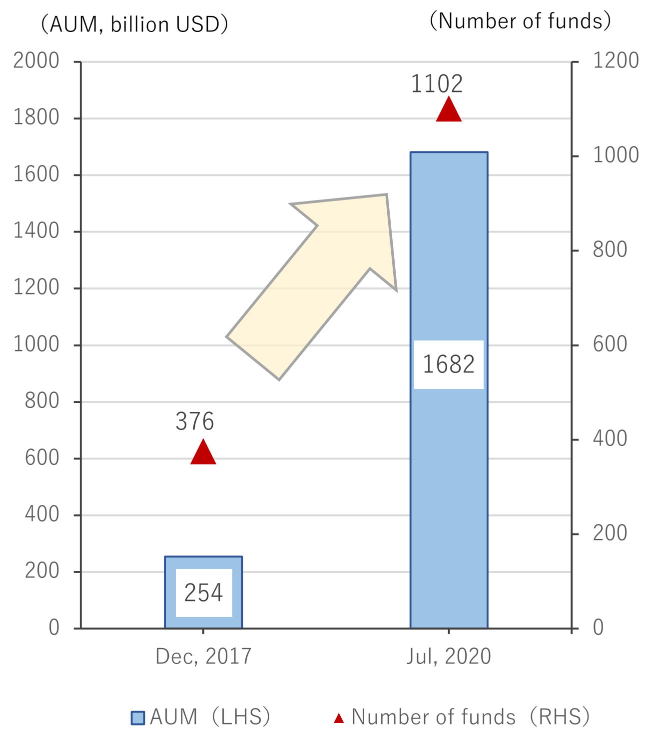
- ✓ Increase in the number of funds whose fund names include investment methods such as derivatives.
- ✓ Increased investments in assets with both equity and bond characteristics, such as convertible bonds.
- ✓ Increase in the number of index funds (MSCI, S&P, etc.) under the name of "benchmark", which is outside the scope of application of this regulation.
- ✓ Tendency to set fund names which can attract investors' attention easily under intensified competition.
- ✓ Increase in the number of funds with the “ESG” designation, which is difficult to evaluate quantitatively.

(Source) The Securities and Exchange Commission (SEC) of the United States

【Column⑧】Discussion at the U.S. SEC Asset Management Advisory Committee

- In the first quarter of 2020, the ESG Sub-Committee was established under the Asset Management Advisory Committee which was set up in the SEC and consists of outside experts. The ESG Sub-Committee is planning to submit recommendations to the SEC mainly on disclosure issues of ESG investment products during 2021. A draft was released in December 2020.
- The recommendations are broadly divided into two categories : (I) disclosure of any risks associated with ESG by issuers ; and (ii) disclosure of ESG-related investment products. The former advocates the unification of disclosure rules based on the disclosure standards set by the SASB, etc. The latter recommends to present the best practices of disclosure related to ESG as it is difficult to take in-depth measures under the current status of insufficient ESG disclosure by issuers.

Increase in ESG-related funds in the United States



Recommendations to the SEC by the ESG subcommittee (Draft)

Disclosure of risks associated with ESG by issuers

- ✓ Require issuers to apply uniform disclosure standards of critical ESG-related risks
- ✓ Apply a framework defined by entities, e.g., SASB, as a disclosure standard in adopting uniform criteria
- ✓ Claim disclosure of ESG risks in the same manner as disclosure of other financial status.

Disclosure for investment products related to ESG

- ✓ Present disclosure examples in line with the terms recommended by the Investment Company Institute (ICI) as best practices.

