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JAPANESE INVESTMENT TRUSTS

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Introduction. Foreigners have been freely permitted to purchase shares of Japanese corporations since 1950, with the condition that the principal would not be freely remitted abroad. Until 1960 little attention was paid to this opportunity. The recent increase in foreign interest in Japanese equities has coincided with the easing of currency and exchange restrictions, particularly the shortening of the waiting period for the conversion of invested principal to the original currency of the investor. As of April 1, 1963, the waiting period was entirely eliminated, with the expectation of increased foreign investments. Because of the significant increase of foreign offerings in the U.S. affecting the U.S. Balance of Payments, on July 17, 1963, President Kennedy proposed the enactment of a United States Interest Equalization Tax of fifteen per cent on purchases of foreign securities. This proposal has dampened the demand in the United States for foreign securities—

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1 Foreign Investment Law (Gaishi ni Kansuru hōritsu), (Law No. 163, 1950), in 5 EHS No. 5410-20 allowed the purchase of stocks and the repatriation of dividends in the currency of the investor but restricted the free conversion of principal to a non-yen currency to installments over a five-year period after the sale of the security for yen. In May 1961 the period during which an investor who had invested in Japanese stock with foreign currencies was required to hold the proceeds from the sale of that investment in yen was shortened to two years. In August 1962 this period was shortened to six months and April 1, 1963, immediate conversion of principal was allowed.

2 Purchases by foreigners through regular securities markets during 1962 totaled $82,000,000, 70% above the figure for 1961. The total of these two years' purchases equaled the total of the entire previous twelve years since the enactment of the Foreign Investment Law. Naomichi Toyama, Why Foreign Investment in Japan Is Increasing, 197 COMMERCIAL AND FINANCIAL CHRONICLE No. 6250 (Mar. 28, 1963) § 2, p. 12. As of March 1962 foreigners represented only 0.33% of the total number of holders of Japanese stocks. Including corporations foreigners owned 1.66% of the total listed stock issued. Ministry of Finance survey as of March 31, 1962, as reported in 50 JAPAN STOCK REV. 2 (Dec. 31, 1962). These figures are also cited by Naomichi Toyama, supra.

3 This proposal, not yet enacted into law, envisages a 15% tax payable by the purchaser on the purchase price of most foreign securities.

4 There has been a decline each month since June in purchases of new foreign issues. By September the flow had practically ceased. Treasury Secretary Douglas Dillon's statement to the U.S. House of Representatives Ways and Means Committee as reported in The Journal of Commerce Nov. 11, 1963, 11 (International ed. Pacific ed).
Japanese or other. There remains, however, a growing awareness of Japan's investment opportunities. Among these opportunities is the institution which has been described as "the best medium for investment of any vehicle yet devised"—the investment trust. The advantages of investing through investment trusts are much more compelling when investing in foreign securities. It is interesting, but perhaps not surprising, that the pioneer of all investment trusts was formed for investing in foreign and colonial stocks.

Scope. It is the purpose of this article to examine: a) the present structure of Japan's investment trust industry in its own legal, historical, and economic setting; b) some similarities of and differences between U.S. and Japanese law and structures; and c) some problems common to both countries and some problems peculiar to Japan that may make a comparative study profitable.

History. The first Japanese investment trust was the Fujimoto Securities Investment Association established in 1937 by the Fujimoto Bill Broker Securities Co., Ltd. (predecessor of Daiwa Securities Co., Ltd., one of the big four securities companies of Japan). This original invest-

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6 The investment trust brings together participating investors to whom are sold certificates of beneficial ownership in a trust fund, and professional managers who, utilizing the proceeds of these sales, select and purchase securities in other enterprises on behalf of the investors. In the United States similar-type organizations, either in trust form or corporate form (in which case shares of the company rather than shares of a trust fund are sold), are known as investment companies. The most popular form of investment company in the United States is commonly called "mutual fund" and refers to a "managed company continuously offering its shares and standing ready to redeem shares at net asset value."

7 For the investor without professional investment advice, such factors as language barriers, currency and exchange restrictions, lack of reliable, objective contacts with banks, economists, etc., understanding of and time lags with respect to information on world politics, social and labor movements, legislation, trade, banking, industry, and company developments all suggest the media of investment trusts for foreign investment.

On the positive side with respect to investment in Japan, investment trusts have special tax advantages and generally lower acquisition charges than in the United States. See Nomura Securities Co. *Zeikin No Hon* (Book as to tax) (revised ed. 1964). Daiwa Securities Co. *Zeikin-Dokuhon* (Reader as to tax) (1964). On April 1, 1964, the tax law was changed to provide that dividends of investment trusts will no longer be taxed at the source at 10% but will be taxed to the recipient at the rate of 5%, Law No. 24, Art. 8 (2), March 31, 1964.

8 The original prospectus of the Foreign and Colonial Government Trust founded in London in 1868 as published in The Times (London), March 20, 1868, states the purpose of the Trust is to provide "the investor of moderate means the same advantages as the large capitalist in diminishing the risk of investing in foreign and colonial government stocks, by spreading the investment over a number of different stocks." Bullock, *The Story of Investment Companies* (1959) refers to this trust as the pioneer of them all.

9 Four securities companies in Japan have accounted for more than 70% of the total volume of transactions in Japan since 1956. These four are Daiwa Securities,
ment trust is said\textsuperscript{10} to have had as its model the “unit trust” of England and its legal basis in the association contract provided in articles 667 to 688 of the \textit{Civil Code of Japan}.\textsuperscript{11} The interesting structural features of this first Japanese investment trust are that it was organized by a securities company with money pooled under association contracts for investment in securities and provided for a liquidation distribution after three years with dividends to be distributed twice yearly. The pooled fund was divided into equal units among a definite number of contributor—investors. At a general organization meeting these investor-members elected an executive committee to determine the investment policies and to manage the fund. The executive committee’s decisions were executed by the Fujimoto Bill Broker. It is reported that this association was soon dissolved because it was alleged to be in violation of the Trust Business Law\textsuperscript{12} and, in any case, suffered from certain structural deficiencies.

In November 1941 a new “unit trust” modeled after the flexible unit trusts of England was formed by the Nomura Securities Co., Ltd. (also one of the big four securities companies of Japan). In this instance, the trustor-manager was the Nomura Securities Co., Ltd., and the trustee, who was to execute the trustor-manager’s decisions, was a trust company, Nomura Trust Company. This new trust had its legal basis in the \textit{Civil Code}, the Trust Law,\textsuperscript{13} and the Trust Business Law. In 1942 five other securities companies established similar investment trusts. In each of these cases, the organizing securities company became the trustor-manager and used Nihon Investment Trust Company as trustee.

The structure of these war-time (November 1941 to August 1945) investment trusts provided for a trustor, who was also the original beneficiary of the trust res. The trustor-beneficiary then sold and assigned\textsuperscript{14} its beneficiary rights to an indefinite number of beneficiary

\textsuperscript{10} \text{Nikkō Securities, Nomura Securities and Yamaichi Securities. The Japan Times, May 29, 1963 (Foreign Investment Supp.) p. B4, col. 1.}
\textsuperscript{11} \text{Investment Trust Ass’n. (Shōken Tōshi Shintaku Kyōbai), Investment Trust in Japan 1 (1963). For a history and discussion of this original investment trust, see Yamaichi Securities Co., Toshi Shintaku Ron (Study of investment trusts) 242-43; Nihon Kogyō Ginkō, Toshi Shintaku No Kenkyu (Study of investment trusts) 290-91 (1960); Kōichi Ishiwara, Fujimoto Ōka Shōken Tōshi Kuniai o megutte (Around the Fujimoto Securities Investment Association), 12 Šōken Tōshi Shintakua Kaiho (Report of the Investment Trust Association).}
\textsuperscript{12} \text{These articles are contained in § 12 (Partnership) and ch. II (contracts).}
\textsuperscript{13} \text{Trust Business Law (Shintaku-gyōdo), (Law No. 65, 1922) in 6 EHS No. 6100.}
\textsuperscript{14} \text{CIVIL CODE art. 467, with respect to assignment of a nominative claim, provides as follows (in 2 EHS No. 2100):}
investors, retaining the powers of management and, with the approval of the trustee, the right to extend or reduce the term of the trust and to determine the dividend rate. The beneficiary rights were divided into equal units. The terms of the trust provided that the compensation of the trustee should be divided with the trustor in consideration of the trustor’s management. The trustor guaranteed up to twenty per cent of any loss of principal and was to receive ten per cent of any gain in principal. (This was considered necessary to attract those investors accustomed to a fixed return.) Flexibility was provided in that management had discretion to buy within a policy of diversification and a limitation on the amount of investment in any one company. There were also certain conditions for selling. These war-time investment trusts were closed-end in the sense that the certificates of beneficial interest were non-redeemable, there was no market for the certificates, and they were non-negotiable.

