

**Global Investment Funds:
Changes in the Last 30 Years and Future Challenges**

October 2016

Kohji Sugita

Research Fellow, Japan Securities Research Institute
Senior Analyst, Japan Investment Trusts Association

This paper is prepared for the participants in the 30th annual conference of International Investment Funds Association based on the author's report published by Japan Securities Research Institute in May 2016.



Kohji Sugita is Research Fellow, Japan Securities Research Institute, and also Senior Analyst, Japan Investment Trusts Association.

He previously worked at Nomura Asset Management Co., Ltd. (NAM) in Japan for about forty years. His career at NAM included the manager of a department for business and product development, the chief representative of NY office and a director at a research institute, established by NAM, specializing in investment funds.

Global Investment Funds:
Changes in the Last 30 Years and Future Challenges
(Summary)

The commemorative 30th Annual Conference of the International Investment Funds Association (IIFA), comprised of investment funds associations from countries around the world, will be held in Japan in 2016.

In this milestone year, this paper analyzes how global investment funds have changed quantitatively and qualitatively over the last 30 years and examines the challenges for the future.

The net assets of publicly offered securities investment funds worldwide increased by 28-fold in the last 30 years to US\$34.1 trillion at the end of 2015. It is estimated that just under 20% of the securities issued in the world are held via investment funds.

Factors that made this increase possible were: (1) global long-term price increase of equities and bonds; (2) growth of household financial assets worldwide; (3) shift of pension system towards defined contribution plans, such as in the United States and Australia; (4) rapid growth of investment funds in emerging economies; (5) diversification of distribution channels; and (6) the enhanced product lineup for diverse investment environment.

The qualitative changes in the last 30 years had the following trends: (1) globalization; (2) rising cost consciousness (expansion of ETFs); and (3) advances in IT adoption.

Challenges for the future include:

(1) to ensure that investment funds make adequate returns to investors, mainly by (i) securing returns on asset management under the changing economic environment; (ii) increasing investor returns; (iii) providing additional value other than investment gains; (iv) performing fiduciary duty; and (v) promoting cross-border fund distribution;

(2) to ensure that investment funds that have become large fulfill their social responsibility, mainly by (i) contributing to improving the quality of the securities market; (ii) developing ESG investment; and (iii) paying more attention to link to the stability of the global financial system; and

(3) to explore business opportunities, mainly by (i) focusing on investment fund markets in emerging economies; and (ii) utilizing “FinTech.”

Global Investment Funds: Changes in the Last 30 Years and Future Challenges

Introduction

The commemorative 30th Annual Conference of the International Investment Funds Association (IIFA), comprised of investment funds associations from countries around the world, will be held in Japan in 2016.¹

In this milestone year, this paper looks back at how global investment funds have changed quantitatively and qualitatively over the last 30 years and what factors caused these changes, comparing them with the situation in Japan, and examines challenges for the future.

The views and opinions expressed in this paper are solely those of the author.

1. Investment Fund Assets Increased by 28-Fold in 30 Years

Looking first at the quantitative changes, it can be seen from Figure 1. that the total net assets of global publicly offered securities investment funds (including exchange traded funds [ETF], hereafter “the fund assets”) increased by 28-fold from US\$1.2 trillion at the end of 1985 to US\$34.1 trillion at the end of 2015. Despite temporary decreases over the years due to the collapse of the IT bubble in the early 2000s, the global financial crisis in 2008, and the European debt crisis in 2011, the fund assets has remained on a growth path relatively consistently. According to IIFA, which in 2015 modified its counting method and began publishing the fund assets including private placement funds for institutional investors, the fund assets at the end of 2015 including the private placement funds was US\$37.2 trillion.

As a ratio to the world GDP,² the fund assets increased from 6.3% in 1985 to 46.6% in 2015 (50.8% including private placement funds).