(Source) Invest Company Institute, SEC Asset Management Advisory Committee

3. Topics on service providers supporting the asset management business :
(1) A real picture of the system costs

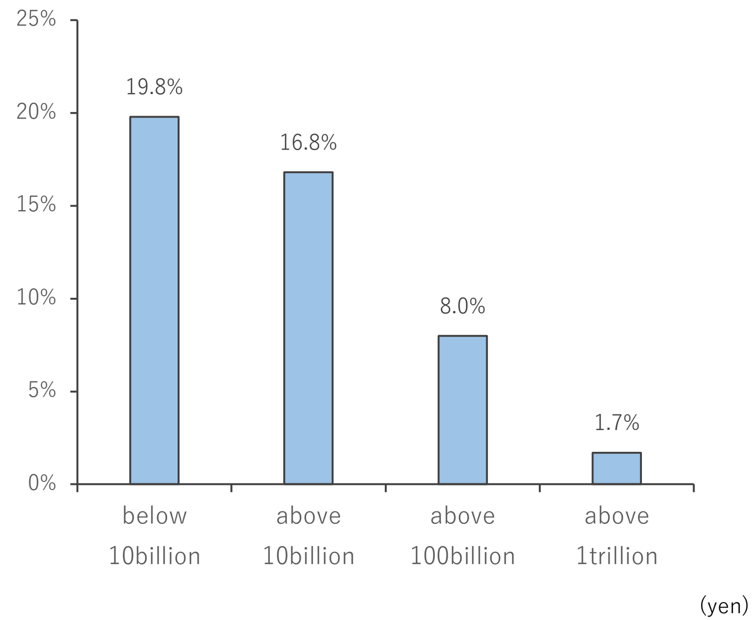
- In overseas markets, global custodians have developed platforms which provide integrated front-to-back office business operation services in response to asset managers' needs. On the other hand, in Japan, the growth in AUM, which is a prerequisite factor for custodians to develop a business, has been limited, and furthermore the service requirements peculiar to Japan have prevented full-scale entry of custodians into the Japanese market (Figure A).
- Under such circumstances, it is pointed out that while major asset management firms are outsourcing their system operations in order to reduce personnel costs, and the expensive costs of outsourcing the system operation causes a barrier to entry for emerging fund managers (Figure B).

A. Peculiarity of the asset management/client market in Japan

Regulations	Accounting, reporting, and administrative services based on Japan's unique legal system and business practices required in contracting services with institutional investors such as insurance and pension funds. • Customization for each customer segment is required. • It is more complicated in case of respond to individual settings to ensure continuity with the past customer service operations.
Customers	Response to individual needs, and requirements for high service levels • For example, there is no buffer in Japan, such as allowing a certain amount of deviation in the calculation of market value and allowing each other to accept a small amount of penalty for temporary over-lending caused by before and after settlement processing.
Competitors	Oligopolistic and Galapagosnizing service provider industry for asset management companies • Compared with major markets in the United States and Europe, Hong Kong, and Singapore, the systems and services offered by global custodians and solution vendors are limited. • As a result, a service system unique to Japan has been established and the costs of switching cause a barrier to entry.

(Source) Boston Consulting Group

B. Estimated average expense ratio of middle-back office operations system by asset size



(Note) Asset management firms managing publicly offered investment trusts in Japan. The expense ratio is calculated by dividing the specific category of expenses, called "Itaku-keisan-hi"or "trust calculation expenses", by the total operating expenses in the profit and loss statement of the mandatory report regulated by the investment Trusts Association, Japan.
"Itaku-chosa-hi or Trust research expenses" generally include system usage fees and outsourcing costs associated with back-up operations such as investment trust accounting.
Asset managers which do not use the expense item of Itaku-keisan-hi (19 out of 83 asset managers) are excluded.
(Source) Earnings reports by each asset manager