In August, 1945, at war’s end, subscriptions were discontinued. Over a period of time the existing trust redeemed the outstanding certificates, in most cases at a profit to the holders, and liquidated. The total amount invested in these war-time trusts was ¥528.5 million ($264 million).

When the war ended, Japan’s commercial, industrial, and financial
world was in ruins. This world had been controlled by the Zaibatsu. Under a policy directive from the President of the United States, the Supreme Commander Allied Powers (SCAP) was directed to destroy the ownership and power of the Zaibatsu in Japan and establish a policy permitting "a wide distribution of income and of the ownership of the means of production and trade." This directive was implemented by a SCAP instruction (SCAPIN 244 of November 6, 1945) to sell the securities of the Zaibatsu. The responsibility of disseminating these shares was given by SCAP to the Japanese securities companies.

In 1948, the Securities and Exchanges Law was enacted by the Diet; this law was patterned after the U.S. Securities Act of 1933 and the Securities and Exchange Act of 1934. At this time, there was interest in reviving the investment trusts through legislation modeled on the U.S. Investment Company Act of 1940 (hereafter sometimes variously referred to as The Act of 1940, the 1940 Act, or The Act). A draft was prepared providing for both investment companies and investment trusts but was violently opposed by the securities companies. The main objection appeared to be allowing the new investment companies to underwrite securities. This objection together with the SCAP feeling that such legislation was premature under the existing economic and social conditions resulted in the draft bill not being submitted to the Diet.

In 1949 the stock exchanges were reopened. Before the year was

18 Literally, the "money-clique," commonly used to refer to Japan's great family holding firms and the combines they controlled. Mitsui, Sumitomo, Mitsubishi, and Yasuda were the largest and the most frequently mentioned of the 14 largest family clans that dominated Japanese business activity. For an interesting discussion of the size and make-up of these combines see Bisson, ZAIBATSU DISSOLUTION IN JAPAN (1954). Bisson notes at 25 that Mitsui in its prime had possibly 3 million employees.

19 Id. at 239 (pertinent paragraphs of the President's Directive to the Supreme Commander Allied Powers dated September 6, 1945).

20 Securities and Exchange Law (Shōken torihikiō) (Law No. 25, 1948) in 6 EHS No. 6600.


24 It is interesting to note the same situation occurred in the U.S. in drafting the legislation for the Investment Company Act of 1940. The first draft of proposed regulation, a draft originating with the SEC, was so unacceptable to the investment company industry that it became apparent Congress would not pass it over the industry's protests. The sequel was a unique and constructive effort on the part of the SEC and investment company representatives to hammer out a bill which would give investors the protection the SEC demanded and give the investment companies a Magna Charta under which they felt they could operate. Bullock, op. cit. supra note 8, at 77.

25 Adams, JAPANESE SECURITIES MARKETS: A HISTORICAL SURVEY 33, 37 (1953), published by Seihei Okuyama, 1 Uchisa-wai-cho, Chiyoda-ku, Tokyo, Japan. Adams notes the stock exchanges of Japan from July 1943 were under the control of the government through a joint stock company called the Nippon Securities Exchange.
out the market collapsed under the supply of stocks. By 1951 there was a pressing need to stabilize and energize a faltering market and provide a supply of long term funds to business enterprise. As noted, there were no investment trusts; there was a short, uneventful, and profitable history of investment trusts and an engrafted policy of "democratization of securities." In these circumstances, a conference of representatives of government and the securities companies met and cooperatively deliberated on ways of achieving a breakthrough in the economic stultification. Investment trusts as a means of absorption of corporate shares was restudied. The result was a compromise shaped to meet the needs of the time and preferences of the participants. The bill presented to and passed by the Diet became the Securities Investment Trust Law of 1951 (hereafter sometimes variously referred to as the Law of 1951, the 1951 Law, or the Law). It was not initiated, written, or enacted to prevent the recurrence of past abuses, if there ever were any. It was not a result of any public clamor, industry lobby, or investor interest. The prospective shareholder, was not then, and evidently not now, concerned or interested in shareholder or individual rights.

The aim was the stabilization of prices and a smooth flow of securities. When reopened May 14, 1949, the exchanges were non-profit membership organizations (Shadan Hōjin) regulated by the new Securities and Exchange Law and designed to be a free market with prices freely arrived at.

"Special notice should be taken of the fact that Japan's investment trust was created in the hope of restoring stability to the country's securities market." INVESTMENT TRUST ASS'N (Shōken Tōshi Shintaku Kyōkai), INVESTMENT TRUST IN JAPAN (1961).

The dissolution of many Zaibatsu organizations and successive capital expansions carried out by many enterprises striving for recovery combined to flood the markets with far too many stocks for the investors to consume. It was the greatest challenge to the country's securities circles to stabilize the faltering markets and, at the same time, facilitate supply of long term funds to a variety of fund-short enterprises. It was under these circumstances that the reopening of the investment trust system was seriously studied by both the Government and the securities circles.

The authors' research has failed to uncover any reported cases under the law. See Blakemore, Postwar Developments in Japanese Law, 1947 Wts. L. Rev. 649 where it is pointed out that a single system of courts, staffed by about a thousand judges has proved adequate in the past to serve the needs of a nation of over seventy million people, and that the total bar of Japan is less than that of an American city of a million and a half population. In 1960 there were 6,458 practicing lawyers in the entire country. See von Mehren, Some Reflections on Japanese Law, 71 Harv. L. Rev. 1495-96 (1958) wherein he states: "Compared with the West, there is in Japan a
Securities companies profit from buying and selling securities for their own account or for the account of their clients, for which they make a charge. By reason of the profits from such business it was rightly considered in Japan that securities companies could (more) economically establish and operate the investment trusts and could afford to keep the acquisition and management charges lower than could an independent trustor with no other business interests, profits, or distributive machinery already paying its way by operating in the same market as would an investment trust. As has been stated, the primary purpose of reviving the investment trust was to provide, as rapidly as possible, capital for a moribund economy and a market for the oversupply of stocks. The conflict of interest implicit in allowing securities companies to act as sponsors and managers of investment trusts was a secondary consideration at the time. A government opinion in 1955 condemned this practice; still, in 1958, the Minister of Finance, under his approval powers, licensed seven new securities companies as trustors. In 1959, after the standing committee for finance was established in the House of Representatives, a member of that committee pointed out that such a dual role was violative of article 108 of the Civil Code, providing that one person could not represent two parties in the same juristic act. The government denied a violation, stating the trustee stood between the trustor and the beneficiaries and, further, the government was studying the problem of separating the two businesses. After much negotiation, and some publicity, the secu-

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relative absence of a strong consciousness of rights.” See also von Mehren, The Legal Order in Japan’s Changing Society: Some Observations, 76 Harv. L. Rev. 1174 (1963). Here he states that: “Traditional Japan never evolved techniques of dispute resolution appropriate for controversies arising in an individualistic setting.”

30 Securities Investment Trust Law, art. 7(1) (Law No. 141, 1953) provides for licensing by approval of Minister of Finance rather than by registration.

31 Civil Code art. 108 reads in part: “No person may, in one and the same juristic act, be a representative of the other party or of both parties; ….” 2 EHS No. 2100.