Furthermore, global investment funds were estimated to hold equities of US\$16.9 trillion³ by a

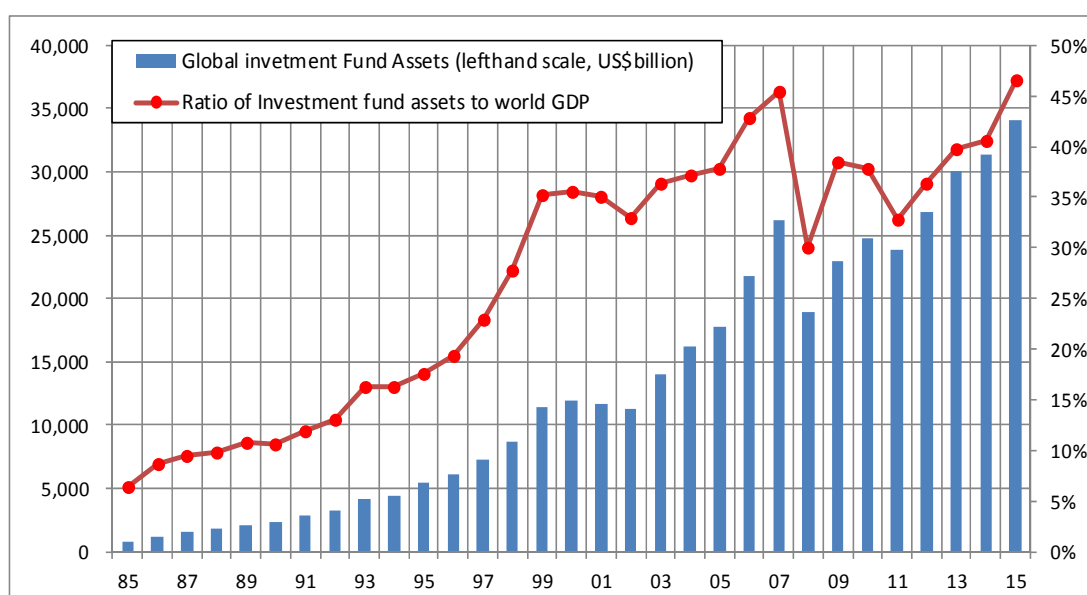
¹ The IIFA 2016 Annual Conference will be held in Osaka from October 24 to 26. An international investment funds seminar is scheduled to be held in the week before the Annual Conference on October 21 in Tokyo.

² According to the International Monetary Fund (IMF) World Economic Outlook Database October 2015, the total nominal GDP of all countries was US\$12.27 trillion in 1985 and US\$73.18 trillion in 2015.

³ The IIFA tabulates the global investment fund assets by types of products. The breakdown of the US\$37.19 trillion assets at the end of 2015 was as follows (unit: US\$ trillion): 15.91 equity funds; 7.83 bond funds; 5.15 balanced funds; 5.07 money market funds (MMF); 0.07 capital guarantee funds; 0.44 real estate funds; and 2.72 others. This includes US\$3.18 trillion in private placement funds for

simple calculation (equity fund assets×90% + balanced fund assets×50%) at the end of 2015, or 27% of the global equity market capitalization at that time (US\$62.8 trillion⁴). Similarly, global investment funds were estimated to hold bonds of US\$14.2 trillion at the end of 2015 using a formula (bond fund assets×90% + balanced fund assets×50% + money market fund assets×90%), or 14% of the global bond outstanding at that time (around US\$100 trillion⁵). Accordingly, under 20% (around US\$31 trillion) of the balance of global securities issued (around US\$160 trillion), combining equities and debt securities, were seemed to be held through investment funds.

Figure 1. Assets of Global Publicly Offered Investment Funds and Their Share of World GDP



Sources: Investment fund assets data from IIFA; ratio to world GDP is calculated using world GDP data from the IMF's "World Economic Outlook Database October 2015."

Comparison with Japan

The assets of publicly offered investment funds in Japan rose by no more than five-fold in 30 years, increasing from 19.97 trillion yen in 1985 to 97.76 trillion yen in 2015. The multiplication factor was considerably lower than the world's 28. While the ratio of investment fund assets to GDP increased from 6.1% in 1985 to 19.6% in 2015,⁶ this increase was much smaller than the worldwide

institutional investors. As the private placement funds' breakdown by types of products is unknown, the author calculated the breakdown by the assets including private placement funds.