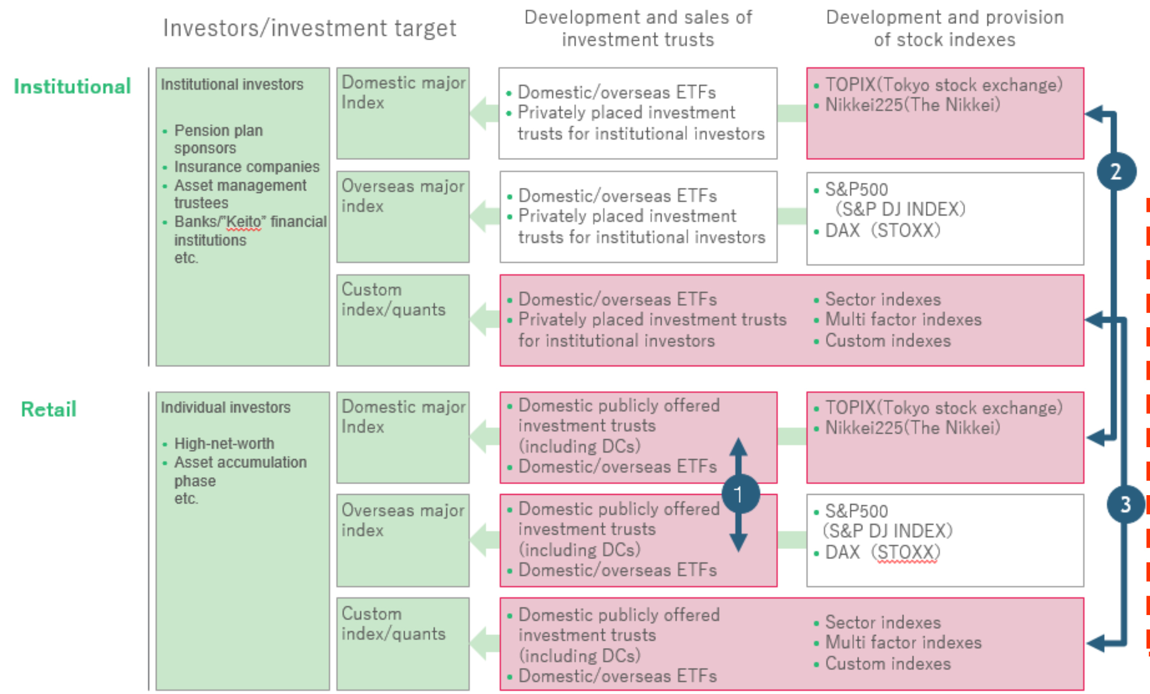
3． Issues related to servicers supporting asset management business :

(2) Functions of index providers in the asset management market

- On the back of expansion of passive investment, major index providers are expanding their businesses and concentration is growing. Trust fees, revenues for asset management companies, are declining, meanwhile the burden of index usage fees is relatively increasing.
- It has been pointed out that the choice of passive funds linked to various investment factors are limited in Japan while there are many pure index funds linked to simple benchmarks.

※ In the US, not only macro factors like economic growth, inflation and so forth, but also various style factors, such as value, growth, size (small / large), carry and so on, are reproduced by corresponding indices. Such a thickness of passive investment contributes to an increase in the balance of ETFs and passive investment trusts.

Overview of providing investors with passive investment opportunities



(Source) Analysis by Boston Consulting Group

Inadequate points from investors' viewpoint

1. There are some differences in trust fees even for funds with the same benchmarks among distributors
   - There are also differences in trust fees for funds with the same benchmarks among asset managers
   - Publicly offered investment trusts (general, no-load, dedicated to DCs) , Differences in management fees among ETFs
2. Higher index usage fees and lack of competition among indexes
   - Higher usage fees for major indexes than those in Europe and US.
   - Insufficient competition due to lack of development of alternative indexes by investors and asset managers
3. Underdeveloped function to provide inexpensive access to various investment strategies of index funds
   - Difficulties in asset allocation to meet investment goals because of limited variety and selections of Indexes/ETFs compared to Europe and US. (inadequate expansion of risk profile)
   - There are few index providers to develop and provide various types of indexes and ETFs; limited only for privately placed investment trusts

(Reference) Fee structure for index-related funds

Index data usage fees : The fees for the use of index data like benchmark constituents and weights utilized for analysis and asset management	Index license fee : Royalty payment for the use of indexes, charged to asset managers who manage index funds
A flat rate. The percentage of commissions is small.	The higher the AUM, the lower the rate is in general. The percentage of commissions is large.