32 For a history of this negotiation see Investment Trust Ass’n, Shōken tōshi shintaku (Securities investment trusts), in 4 Shintaku jitsumu koza (lectures on business trusts) 48-58. The securities companies originally wanted to own all of the stock of the trustor companies. The Minister of Finance could not agree to this since it conflicted with the Anti-Trust Law limiting banks (including securities companies) to 10% or less of the securities of any one company, but he did bow to the proposition that a new trustor company without large capital might arouse concern in the investor-beneficiaries and such a trustor would face difficulty in finding experienced professional investment and office management personnel. After long negotiation it was agreed that the securities companies would, within five years, decrease their stock ownership of the trustor companies to ten per cent or less. Further, as to interlocking officers of the securities companies and the trustor companies it was claimed they are not competitive and therefore not under the limitations of the Anti-Trust Law.

The Minister of Finance provided the following guide:

1. The full-time officers of the securities companies cannot also be full-time officers
rities companies established "independent" management companies in 1960-61. We will consider the independence of these management companies later.

Growth and Influence. Japanese investment trusts have flourished under the administration of the Law of 1951. In twelve years' time, net assets of Japan's investment trusts have risen from zero to over three billion dollars.\(^3\) Fourteen per cent of the total market value of approximately twenty-two billion dollars of all listed stocks on the Tokyo Stock Exchange are held by investment trusts.\(^4\) Ten per cent of the daily volume on the Tokyo Stock Exchange is attributed to investment trusts.\(^5\) By 1962 Japan was second only to the United States in the percent of population owning investment securities.\(^6\) Investment trusts have contributed heavily to this "democratization of securities." While there are no figures available to indicate the proportion of investment trust shares held by individuals, it is assumed by the Investment Trust Association to be approximately 99% of open-end shares and about 90% of unit investment trusts shares. This assumption is supported by the estimate that one of every ten families in Japan hold investment trust certificates\(^7\) and the figure for the average per capita holding which is $150.00.\(^8\) It has been truly said that the present Japanese securities market is an investment trust market. The extent of individual ownership of stocks in Japan is indicated by a Ministry of Finance report as of March, 1963 showing individuals held 27,166,675,143 shares of 58,030,229,788 stocks listed in the first section of the stock exchanges (comprising stocks of 887 companies) or

of the trustor company; 2. officers of the securities companies who are full-time officers of the trustor company may not exceed 50% of the trustor company officers. Further: To aid in making the trustor companies independent a charge was instituted for the purchase of investment trust certificates. The Trustor companies formed a new sales company which would be paid for selling the shares. The sales companies were formed with the trustor management company owning 90% and the securities company owning 10% (except in one case where the trustor owned 100% of the selling company).

\(^3\) The market value of all investment trust securities at the beginning of 1963 was $3,525 million (¥1,269,331 million). Excluding bond investment trusts there was $3,142 million (¥1,131,345 million). The total market value of all listed stocks on the Tokyo Stock Exchange was $22,303 million (¥8,002,925 million). The Japan Times \textit{supra} note 9, at p. B7.

\(^4\) See note 39 \textit{supra}.

\(^5\) The Japan Times, \textit{supra} note 9, at p. B7.


\(^7\) Central Committee for Promotion of Savings, Survey Relating to Motives of Saving (Chochiku no Doki-tô ni Kansuru Chôsa) 10, Mar. 1963.

\(^8\) NOMURA SECURITIES INVESTMENT TRUST MANAGEMENT Co., \textit{op. cit. supra} note 16, at 22.
46.80%. Additionally, investment trusts whose shares are predominantly held by individuals help 5,747,630,593 or 9.90%.

In the United States, investment company assets approximate twenty-nine billion dollars. The mutual funds account for approximately twenty-three billion dollars of this amount and about four and one-half per cent of the market value of all stocks listed on the New York Stock Exchange.

While it is difficult to determine what the ultimate demand for investment trust shares will be, their present influence and rapid growth in both Japan and the United States warrant an analytical and comparative review of this powerful investment medium and an appraisal of its success in protecting the investor, the money market, and the free flow of savings and investment.

The Securities Investment Trust Law of Japan, as amended, consists of six chapters containing forty-one articles numbered between 1 and 38.

What kind of law emerged from the above history to produce the above results? What structures have resulted? What problems have arisen?

The Law of 1951 is not complex legislation. It has few definitions, which are anything but elaborate. It provides a comprehensive system of regulation of investment trusts. Regulation is accomplished primarily through the licensing and approval powers of the Minister of Finance. The standards, within which the discretion of the Minister of Finance is to be exercised, are broad and indefinite.

The Law of 1951 provides for the trust form entity only, eliminating the investment company entity as not being within the tradition and requiring further study. It permits much of the structural and management practices of the war-time investment trusts which served the same

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40 "Mutual fund" is the common name for the open-end management investment companies found in the United States, as opposed to closed-end investment companies. See note 6 supra.
42 Much substantive regulation is accomplished by definition in the United States. The Investment Company Act of 1940 has 58 paragraphs of definition, some paragraphs run from 200 to 300 words in length. The three definitions of the Securities Investment Trust total 110 words.
43 For example: Article 12 requires that the Minister of Finance approve the terms of the trust contract. Article 13 sets the standards for disapproval: "If inappropriate for the public interest or for the protection of investors, ... or violative of the laws or ordinances, or for stating an untruth, or for failing to disclose."
function of affording the small investor an opportunity to diversify his holdings, spread his risks, and obtain experienced and continuing investment supervision (irrespective of the objectivity and conflicts of interest in that supervision). The organization and management of investment trusts by securities companies was not provided for by the law, but may be said to have not been specifically prohibited. This "traditional" practice was reasserted under the administration of the Law of 1951, when immediately after its passage seven securities companies registered as trustors of investment trusts. In 1958 seven additional securities companies were licensed as trustors. In 1960-61 these fourteen securities companies established fourteen "independent" management companies and transferred their trustor functions to them.

The Law. Under the Law of 1951, the Minister of Finance is the supervisory and regulatory power regulating by rule as well as by order. As such, he is responsible for investor protection as one of the stated purposes of the law. To accomplish this he is provided with authority to compel complete, accurate, fairly presented information of any degree of relevancy or materiality, including the character, circumstances, policies, and financial responsibilities of the trust, its trustor-manager, and the officers, directors, and ten per cent shareholders of the trustor. The Minister of Finance is also given broad authority to license the trustors and to prescribe the form and content of the contract of trust. This allows him, among other powers, to provide any amount and degree of investor protection he may determine and, considering the disinclination of the Japanese either to provide for or protect individual rights, with little likelihood of judicial review. The substantive provisions of the law will be considered below. Once licensed as a trustor and doing business under an approved contract of trust, the trustor has complete discretion in transacting an investment business under the terms of the contract of trust and the proscriptions of articles 16 and 17 of the 1951 Law. An unprecedented loss of principal, or violation of the Law or terms of the contract of trust could lead to the

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44 The "independence" of these companies is noted in the agreement set out in note 32 supra.

45 Except for the prohibitions of articles 16 and 17 on the buying and selling powers of the trustor, which provide some degree of protection not subject to the discretion of the Minister of Finance.

46 Masami Ito, The Rule of Law: Constitutional Development, LAW IN JAPAN (von Mehren ed. 1963) states that: Any law regulating fundamental economic rights will be held valid unless proved to be completely arbitrary and contrary to reason. Id. at 212.
circumscription or termination of the business. Whether the operation of the trust will be in the interest of the certificate holders largely depends on the administration of the provisions for licensing of the trustor and approval of the terms of the trust contract prior to the actual conduct of the business of that particular trust.

**Article 1** states:

The purpose of this Law is to facilitate investment in securities by [the] general investing public, through establishing a system of securities investment trusts whereby protection of beneficiaries of securities investment trusts will be enhanced.

**Article 2** covers the definitions under the Law; the entire article is quoted:

The term “securities investment trust” used in this Law shall mean any trust, the purpose of which is to manage the trust property by investing it in specific securities in accordance with the trustor’s directions, and whereunder the right of beneficiary is to be split up among, and acquired by, an indefinite number of persons.

2. The term “securities” used in this Law shall mean those valuable instruments (wertpapier) that are mentioned in paragraphs 1 and 2 of Article 2 of the Securities and Exchange Law (Law No. 25 of 1948).

3. The term “trustor company” used in this Law shall mean a company which makes it its business to act as the trustor of securities investment trusts.