⁴According to data of the World Federation of Exchanges (WFE).

⁵The Bank for International Settlements (BIS) estimated the outstanding amounts of global debt securities at the end of June 2015 as consisting of US\$87.9 trillion for domestic securities and US\$21.5 trillion for international securities. The BIS states that the two have some overlaps and does not announce their total value. However, from a figure in the Q2 2015 BIS Quarterly Review, it can be construed that the total was nearly US\$100 trillion.

⁶Japan's nominal GDP was 325.4 trillion yen in 1985 and 499.1 trillion yen in 2015.

increase from 6.3% to 46.5%. The primary reason of the small growth in Japan relative to the world was stagnant equity prices that have persisted in Japan for more than 20 years, as will be discussed later.

The share of Japanese investment funds' domestic equity holdings at the end of 2015 to Tokyo Stock Exchange equity market capitalization was calculated to be 3.9% (23.27 trillion yen/589.79 trillion yen⁷), whereas the share of investment funds' domestic bond holdings to the Japanese domestic bond outstanding at that time was calculated to be 0.9% (10.25 trillion yen/1,101.35 trillion yen⁸).

2. Factors Behind the Increase

The significant growth in global investment funds in the last 30 years can be attributed to a number of factors, including: (1) long-term price increase in global equity and bond market; (2) growth of household financial assets worldwide; (3) shift of pension system towards defined contribution (DC) plans, such as in the United States and Australia; (4) introduction and growth of investment funds in emerging economies; (5) diversification of investment fund distribution channels; and (6) the enhanced product lineup for diverse investment environment.

(1) Price increase in securities markets

Figure 2. shows the trends in equity prices and long-term interest rates in advanced economies in the last 30 years.

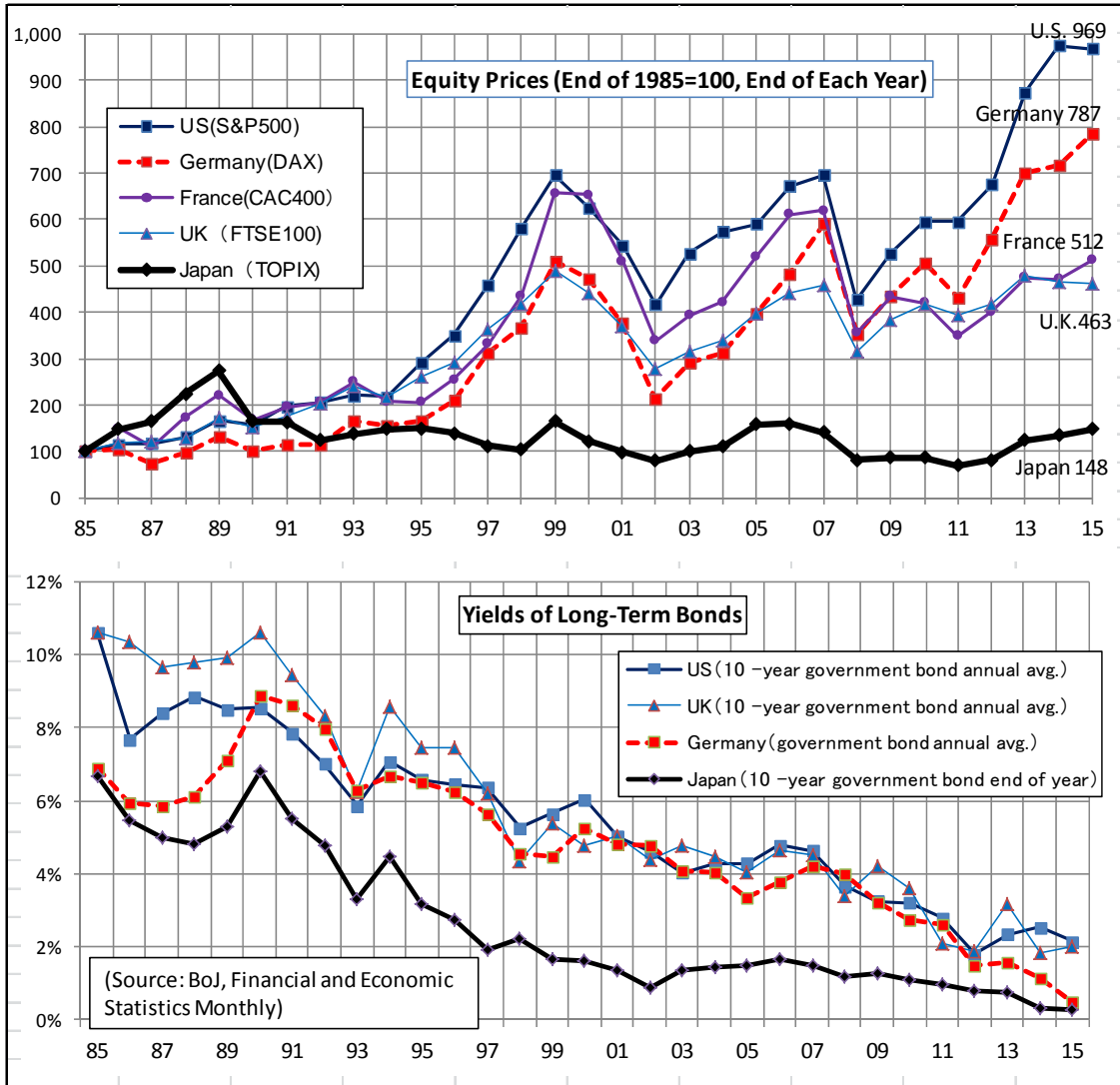
Though overseas equity prices have plummeted on some instances, they have significantly increased over the 30-year period between the end of 1985 and the end of 2015 by: 9.69-fold in the United States; 7.87-fold in Germany; 5.12-fold in France; and 4.63-fold in the United Kingdom.