【Column⑨】Realization of an international financial center open to the world

Approaches to complying with regulations

- **Encoding overseas management companies to enter Japan's market through support in English**
  - One-stop services in English to support pre-application consultation for overseas asset management firms which consider new entry into Japan. It also helps with registration procedures and conducts post-registration supervision.
  - The Japanese Financial Services Agency and the Local Finance Bureaus established the "Financial Market Entry Office"(the "Office") (on January 12, 2021).
  - The Office was relocated to Nihonbashi Kabutocho, a more convenient location for financial institutions (on June 11, 2021)

<Registration of No. 1 and No. 2 projects initiated by the "Financial Market Entry Office">

① Affirmative Investment Management Japan Co., Ltd. registered investment advisory and agency business as the Japanese base of Affirmative Investment Management Partners Limited, a UK asset management company (on April 16, 2021).

② "Schonfeld Strategic Advisors (Singapore) Pte Ltd," a Singapore subsidiary of Schonfeld Strategic Advisors LLC, a U.S. -based asset management company, opened a branch office in Japan. Schonfeld Strategic Advisors(Japan) Pte. Ltd. completed registration of investment management business and investment advisory and agency business (on May 21, 2021).

- Pre-application consultation and registration procedures for these two cases were conducted by the Office in English.

- **Establishment of an entry system (notification system) for asset managers with overseas operational experience**
  - ① An investment manager which has been already registered by overseas authorities and obtains a track record of managing customer assets (only overseas funds) (a temporary measure for five years) ② An entry system has been established with a simple procedure (notification basis) for funds managed by asset managers, mainly targeting overseas professional investors.
  - Enactment and promulgation of the revised Financial Instruments and Exchange Act in May 2021 / Scheduled to be enforced together with relevant government ordinances by the end of November 2021

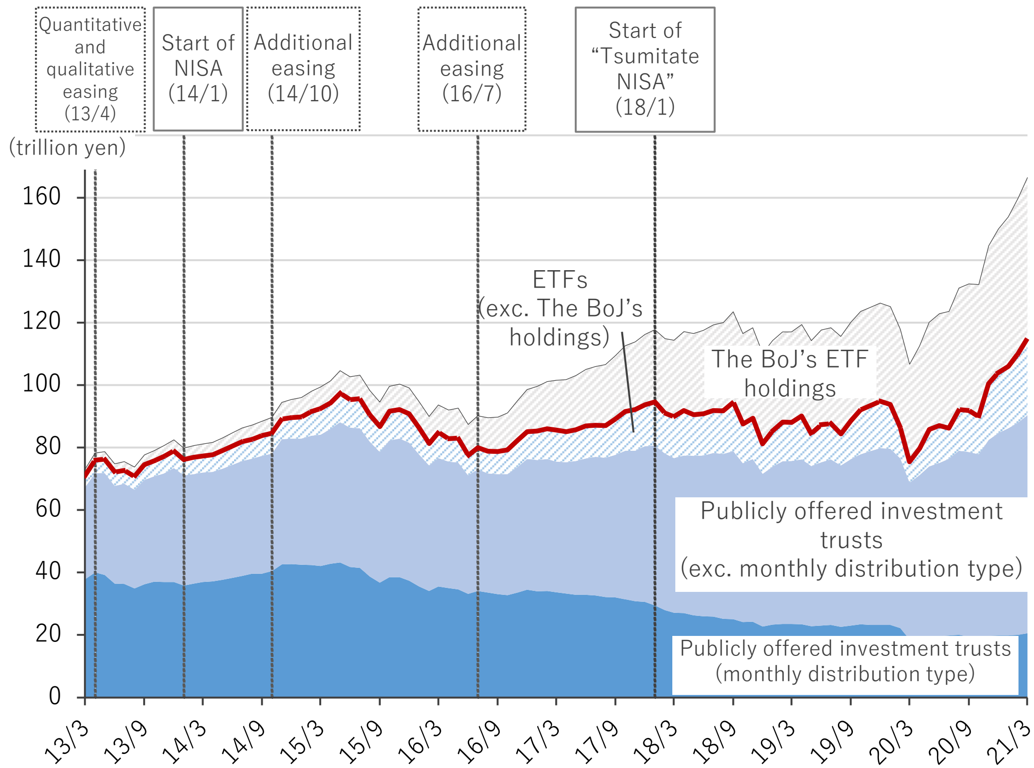
- **If competition is accelerated by entry of various overseas asset managers and recruitment of investment specialists, it is expected to lead to excellent asset management services, thus contributing to customers.**