**Article 3** prohibits entities other than securities investment trusts from investing in securities and having an indefinite number of beneficiaries.

**Article 4** provides that only a trustor company which is a corporation with a minimum capital of ¥50 million ($138,888.00) may enter into

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47 Even after licensing, a failure to continue to conform to the requirements of article 7(2) i to iii will result in cancellation of the license. The Ministry of Finance has no discretion to license or fail to cancel a license in these circumstances.

48 Art. 2(1) and (2): The term “securities” in this Law shall mean those as mentioned in the following:

1. Government bonds;
2. Local government bonds;
3. Bonds issued by a juridical person in accordance with a special law;
4. Secured or unsecured debentures;
5. Investment certificates issued by a juridical person established under a special law;
6. Stocks, or certificates representing the right to subscribe to stocks to be issued;
7. Beneficiary certificates of securities investment trust or loan trust;
8. Securities or certificates issued by foreign countries of foreign juridical persons and which are of the same nature as those mentioned in the preceding each item;
9. Such other securities or certificates as may be prescribed by Cabinet Order. Such right to be represented in securities mentioned in the preceding each item shall, even when there have been no securities issued therefor, be regarded as such securities.
a contract of securities investment trust. The trustee must be a trust company or a bank doing trust business.

**Article 5** provides that beneficiary rights shall be equal, divided into bearer certificate units of equal value with the following information on the certificate: names of trustor and trustee, amount of principal of the trust, aggregate number of units, effective period of the trust, time and place of redemption and of distribution of income, method of computation and manner and time of payment of remuneration and charges payable to the trustor or trustee. The bearer certificates may be registered at the request of the holder. The open-end investment trust form requires two additional statements on the maximum amount of trust and the amount presently issued.

A securities investment trust cannot exist in Japan without a licensed trustor. The licensing arrangement, covered under Chapter II of the Law, brings the trustor and the trust within the regulatory powers of the Law, which are vested in the Ministry of Finance, Securities Bureau. **Article 6** provides that any company which is to act as a trustor company shall obtain a license from the Minister of Finance who shall determine, under article 7, whether the applicant meets the following two standards:

1. That the applicant for license is found possessed of suitability sufficient for engaging in the business of the trustor of a securities investment trust, judged in the light of the applicant’s personnel setup, and experience and ability in investing in valuable instruments, as well as of the state of securities market, etc.;

2. That the prospect of the income and expenditure in the applicant’s business as trustor of securities investment trusts is considered good enough.

If, upon examination, these standards are met the license shall be granted unless: a) the applicant is not a corporation with capital of fifty million yen; b) the applicant has been sentenced or fined under this Law or the Securities and Exchange Law and five years has not elapsed since the sentence or fine was suspended or completed; c) the applicant’s license has been cancelled for the above reasons or its securities registration has been cancelled under the Securities and Exchange Law and five years has not elapsed since the date of such cancellation; d) any of its directors are unrestored bankrupts, or have violated the law or have been directors of companies within 30 days of the time of that company’s license being cancelled; or, e) if any
false statement in particulars of importance exists in the application. 

**ARTICLE 8** provides for notification of denial of license with the reasons therefor.

**ARTICLE 9** provides for filing a certified notice of any changes in matters covered in the application for license. Articles 10 and 11 have been deleted.

Chapter III covers the business of the trustor company. **Article 12** requires that the trustor company shall, when concluding a contract of trust, make it conform to terms approved in advance by the Minister of Finance. **Article 13** requires the filing of an application for approval together with a document stating the terms of trust. If the terms of trust "contravene the laws and ordinances or be found inappropriate for the public interest or for the protection of investors, or ... [contain] false statements with respect to matters of importance or there be failure to state matters of importance, the Minister of Finance shall deny approval..." Articles 14 and 15 require approval of the Minister of Finance for amendments or cancellation of the terms of trust. Once the trustor is in business the only statutory prohibitions with respect to its conduct of that business are articles 16 and 17.50 **Article 16** prohibits the trustor from directing the trustee to underwrite securities with the trust property or to grant loans (except call loans) and defines "to underwrite securities." **Article 17** prohibits the trustor from directing the trustee to acquire, except through the market, securities held in the name of the trustor, its directors or 10% shareholders, or to sell or loan securities held as trust property to the trustor, its directors or 10% shareholders, except through the market. **Article 18** states the trustor shall apply for and receive approval of the Minister of Finance before engaging in any other business. **Article 19** states the trustor shall prepare a report on the trust property every six months, and within two months after the termination of a trust prepare a statement of final account on the trust property to be filed with the Minister of Finance. **Article 20** requires the trustor company to prepare books and documents relative to the trust property as well as to its businesses in accordance with the ordinance of the Minister of Finance.51 Paragraph 3 of this article pro-

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50 See also note 38 supra.
51 The regulation as to books and documents of the trustor company of a securities investment trust (Securities Exchange Committee Regulation No. 10, 1951), as amended by the Minister of Finance Ordinance No. 50 of 1960, provided:

The regulation as to books and documents of the trustor company of the securities
provides the only statutory right granted to the investor as an individual; that is, the right to inspect or copy any book or document relative to the trust property in which he has an interest.

Chapter IV contains the supervisory powers available after the trust is operative and requires directors of the trustor to have the approval of the Minister of Finance before engaging in the regular affairs of another company or business undertaking. The approval of the Minister of Finance is required to discontinue business, consolidate, merge, or assign a whole or any part of the trustor's business. The Minister may demand materials or reports relative to the trust or may inspect the trust property or books and documents of the trust, trustor, or trustee. The Minister of Finance shall cancel the license if the trustor comes under items (1) to (3) of paragraph 2 of article 7. If the trustor, or any of its directors, contravene the Securities Investment Trust Law, the Securities and Exchange Law, or the contract of trust, or, if the assets deteriorate or grave losses are inflicted on the trust property by the trustor, the Minister of Finance may cancel the license, or revoke the contract of trust, or transfer the trustor business to a new trustor, or order the trustor not to enter into new or additional contracts of trust, or order the dismissal of any director causing such violation, deterioration, or loss. The Minister of Finance may require the trustor to publish in a newspaper designated by him (a) amendments to the terms of trust granted under article 14, or (b) a six months report on the trust property submitted under article 19.

investment trust shall be provided for as follows, under article 20(1) of the Securities Investment Trust Law.

The books and documents which the trustor must prepare under article 20(1) of the Securities Investment Trust Law shall be the following:

1. Ledger as to trust accounts;
2. Detailed statement (account) as to profits used as dividends;
3. Detailed statement as to trust assets;
4. Register of beneficiary certificates;
5. Book as to standard price of beneficiary certificate;
6. Order of direction to invest in trust assets;
7. Ledger as to total accounts;
8. Cashbook;
9. Detailed statement as to the trustor's account receivable for remuneration;
10. Detailed statement as to undistributed income and capital gains;
11. Detailed statement as to undistributed redeemed money;
12. Detailed statement as to undistributed charges.

This regulation shall come into force from the day of its promulgation.

In the event of merger, consolidation, or transfer of the trustor's duties to a new trustor, public notice is given and any beneficiary may file any objection within a certain period. If a beneficiary does not object he is deemed to accept the new trustor. If the beneficiary objects then his share is redeemed under the provisions of the COMMERCIAL CODE (Shōhō) articles 245-2, 245-4 and 408-3, in 2 EHS No. 2.200.

See (a), (b), and (c) under art. 7, p. 327 supra.
Chapters V and VI (articles 25 to 38) are of little substantive importance.\textsuperscript{54}

**Resulting Structures.** There have been no reported cases under this important law and hence no judicial review by which to observe whether the industry has developed in ways unforeseen or unintended by its sponsors or the Diet. Under the Law of 1951 both common and anomalous structures have resulted.

The investment trusts of Japan are characterized as "contract-type" as distinguished from "investment-type."\textsuperscript{55} This means the investment trust is established by a contract of trust between the trustor and trustee for the benefit of an indefinite number of investors. The legal rights and duties flow from this relationship rather than from a corporation-shareholder relationship.