At the same time, long-term interest rates in advanced economies have been on a downward trend relatively consistently, falling from 10.62% to 2.14% in the United States, 10.61% to 2.01% in the United Kingdom, and 6.87% to 0.50% in Germany (it means bond prices recorded sharp increases).

⁷According to the key statistics for domestic stocks of the Monthly Statistics Report, Tokyo Stock Exchange.

⁸Total public and corporate bonds outstanding by the Japan Securities Dealers Association's "Issuing and Redemption Amounts of Public and Corporate Bonds (January 2016 Update)."

Figure 2. Equity Prices and Long-Term Interest Rates in Advanced Economies



These rises in securities prices contributed to the strong performance of investment funds (delivery of favorable returns to investors), and accordingly, to increases in the inflow of funds from investors.

Incidentally, the author tried to calculate the breakdown of the increase in assets of global investment funds for the 15-year period between 2000 and 2014 for which the author had access to same criteria data. The result was that the US\$19.8 trillion increase in the assets was brought about by an inflow of money from investors⁹ equal to US\$10.5 trillion (53%), and the rest by market value fluctuations and other factors equal to US\$9.3 trillion (47%).

Comparison with Japan

As Figure 2. shows, equity prices in Japan (TOPIX) increased by a factor of 1.48 between the end of 1985 and the end of 2015, one-sixth of the multiplication factor of 9.69 in the United States.

⁹The inflow of funds from investors is calculated by subtracting the redemption amount from the sales amount. This is referred to as “net sales” by the IIFA.

Setting the peak equity price in Japan (end of 1989) at 100, equity prices have halved in Japan (54) whereas in overseas they have risen to 579 in the United States and 600 in Germany as of the end of 2015.

Long-term bond yields in Japan dropped significantly from 6.68% to 0.27% as shown in Figure 2. (bond prices increased). However, the margin of decline was 6.41% and small compared to the 8.48% in the United States and 8.60% in the United Kingdom. Additionally, long-term bond yields in Japan fell to below the 2% level in 1999, ahead of other countries. An unfavorable climate for making new investments in bonds has persisted since then.

Along the lines of the preceding factor analysis of the increase in the global investment fund assets, the author calculated the breakdown of the portion of the increase attributed to the inflow of funds from investors and the portion attributed to fluctuations in market prices and other factors.