- **Mainly led by the "Financial Market Entry Office"," the Japanese government will support the establishment of business bases in Japan by providing pre-application consultation, registration, and post-registration supervision in English for overseas financial institutions including securities companies and banks which consider new entry into Japan and mainly handle customers in English.**

III. Course of action 1. Trends in Japan's Publicly Offered Investment Trust Market

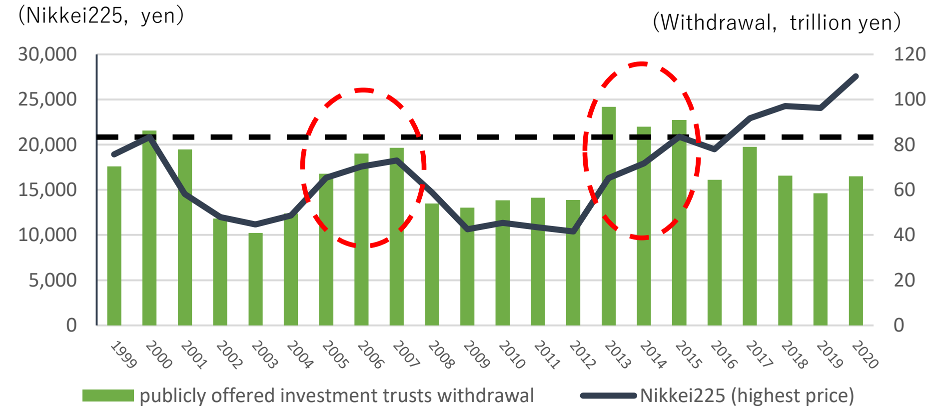
- The AUM (excluding ETF) of the publicly offered investment trust market in Japan temporarily declined due to the market plunge caused by the COVID-19 outbreak, but recently it has been increasing thanks to the recovery of the stock market and growing interest in investment by households(Figure A).
- The historical changes in withdrawal of publicly offered investment trusts reveal that the withdrawal increased during the upward trends in 2007 and 2015, but there has been no outstanding increase in withdrawal during the recent period since 2016 (Figure B).
- It is expected that asset management firms will continue their efforts to contribute to stable household asset formation so that these developments will spread steadily and lead to successful investor experiences (Figure C).

A. Net assets in Japan's publicly offered investment trust market

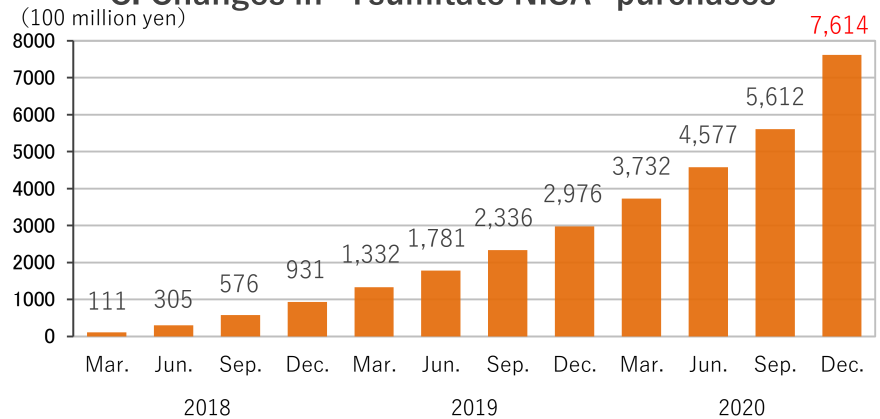


(Note) ETF holdings are ETF holdings held by the BOJ (market value basis, semi-annual totals).
(Source) Investment Trust Association, Bank of Japan, JFSA

B. Withdrawal of publicly offered investment trust and Nikkei 225



C. Changes in "Tsumitate NISA" purchases



(Source) The Investment Trust Association, Japan, Nihon Keizai Shimbun, JFSA

（1）Dialogue with asset management firms/parent companies, etc.