Two categories and five kinds of "contract-type" investment trust have evolved. The structural and operating features common to all are:

1. By a trust contract, a licensed trustor (manager) company designates a trustee to set up a trust fund of money or securities for investment in securities. The trustee is a trust company or a bank engaging in trust business. The board of directors of the trustor company have the ultimate fiduciary responsibility to the investors.\textsuperscript{56}

2. The fund is divided into equal units of beneficiary rights, which are then sold in certificates to an indefinite number of investors. These beneficiary certificates are redeemable\textsuperscript{57} at any time. The

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\textsuperscript{54} Article 25 provides that article 11(1) of the Anti-Monopoly Law (Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade) (Shiteki dokusen no kinshi oyobi Kōsei torihiki no kakuho ni kansuru hōritsu) (Law No. 54, 1947) shall not apply in cases where a trustee company acquires with the trust property or holds stocks, provided, however, that this shall not apply in the case where the trustee company may exercise the voting right of the stock in question. This has been interpreted by the Minister of Finance Circular No. 201 of 1951 to mean those cases where the trustee does not unconditionally assign the voting right to another. Thus, if the investment trust owns more than 10% of the stock of a single corporation, then the trustee has to unconditionally appoint another to vote those shares or abandon the right to vote them. A problem with abandoning them is that the trustee may hold such a large amount that no quorum might result. The practical effect is that irrespective of the amount owned, less than 10% or more, the trustee appoints another to vote the shares.

\textsuperscript{55} The essential difference being that between a trust and a corporation. In the United States, an investment company may be either a trust or a corporation. In Japan only the trust is allowed and covered by legislation. Either the "contract-type" or "investment-type" provides an indefinite number of investors with an opportunity to invest indirectly in many securities by investing directly in one certificate or share.\textsuperscript{56} They also have a primary fiduciary responsibility to the trustor company.

\textsuperscript{57} The right to redeem is not statutory but is provided for under the only terms of trust that the Minister of Finance will approve. The right to redeem may be suspended
certificates are bearer-type but may be registered at the request of the holder.

3. The trustor operates and manages the trust by directing the trustee. The trustor's main function is directing the investment, sale, and reinvestment of the trust assets. The trustor also issues and redeems beneficiary certificates and distributes profits. The trustor has complete discretion in giving directions to the trustee for investment within the terms of the trust and articles 16 and 17 of the Law of 1951.\(^\text{58}\)

4. The trustee buys and sells securities as directed by the trustor, and serves as custodian and accountant of the trust assets, receives dividends, and endorses the beneficiary certificates.

5. The investor-beneficiary has no voting rights.

6. Securities firms designated by trustors to sell and repurchase investment trust beneficiary certificates are divided into three classes: (1) those which have formed investment management companies to handle their investment trust business; (2) investment trust sales companies which are majority-owned by the trustor; and (3) affiliates of those in Class (1). All three classes confine their sales and repurchases to those of a single trustor.\(^\text{59}\)

The categories and kinds of investment trusts by name and distinguishing characteristics are:

1. *The Unit Investment Trust.*\(^\text{60}\) The first to be formed under the 1951 Law and the most popular\(^\text{61}\) is also called the "semi-closed..."
investment trust." This trust offers an indefinite number of five-thousand-yen units during a one-month period. The lifetime is fixed—all present unit trusts are for five years. Because the term is five years with only a one-month subscription period, the trustor usually establishes sixty unit trusts (one each month over a sixty-month [five-year] period. At maturity, the investor-beneficiary receives the market value of his shares plus undistributed dividends. If the beneficiary redeems prior to maturity he pays a charge of one and one-quarter per cent of the current net asset value, plus from six per cent to one-tenth of one per cent depending on the time elapsed since the certificate was issued. The regular charges to an investor are an initial five per cent sales charge and an annual management fee charge of nine-tenths of one per cent computed on the principal at the end of each fiscal year. There is a one and one-half per cent price on all securities sales.

2. The Open-end Investment Trust. The first open-end investment trust was started in 1952. The open-end bond, open-end basic industries, and balanced open-end investment trusts are variations in this category. All open-end investment trusts have an indefinite life and a stated maximum number of ¥1,000 units which are

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62 The closing of one unit investment trust and the opening of a new one every month would appear to create problems of time, personnel, cost, and market influence. Extension of one year is allowed. It may also help explain the statement of Matsui that 70% of the transactions are on a back-to-back or wash sale (baikai), type of transaction, within the securities houses. Matsui, Shōkenkai no iomen no mondai ni tsuite—Shōken Torihiki Shingikai no gidai o chūshin ni. (Concerning the urgent problems of the Securities business—centering around the subjects given by the Securities Transaction Council), 143 Shoji Hōmu Kenkyū (1959).

63 A voluntary regulation (Reform of Investment Trust System, May 31, 1961) issued by the members of the Investment Trust Association prescribed that distributions of capital gains and dividends of unit trust may not exceed ¥310 yearly or 62% of par value of ¥5,000.

66 This contrasts with the usual 8½% purchase charge and ½ of 1% annual management charge by Mutual Funds in the United States. Practice varies in the U.S. and some companies make no charge on purchase, others who have buying programs whereby the buyer contracts to continue to purchase shares over a period of time provide a large penalty for discontinuance in the first year—this can amount to as much as 50% of the amount of the investment if discontinued in the first year.

68 This new and different structure was recognized through an amendment to article 5 of the 1951 Law. This amendment requires that beneficiray certificates under open-end investment trusts contain two items of information in addition to the matter required by paragraph 6. 1952 Amendment Law No. 141, August 1, 1953. The Japanese open-end investment trusts are similar to U.S. open-end investment trusts and investment companies, as defined by SEC, Report on Investment Trusts and Investment Companies, 799 (1940).

(a) the continuous offering of securities at prices which will net the fund amounts equivalent to the net asset value of each outstanding share at the time of sale; and (b) the obligation of the investment company or trust to redeem or repurchase its outstanding shares by paying the equivalent of the net asset value per share.
sold in units of ten—¥10,000—($27.77). The stated maximum is many times the amount of the original issue and may be amended upwards with the approval of the Minister of Finance; thus, new certificates may be continuously offered. The redeemed shares may be, and usually are, resold. There is no issue market established for beneficiary certificates. The original issuers of the certificates and their designated securities companies make a market for them.67 This ordinary open-end investment trust may distribute profits without limitation; also it may accumulate twenty per cent of realized and unrealized capital gains each year up to eight per cent of the market value of the trust fund.

The redemption or repurchase charge is two per cent plus the regular securities sales tax of one and one-half per cent. The acquisition charges are three per cent per share for each five hundred shares or less and two and one-half per cent for each share over five hundred. The management fee is nine-tenths of one per cent per annum computed on the average net asset value.

3. The Basic Industries Open-end Investment Trust is similar to the ordinary open-end investment trust except that its scope of investment is limited to twenty or thirty corporations engaged in basic industries as determined by the trustor, as set out in the trust contract and approved by the Ministry of Finance.68 The above three types of investment trusts select their portfolio from the more than 1100 different stocks in more than 20 industrial classifications listed with the TSE. Out of this number each investment trust, with the help of research specialists, places into its portfolio 100 to 150 favorable stocks from roughly 450 stocks considered suitable, resulting in extremely well balanced investments.69

4. The Bond Open-end Investment Trust70 is limited to investment

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68 The Basic Industries Open-end Investment Trust Contract is quite similar to the Open-end Investment Trust Contract other than its portfolio of investment. Article 20 of the 1961 Nikko Basic Industries Open-end Securities Investment Trust Contract (Dec. 2, 1961) states:
   The stocks directed by the Trustor to invest in shall be exclusively those listed on securities exchange, belonging to electric power, iron and steel, and other basic industries previously specified by the Trustor.
   The Nikko Contract, supra, specified 30 basic industries.
70 Only 3% of the debt of Japanese companies is debentures. The debenture market continues weak with the result that this type of security has little appeal to the investing public. See Christensen, Japanese Equity Financing, 38 WASH. L. REV. 105, 108 (1963).
in bonds and debentures. Distributions of principal are limited to seven and seventy-seven one-hundredth per cent per year. The units are one yen per value and the minimum purchase is in units of ten thousand. There is no acquisition charge on new certificates. The redemption charge is one per cent. The management charge is two-tenths of one per cent of the average principal. New certificates may be purchased only during the month of the anniversary of the founding when the bonds have become ex-rights. Because of the one month per year subscription period, the larger companies establish twelve open-end bond investment trusts, one each month.