Of the 46.4 trillion yen increase over the 15-year period between 2000 and 2014 in Japanese fund assets, the inflow of funds from investors was equal to 74.7 trillion yen and the rest was equal to -28.3 trillion yen (including dividend payment). In case of Japan, the fact that fluctuations in market prices and other factors became negative due to stagnant equity prices as well as payment of high dividends¹⁰ made its situation starkly different than the world situation (as was described, the portion of market price fluctuations and other factors attributed significantly and accounted for half of the increase in the world fund assets).

(2) Growth of household financial assets

Financial assets held by households (individuals), the main clientele of investment funds, increased in the last 30 years, enabling to increase the portion of risk assets.¹¹ This became a basis for the expansion of investment funds.

For example, in the United States which accounts for half of the global investment funds, the balance of household financial assets increased by 6.5-fold from US\$10.89 trillion in 1985 to US\$70.33 trillion in 2015.¹² Its ratio to GDP grew from 2.5 times to 3.9 times, allowing for the possession of more risk assets.

In Europe, the total balance of 19 countries in the Euro area increased by 1.4-fold in 11 years from 15.28 trillion euros at the end of 2004 (the year that Eurostat statistics trace back to) to 21.67 trillion

¹⁰This was due to the impacts of monthly dividend funds. Since 2010 for which the statistics of Japan Investment Trusts Association (JITA) are available, 30 trillion yen were paid in dividend payments in the six years through 2015. When the Bank of Japan (BoJ) revised its flow of funds statistics in March 2016, the BoJ changed to listing dividends from principals of investment funds and capital gains as outflows of funds from investment funds to investors.

¹¹Matthew Fink, former President of the Investment Company Institute (ICI) and author of *The Rise of Mutual Funds*, Oxford University Press, 2011 uses a term in his book “a growing middle class” as a contributor to the increase in investment funds in the United States.

¹²From Federal Reserve Board “Financial Accounts of the United States” (viewed on April 5, 2016).

euros at the end of September 2015.¹³ Furthermore, the balance of household financial assets in Germany for which euro-denominated statistics are available from 1992 increased by 2.5-fold in 23 years from 2.19 trillion euros¹⁴ at the end of 1992 to 5.37 trillion euros¹⁵ at the end of September 2015.

Comparison with Japan

The balance of household financial assets in Japan tripled in 30 years from 572 trillion yen in 1985 to 1,741 trillion yen in the end of 2015.¹⁶ However, the speed of growth is significantly lower than the 6.5 times of the United States. Furthermore, comparing 1992 and 2015 for which comparisons including Germany are possible, the balance of household financial assets grew by 2.5-fold in Germany and 3.8-fold in the United States, whereas the rate remained at 1.7-fold in Japan.

Incidentally, there are two factors that cause changes in the balance of financial assets: (i) financial flows (net acquisition calculated by subtracting financial asset disposition from acquisition); and (ii) market price increases of financial assets.

The reasons behind the slow growth of household financial assets in Japan lie in decreasing financial flows (i) and a slowdown in the rise of market prices (ii).

Figure 3. compares (i) Japan's rate of net acquisition of household financial assets (share of the relevant year's amount of net acquisition of financial assets to the financial asset balance of the end of the previous year) and (ii) Japan's rate of market price increases of financial assets (share of the amount arrived by subtracting annual financial flows from the amount of the annual increase in the financial asset balance (= price increase portion) to the financial asset balance of the end of the previous year) with those of the United States and Germany.

While Japan's rate of net acquisition of financial assets in the top graph exceeded that of the United States until the 1990s, it has fallen to below 2% since the beginning of the 2000s, less than that of not only Germany but also the United States.¹⁷

Furthermore, Japan's rate of market price increases of financial assets in the bottom graph is significantly lower than that of the United States. The arithmetic mean of the rate of market price increase in the 30 years between 1986 and 2015 was 3.9% in the United States versus no more than 0.7% in Japan.¹⁸

¹³From the Eurostat database (viewed on April 5, 2016).