- Under the strong leadership of the management team, each asset management company needs to achieve sustainable and favorable fund returns over the mid- to long-term and expand AUMs by gaining the credibility of their customers through; I) strengthening governance which prioritizes customers' interests; ii) establishing a managerial structure which emphasizes the value of long-term investment; iii) clarifying and realizing the corporate vision; and iv) working toward business operations to attain product governance and improvement in asset management capabilities, which prioritize customers' interests. In terms of the effectiveness of these efforts and the outcome as well as fund performance, the JFSA will continue to engage in dialogue with asset managers in order to lead to broader and more effective initiatives.

（2）Visualization of investment performance

- In addition to continuing our efforts for visualization, the JFSA will deepen dialogue with each asset management company on the outcomes, and deepen understanding of the optimal state of funds and asset management, which truly contribute to customers' interests, as well as the ideal state of asset management firms and financial groups to achieve such investment. Following the investigation of privately placed investment trusts in this business year(July 2020 – June 2021), the JFSA will collect information from asset management firms, trust banks, and insurance companies on discretionary assets, and conduct investigation, analysis, and publication.

（3）Encouraging new market entrants

- The Financial Market Entry Office continuously expedites the registration process to attract further overseas asset managers and other entities, and it also takes smooth measures on the entry system for asset managers, with operational experiences overseas, established under the Revised Financial Instruments and Exchange Act.
- The JFSA facilitates the smooth entry for domestic independent asset managers and other entities as well to promote the provision of investment products and services with a competitive edge and distinctive advantages.

（4）ESG/SDGs investment

- ESG/SDGs investment is an area expected to grow particularly going forward. The JFSA will conduct a wide range of surveys and analyses of ESG/SDGs in the asset management industry, including specific indicators, and monitor asset management firms.

（5）Other initiatives

- The JFSA continuously conduct research and dialogue with asset managers on alternative investment, regarding which most asset managers are working on their enhancement of business operations so that their initiatives on alternative investment become a norm from a mid- to long-term perspective.
- The JFSA will continue to pay close attention to asset managers' efforts to diversify their investment methods and improve operational efficiency through the use of DX in order to boost profitability of the entire fund management business and contribute to their customers through improved fund performance.
- In order to upgrade the entire investment chain associated with asset management and to provide customers'-interests-first-products, the JFSA will continue to interact with service providers which support asset management business, such as system providers and index providers.

III. Course of action 2. Continuous dialogue with asset managers and future measures

①
Customer (Investors)
- House hold

② Institutional investors
- Pension
- Insurance company, etc.

③ **Product (Investment vehicle)**
- Stock Exchange
- Investment Trusts
  - Privately placed
  - Publicly offered

④ **Distributors**
- Banks
- Securities firms
- Others

⑤ **Asset management firms**
- Japanese asset managers
  - Major
  - Independent
- Foreign asset managers
- PE/VCs

⑥ **Servicer**
- Trust banks
- IT system vendors
- Index providers

Future measures

① Visualization of fund performance for publicly offered/privately placed investment trusts and discretionary assets
- ✓ Promotion of sound competition among asset managers and investment products

② Research and analysis of the initiatives and investment methods taken by institutional investors for advanced asset management practices

③ Research and analysis of the ESG/SDGs investment conducted by Japanese asset managers

④ Approaches to providing customers'-interests-first-products
- ✓ Ensuring thorough prioritization of customers' interests through surveys and publication pertaining to sales practices and investment practices
- ✓ Address the issue of differences in trust fees for some index funds linked to the same benchmark
- ✓ Initiatives to realize further transparency for costs such as "other expenses "

⑤ Providing favorable and sustainable mid- to long-term performance
- ✓ Continuous dialogue with asset managers for improved governance and asset management capabilities
- ✓ Research and analysis of alternative investments, e.g., PEs
- ✓ Encouraging new market entrants

⑥ Research and analysis of various service providers supporting asset management business
- ✓ Continuous survey on system infrastructure and system-related costs
- ✓ Continuous research on index providers (cost analysis, diversification of passive investment trusts, etc.)