5. Balanced Open-end Investment Trust. April 15, 1964 saw the introduction of the first two balanced funds. Two more followed in that month. The first two operate under a required ratio of not more than 65% in common stocks with the balance in bonds and call loans or cash. The other two have a ratio set by the trust agreement of not more than 60% in common stocks, the balance being in bonds, etc. The total invested in all four trusts is approximately $11 million.

COMPARATIVE EVALUATION

No studies of Japanese investment trust law have been found. This void, plus a total absence of judicial pronouncements on the law or its implementing regulations, suggests the need for a comparative study to measure the law and structures against the legislative intent and the common function of investment trusts.71

Comparative studies of U.S. investment company law and Japanese investment trust law have been done seldom, if at all. The main difficulty in making such a study is that the economic, social, legal history, and environment of each country is markedly different from the other's. On the other hand, several factors indicate the possibility and profitability of such a study. One such factor is that the 1951 Law is supposedly largely based on the U.S. Investment Company Act of 1940.72 Another factor is the basic and general similarity of the Japanese investment trusts and the U.S. managed, open-end investment companies (mutual funds).73 This last factor is enhanced by

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71 This function is to afford the small investor an opportunity to diversify his holdings, spread his risks, and obtain competent and continuing investment supervision.
73 All Japanese investment trusts provide for repurchase (redemption) at net asset
the availability of a recently completed investigation of U.S. mutual
Finance and Commerce of the University of Pennsylvania for the
United States Securities and Exchange Commission \(^4\) (hereafter re-
ferred to as the Wharton Study).

As an aid in evaluating and applying to Japan's investment trusts
the findings and conclusions of the Wharton Study with reference to
investor protection, portfolio company control, and market impact,
comments on a few of the pertinent counterpart provisions from the
detailed coverage of the 1940 Act are here set out.\(^5\)

The 1940 Act. The declared policy and purpose of the 1940 Act are
to mitigate and, where feasible, eliminate the abuses found to exist in
the investment company industry in the United States while giving
government sanction to this investment media. This is accomplished
by full disclosure of information regarding investment companies and
their securities both to the supervising governmental body (the Secu-
rities and Exchange Commission), and to the general investing public,
and by the regulation of the activities of investment companies.

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1. SEC REP. ON INVESTMENT TRUSTS AND INVESTMENT COMPANIES 27 (1940). See also note 66 supra. A typical "mutual fund" will be organized by persons who will also organize a management company to manage the fund. The management company will usually contract with an investment advisor for advice; the usual charge by the investment advisor is one-half of one percent of the principal of the fund advised.

2. This study, the most comprehensive in twenty-five years, was prepared for the SEC by the Wharton School, presented to Congress, and made available to the public as H.R. Rep. No. 2274, 87th Cong. 2d Sess. (1962) (hereinafter cited as the Wharton Study).

3. For an invaluable analysis of the 1940 Act and the background of its enactment see Jaretski The Investment Company Act of 1940, 26 WASH. U.L.Q. 303 (1941). Jaretski notes that the 1940 Act had the unanimous approval of both industry and Congress at the time of its enactment. Only slight changes have been made to date. The Wharton Study and some continuing studies by the SEC indicate the Act is presently being reviewed with particular attention to questions of investor protection as it pertains to the affiliation of investment company advisors and management companies, professionalism of investment advisors and salesmen, charges, results of professional advice in relation to charges, and effectiveness of the independent directors. On this last subject see Business Week, March 7, 1964, p. 88.
The Act requires the registration of most non-exempted investment companies and their shares. Such registered companies thereby acquire a status which simplifies administrative control. After registration a company must comply with various reporting requirements designed to provide the Securities and Exchange Commission (hereafter referred to as the SEC), the company shareholders, and the general public with current information concerning its operation. The SEC, as administrator of the Act, has the duty to make sure that the various provisions of the law are met. It has little opportunity to impose restrictions inasmuch as its powers revolve around disclosure rather than the merits of an issue or the fairness of the charges. The SEC does have wide discretion with respect to registration statements and periodic reports and in its powers to exempt companies from the Act. Unofficially, it exercises a policing power in its processing of proxy statements and in the registration of securities. Investment companies are more often concerned with the sale of their securities, which must be registered under the Securities Act of 1933, than with any other aspect of SEC administration. Closed-end companies, which are seldom selling their securities, are not as involved in sales as are the mutual funds which must maintain a current prospectus in order to continue offering and selling their shares to the public.

The Act of 1940 gives investment company shareholders certain formal rights to participate in decisions involving the initiation and continuance of investment management and underwriting contracts. Shareholders are further protected by explicit information on the company investment policy and must be involved in any change in the nature of that policy. Shareholders vote for directors annually and receive company reports not less than semi-annually. At least forty percent of the directors of the management company must be independent of any affiliation with the management company, and a majority must be independent of any affiliated broker or underwriter. Section 17 prohibits, unless SEC approval is given, specified types of transactions between any affiliated person, promoter, or principal underwriter of

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76 Investment companies with assets of less than $100,000 need not register.
77 The timing of new issues by closed-end funds is important and requires prompt clearance of the registration by the SEC. Most open-end companies have vital sales organizations which would disintegrate if selling were interrupted. The recurrent filings by investment companies puts the SEC in a strong position to impose its views without resort to enforcement machinery of the laws. The investment companies are seldom in a position to resort to administrative proceedings, judicial review, or other right-protecting mechanisms which are time-consuming procedures, to determine the correctness of the SEC position.
an investment company or affiliated persons of any such persons and the investment company. Borrowing by mutual funds is limited by a requirement of 300% asset coverage at all times. No senior securities are allowed to be issued by mutual funds and their shares are valued at asset value.

Portfolio company control is regulated by section 5(b)(1), providing that seventy-five per cent of the total assets of a diversified fund shall meet the requirements that: 1) no more than five per cent of the assets of the fund may be invested in the voting securities of any one company; and 2) the fund may not hold more than ten per cent of the outstanding voting securities of any one portfolio company. A diversified registered investment company is given desirable tax benefits. Within the framework of its registered investment policy and the five and ten per cent rules for diversification there is little restraint on management's judgment regarding investment. The regulatory powers of the SEC do not, however, include any effective means of insuring expertise of management in investing.

The Act has served well. It was passed with the unanimous approval of both the industry and government and has undergone only slight changes in twenty-four years. The investigation by the Wharton School and the continuing SEC studies have so far revealed no blatant excesses or abuses. It is expected, however, that out of these studies a number of proposals for amendment will be made.

The Wharton Study. The Wharton Study originally covered 156 (later 232) open-end investment companies whose assets in 1958 comprised approximately 96% of all registered open-end company assets. Registered open-end investment companies as of December 31, 1961, totaled 344 with aggregate assets of $24.4 billion. As of June 30, 1961, all registered investment companies had total assets of $29 billion.

The Wharton Study concluded that the most important and critical area of concern was that of investor protection, particularly the problems of conflict of interest between fund management and shareholders, and the possible absence of arm's-length bargaining between the fund manager and the investment adviser. Another area of growing concern was that of market influence of mutual funds and investment companies as a whole. Considered of no present serious consequence was the problem of fund size in all its aspects, particularly from the standpoint of fund control of portfolio companies. The findings leading to these conclusions (as well as some findings and conclusions on invest-
ment company and fund performance) are considered to have varying degrees of applicability to the Japanese investment trust industry.