¹⁴From Bundesbank statistics (viewed on April 5, 2016).

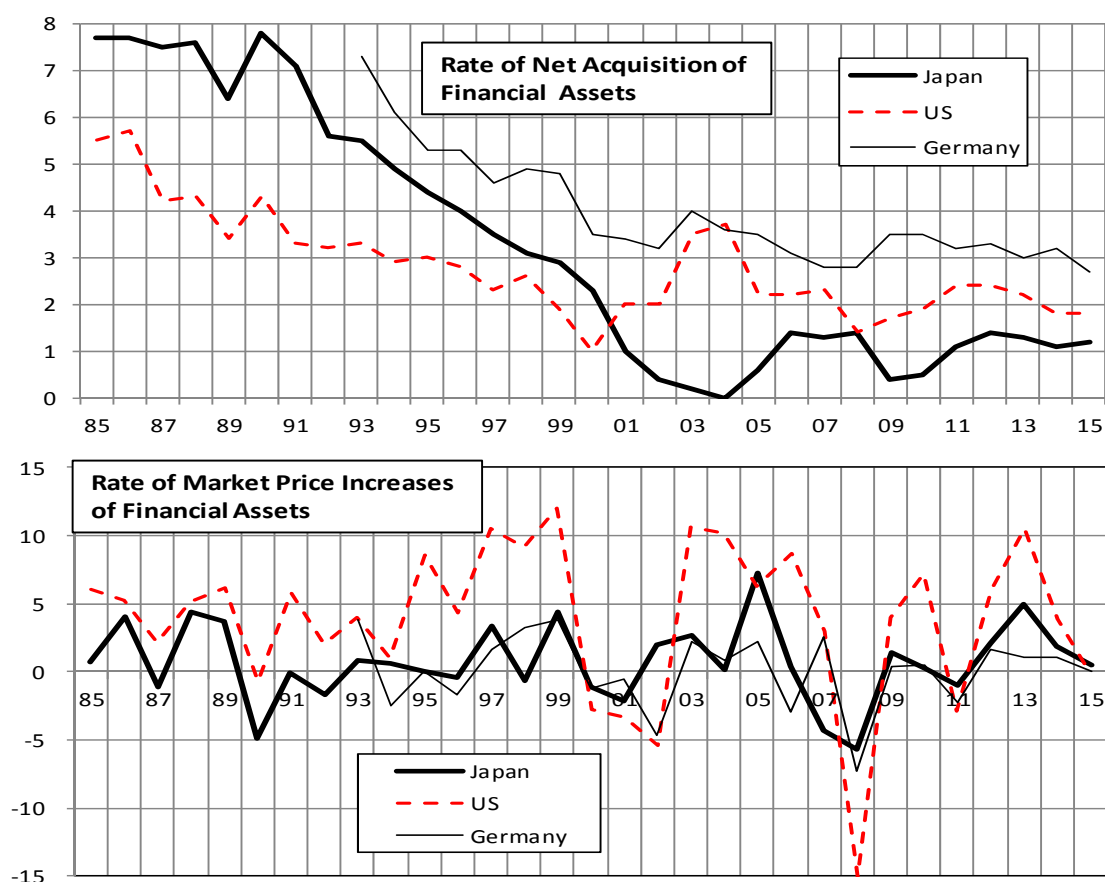
¹⁵Same source as footnote 13.

¹⁶BoJ's Flow of Funds statistics (preliminary figures for new system published in March 2016).

¹⁷The decrease in Japan's flow of funds is believed to stem from a slowdown in economic growth (sluggish growth of personal income) and an aging population (an increase in the population that decumulates financial assets). However, some note: "The assets of individuals should be thought of as consisting not only of financial assets but also including real estate and liabilities. The decline in the acquisition of financial assets partly has to do with the fact that funds are flowing to offset liabilities in response to falling real estate prices." (Satoshi Nojiri, Head of Fidelity Investor Education Institute)

¹⁸Japan's rate of market price increase of financial assets may be low as financial assets place a

Figure 3. Rate of Net Acquisition of Household Financial Assets and Rate of Market Price Increase in Japan, United States, and Germany (Unit: %)



Source: Compiled from Flow of Funds statistics of each country.