**Investor Protection.** We have previously noted that the trustor-manager was originally a securities company which was also the organizer, underwriter, and investment adviser to the fund, as well as an underwriter, broker, dealer, and investment adviser to its securities clients; and that in 1961 the trustor securities companies, under an agreement worked out with the government, placed their trustor-manager functions into fourteen separate management companies. The securities companies continued to supply their names, offices, officers, directors, and sales outlets to the new management companies. This legal separation of the management company and broker is not greatly different than the situation prevailing in the United States where the management company is usually only legally separated from the investment adviser and the broker. In Japan, contrary to the situation in the United States, the fourteen trustor-manager companies and their parent companies control the investment trust industry one hundred per cent and also account for most of the securities transactions in Japan. The four largest management companies account for over eighty per cent of all investment trust assets through over two hundred investment trusts, while their parent companies account directly for over seventy per cent of the day-to-day market transactions on the stock exchange and indirectly for a much larger percentage. The business of the trustor company may or may not provide a conflict of interests for its board of directors depending on whether or not the trustor company and its directors have other business or other business affiliations, direct or indirect, and, if so what that other business is. Even though the trustor company and its directors have only the trustor business, with so many investment trusts being managed by the same trustor (with the same objective in investment and the same stocks in

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78 Members are listed in Investment Trust Ass'n (Shōken Tōshi Shiutaku Kyokai), Investment Trust in Japan (1963). Of the Association of the 14 investment trust management companies, 13 have their parents' name and 8 of the 14 are officed at the same address. See also Nomura Securities Investment Trust Management Co., Ltd., A Brief Outline of Investment Trusts in Japan 2 (1963) which refers to the management companies as independent and adds: “The relations between the securities firms and the management companies are still very close as the former remain as parent firms over the latter.” The amount of interlocking officers and directors and control allowed the parent companies is detailed in note 32, supra.

79 The Wharton Study op. cit. supra note 74, at 463 finds: “In many cases, the distinction between the advisor and client company is strictly legal, the investment company possessing no office or personnel independent of that of its agent, the investment adviser.”
many cases) there could arise a conflict of interest in the duty to each trust. For example, when an attractive purchase is available, which trust is to be given the opportunity? When it is deemed advisable to sell a security that may be held by each of twenty different investment trusts, which trust sells its holding first on a declining market; or might all be sold at the same time at a discount by reason of the size of the disposition? Given these facts, the principle of investor protection may well resolve itself into a matter of the enlightened self-interest of the trustor and securities companies, themselves subject to the degree of control the Minister of Finance deems appropriate.

Some of the conflict of interest problems posed have been previously stated as involving Civil Code article 108 providing that one person cannot act for both sides in a legal act. It is more clearly put by noting that article 20 and article 26(3) of the Trust Law require the directors of a trustor company to serve the best interest of the trust, while corporation law requires a director to "make his greatest efforts in the interest of the corporation and he should on no account have his hand in dealings that bring or result in profit to himself or to a third party, against or at the sacrifice of the interest of the company." A director serving a securities company with investment trusts must try to serve two masters in their business of buying, selling and holding securities in a situation in which every transaction will be presently or ultimately to the advantage of one and the disadvantage of the other. It is suggested that in a universe where these same securities companies control the securities markets, this conflict is not fully resolved by a requirement that buying and selling between the trust and its manager, officers and 10% shareholders be through the market.

Some of the same variety of potential conflicts of interest that exist in the investment trust industry were noted in the Wharton Study and occasioned the following findings. The special characteristics of mutual funds with an external adviser closely affiliated with the management of the fund tend to weaken the bargaining position of the fund in the establishment of advisory rates. The disposition of brokerage business by investment companies is considered a source of possible

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80 Art. 20: "A trustee shall manage trust affairs with the case of a good manager in compliance with the tenor and purport of the trust." Art. 26, (3): "Any person who manages trust affairs in place of the trustee shall assume the same responsibility as the trustee." 6 EHS No. 6130.


82 Securities Investment Trust Law, art. 16 and 17.

conflict of interest, particularly where the manager is affiliated with the broker. The close affiliation of manager and broker tends to result in the fund not receiving the most advantageous return. The study notes that valuable services, including investment research, can be secured in return for receiving brokerage which may be lost by reason of the tendency of the manager to award itself or affiliate the brokerage. In addition to direct participation of investment advisers in the distribution of shares and brokerage, in many cases advisers and control groups participate in these activities indirectly, through parents, subsidiaries, or otherwise affiliated organizations. Funds in which the controlling organization or individual of the fund were affiliated with a broker exhibited higher turnover rates than did the industry as a whole in every year from 1953 through 1958, indicating such relationship encouraged buying and selling—enhancing the profits of the broker and the expense to the fund. (We will note that the rate of turnover of Japanese investment trust securities indicates that this is not the case in Japan.)

The existing mechanisms for protecting shareholder and public interests primarily include the required provision of information to shareholders, shareholder voting rights, the legal obligation to select independent directors, limitations on principal transactions by affiliated persons, and supervisory protection. The findings with reference to the effectiveness of these provisions indicate:

1. Investors pay little attention to most of the protections provided by the Act of 1940, feeling they are fully protected from abuse by government regulations such as The Act and other securities legislation. Shareholders look to the fund management not only for diversification but for expert management and devotion to shareholders' interests. It is thought possible, that in spite of the information provided, shareholders are led by the structure of formal relationships into supposing that their fund is a truly independent organization, whose officers and directors negotiate at arm's length on their behalf with the investment adviser in fixing fees, deciding on brokerage allocations, continuing the services of the investment adviser or broker based on an appraisal of the adequacy of performance, fairness of charges, etc. These

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84 Id. at 32-34, 435.
85 Id. at 435.
86 Id. at 20.
87 Id. at 34.
88 Id. at 3.
89 Id. at 33.
findings if related to the Japanese industry should note the
tendency (not observed in the investment company industry) of
U.S. investors to protect their rights whereas the Japanese, as
noted, tend to either have no consciousness of individual rights
or to sublimate such consciousness.

2. Investor protection through voting rights, annual meetings, and
independent directors may be contrary to the realities and of
limited value in the mutual fund industry, serving primarily as
potential checks in preventing major abuse.\textsuperscript{90} It is considered that
the redemption privilege is largely responsible in the United
States for the apathy of investors who will register their dis-
approval by selling rather than using the rights provided by law.\textsuperscript{91}
Shareholder attendance at meetings has been low and voting has
been primarily by proxy; hence, management control has been a
virtually automatic consequence of the possession of the corporate
proxy machinery by the promoting management adviser.\textsuperscript{92} The
SEC is currently examining the position of the independent
directors, plus whether the investment company directors as a
whole safeguard the rights of shareholders, particularly where
some of the directors have a potential conflict of interest by reason
of their other business interests as fund officer, adviser, or under-
writer.\textsuperscript{93} We have previously noted that Japanese investment
trusts have no voting privileges for their beneficiaries, nor any
meetings. The independence of directors, if any, is not covered
by law or regulation.

3. One of the most powerful and important shareholder protections
incorporated into the Investment Company Act was the section 17
limitation upon sales and purchases of securities and other prop-
erties between investment companies and affiliated persons. This
section has virtually eliminated several classes of transactions
associated with major abuses of the past.\textsuperscript{94} The Japanese counter-
part, articles 16 and 17 of the Law, by failing to include directors
and affiliated or controlled persons has left a wide door open to
transactions in derogation of the best interests of the investors.

4. No comments or findings were addressed to the SEC, the supervi-
sory authority, who sponsored the study, but we may note that

\textsuperscript{90} Id. at 7, 8, 35, 453.  \textsuperscript{91} Id. at 63-69.  \textsuperscript{92} Id. at 465-466.
\textsuperscript{93} Business Week, March 7, 1964, p. 88.
\textsuperscript{94} Wharton Study, \textit{op. cit. supra} note 74, at 35.
in Japan the trustor licensing and trust contract approval powers of the Ministry of Finance are very broad, allowing it, at these points, broad discretion. With so much power, it is important to note that the Ministry of Finance is not an independent agency, as is the SEC, but is subject to political pressures and changes.

Size. An original purpose of the Wharton Study was to investigate the relationships of the size of investment companies (funds) and their investment advisers to the securities markets and to the policies of portfolio companies. We will now note the findings in these regards and also the effect of size as it affects the investors in the fund, i.e., in performance.

The Study found that managing and advising funds did not require large capital or large numbers of employees, that 163 investment advisers with a median of 4 shareholders managed and generally controlled 232 funds with a median of 8,792 shareholders. Over one-half of these advisers had net worth of less than $100,000 and 28 had less than $10,000. Only one adviser had as many as 600 employees (mostly sales employees). Of the advisers supervising assets of over $600 million, the two whose major activity was advisory had less than 100 employees, one of them having fewer than 50.

Most important to investor welfare is the performance of the funds in maintaining and increasing the income and the value of the assets administered. The Study found there was no appreciable difference in the performance of funds with less than $10 million in assets and those with over $300 million in assets, nor was there a strong tendency for the new funds to perform either better or worse than the established ones.

The Japanese Big Four securities firms, the original trustors of the first investment trusts, each have a capitalization of ¥8,000 million ($22.2 million) and average 8,000 employees each. These four account, directly, for over 80% of all investment trust assets, and in association with eight of the medium-sized securities companies, for 97% of this more than $3 billion industry. We have noted that the
1951 Law requires ¥50 million in capital and the personnel, experience, and ability to invest in the market as a trustor of an investment trust. We have also noted the securities companies argued the necessity of large size when negotiating the terms of the legal separation of their trustor functions to new management companies.104

Portfolio Company Control. The Wharton Study reported that outright control of portfolio companies by mutual funds was a rarity and is confined mainly to small portfolio companies in need of venture capital. Further, that neither the extent nor character of fund influence over these mainly commercial and industrial concerns appeared to warrant serious concern.105 The funds generally sell such securities rather than attempt to exert their influence.106 Virtually all funds vote at annual election by giving their proxies to the management committee of the company involved.107

The U.S. funds under study were limited to maintaining 75% of their assets in companies in which they hold 10% or less of the outstanding voting securities.108 In Japan the Ministry of Finance approved terms of trust limiting the holdings of any single investment trust or any group of investment trusts under one trustor to 20% of the outstanding voting securities of any one portfolio company.109 Also to be noted with respect to this issue in Japan is the fact that the usual capitalization ratio of stock companies in Japan is two-thirds debt and one-third equity.110 In practice, voting rights are assigned either to the portfolio company itself or an independent person, irrespective of the amount held.111

Impact on the Market. The Wharton Study made findings of the impact of mutual fund activity not only on the level of prices but also on the relative stability of prices (the extent to which fund activity moderates or accentuates market movements).

U.S. mutual funds, with a much smaller percentage of the total market value of listed stocks and of daily transactions in those stocks than that of the Japanese investment trusts, significantly and sub-

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104 See note 32 supra.
106 Id. at 26.
107 Id. at 417.
109 See note 58 supra.
110 Christensen, Japanese Equity Financing, 38 WASH. L. REV. 107 (1963)
111 See note 54 supra.
stantially affected the daily movements in the stock market and possibly the month-to-month movements, and have, together with other factors, stimulated stock prices markedly during the past decade of rapid growth of the investment company industry. The Japanese Investment Trust Association states that investment trusts in Japan have contributed to the stability and expansion of Japan's securities markets.

With respect to the stabilizing or de-stabilizing influence of mutual funds it was found that the turnover rate of stock holdings in the various funds was higher than the rate of turnover of all stocks listed on the New York Exchange. Such a finding is indicative of a de-stabilizing influence inasmuch as a further finding was made that funds tended to trade with, rather than against, the trend in the cyclical movement of stock prices.

In Japan, the percentage of total stock transactions by investment trusts compared to the total of all transactions on the securities exchanges indicates a low turnover rate of portfolio stocks—in the last six years less than the percentage ratio of total stocks held to the total of listed stocks. This indicates a stabilizing effect on the market. Other factors, such as the investment trusts' five-year growth rate of more than fourteen-fold (while the U.S. mutual funds were experiencing an annual fourteen per cent increase in assets from the sale of new shares), and the monthly redemption of unit investment trusts which have reached their five-year maturity will influence prices and the stability of the market.

The findings and conclusions of the Wharton Study on fund influence on prices and markets in the United States (where mutual funds hold approximately four and one-half per cent of the value of all listed stocks on the New York Stock Exchange compared to the

\[\text{\footnotesize{112 Wharton Study, op. cit. supra note 74, at 21.}}\]
\[\text{\footnotesize{113 Id. at 359.}}\]
\[\text{\footnotesize{114 INVESTMENT TRUST Ass'ns, op. cit. supra note 78, at 26.}}\]
\[\text{\footnotesize{115 Wharton Study, op. cit. supra note 74, at 15.}}\]
\[\text{\footnotesize{116 Id. at xi, xii. However, the Investment Company Institute in a monograph prepared for the Commission on Money and Credit, states that "Studies conducted of the operations of investment companies in all down periods of the stock market in the last 15 years have shown the investment companies to be stabilizing influences, thus aiding the orderly operation of the capital markets." INVESTMENT COMPANY INSTITUTE, MANAGEMENT INVESTMENT COMPANIES 90 (1962).}}\]
\[\text{\footnotesize{117 Nomura Securities Investment Trust Management Co., Ltd., op. cit. supra note 78, at 23.}}\]
\[\text{\footnotesize{118 Id. at 21.}}\]
\[\text{\footnotesize{119 Wharton Study, op. cit. supra note 74, at 5.}}\]
\[\text{\footnotesize{120 75.5\% of the funds' common stock purchases are conducted through the New York Stock Exchange. Id. at 13.}}\]
Japanese investment trusts holdings of 14% of the total market value of all listed stocks) should a fortiori hold true of the influence of Japanese investment trusts on prices and markets. Further, such influence may well increase at a geometrically greater rate than the arithmetical increase in the market value of securities held by investment trusts to the total market value of all listed securities.

**Performance.** It has been well said, particularly from the standpoint of the investor "the reason for being of any trust—[is] to secure better than average results."\(^{121}\)

The Wharton Study found no significant difference or relation:

1. in the year-by-year or cumulative performance between the funds without an outside investment adviser and those with an outside adviser;\(^ {122}\)

2. as compared with funds of comparable type and size between the performance of broker-affiliated funds and that of funds without those affiliations;\(^ {123}\)

3. as noted above,\(^ {124}\) between the performance of small-size funds and large size funds or new funds and older funds;

4. between the rates of management fees paid by the funds and their cumulative performance results;\(^ {125}\)

5. between sales charges and the funds cumulative performance results.\(^ {126}\)

The Study found very few funds that recorded consistently either superior or inferior performance.

The findings on the performance of the funds as a group were to the effect that:

1. mutual funds may have the ability to fulfill their own market predictions, and in particular to validate their own appraisal of the market movement of individual issues;\(^ {127}\)

2. they may possess the ability to pick the most profitable prospects,\(^ {128}\) but also no superior or inferior ability was shown to

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\(^{121}\) Bullock, The Story of Investment Companies 97 (1959).

\(^{122}\) Wharton Study, op. cit. supra note 74, at 494.

\(^{123}\) Id. at 349.

\(^{124}\) See text accompanying notes 99, 100 supra.

\(^{125}\) Wharton Study, op. cit. supra note 74, at 345.

\(^{126}\) Id. at 347.

\(^{127}\) Id. at 358.

\(^{128}\) Id. at 360.
direct capital into particularly profitable areas of economic investment\(^{129}\) (diversification may tend to obscure such ability).

(3) There was no showing of positive correlation between the funds' selections and an increase in per share earnings of those selected;\(^{130}\) and

(4) comparisons suggest that the funds' performance approximated that of a common stock average.\(^{131}\)

No comparative analyses of Japanese investment trusts as among trusts of the same type or between trusts as a whole and the market averages have been studied. The previous references to the degree of concentration of the industry would be pertinent in evaluating such studies.

**Conclusion.** The tremendous growth in assets of Japanese Investment trusts resulting in an expanded share of the securities markets is of significance to the Japanese economy. An acquaintance with this industry is of necessary importance to an understanding of Japanese securities markets. The evolution of an investment media to protect the investor by spreading his risk, providing experienced and professional investment advice (i.e., persons of integrity who are dedicated solely to the best interests of their clients and who would not allow their judgments to be compromised by attempting to serve competitive or conflicting interests) at a cost that will not eliminate the small investor, and will at the same time, protect the national economy and the money market is a worthy task, best approached with an understanding of the accomplishments and failings of the past.

\(^{129}\) Id. at 393.

\(^{130}\) Id. at 393.

\(^{131}\) Id. at 295.