(3) Shift towards DC pension schemes

Looking at the worldwide investment fund assets by country as of the end of 2015 (Figure 4.), the United States ranks in first, accounting for approximately half of the worldwide total, and Australia with a population of 24 million ranks in sixth (Australia ranks in fourth if Luxembourg and Ireland, the domiciles of offshore funds, are excluded).

Both the United States and Australia are known for their advanced DC pension schemes. In these countries, DC indeed serves as an engine for the growth of investment funds.

For example, the balance of DC assets in the United States grew by 19-fold from US\$0.74 trillion in 1985 to US\$14.07 trillion in 2015 if Individual Retirement Account (IRA) and employer-based plans (e.g., 401k) are combined. With regard to the amount of DC assets managed by investment funds, the amount for IRA increased from US\$0.03 trillion in 1985 to US\$3.50 trillion in 2015 and the amount for employer-based plans to US\$3.63 trillion (the 1985 figures for employer-based plans

disproportionate weight on cash and deposits.

was unavailable), or US\$7.13 trillion in total.

As a result, US investment fund assets held by DC plans made up approximately 46% of the total assets of US investment funds and 61% of US equity funds at the end of 2015.

In Australia, the assets of Superannuation, which is a compulsory DC corporate pension arrangement¹⁹; institutionalized in early 1990s, expanded by nine-fold from 0.23 trillion Australian dollars to 2.02 trillion Australian dollars over the recent 20 years (June 1995 to June 2015).

While accurate statistics could not be found related to what percentage of the Australian investment fund assets is made up of Superannuation, given for the fact that the Australian investment fund assets was 2.09 trillion Australian dollars as of the end of 2015, the DC pension share is considered larger than that in the United States.

Incidentally, the US\$-denominated Australian investment fund assets increased phenomenally from US\$ 3.3 billion 1985 to US\$1,521.3 billion at the end of 2015 as can be seen in Figure 4.

Comparison with Japan

In Japan, the DC pension scheme was launched in 2001. However, the balance of DC assets as of September 2015 stood at only around 9 trillion yen. The amount of investment in investment funds was around 4 trillion yen,²⁰ accounting for no more than 4% of the 93 trillion yen investment fund assets at that time.

(4) Expansion of investment fund markets in emerging economies

In 1985, the IIFA kept investment fund statistics for 12 countries, and not any emerging economy was included. In 2015, the number of countries rose to 46, of which 17 were emerging economies.²¹

Figure 4. shows the assets of investment funds by country, its share of the world total, and the rate of growth by separating them into advanced and emerging economies for years of turning point since 1985.

The composition in which U.S. investment funds make up over half of the world total has not changed over the 30-year period. However, the U.S. rate of increase since the beginning of the 2000s (between the end of 1999 and the end of 2015) has been 159%, falling below the world total of 194%. In this regard, the U.S. investment fund market is showing signs of maturation.²²

In other advanced economies, the domiciles of offshore funds—Luxembourg and Ireland—have a high rate of increase (375% and 1,612%, respectively, between the end of 1999 and the end of 2015),

¹⁹ According to APRA Insight Issue 2 2007 Special Edition, “Celebrating 10 years of superannuation data collection 1996—2006,” p. 3, <<http://www.apra.gov.au/Insight/Documents/07-Insight-issue-2.pdf>>.

²⁰ Both the DC balance and amount of investment in investment funds were taken from the Rating and Investment Information, Inc., “DC no Ōte Hansha betsu 2015 nen 9 gatsumatsu Shōhin Zandaka” [Product Balance End of September 2015 by Major Sellers of DCs], *Nenkin Jōhō [Pension Information]*, January 18, 2016.

²¹ The separation into advanced and emerging economies follows the classification used in the IMF’s “World Economic Outlook Database October 2015.”

²² Percentage of households owning mutual funds in the United States reached the 40% range in 2000 and has leveled off since then.

suggesting that the domiciles of investment funds and fund distribution markets had been globalizing as will be discussed later.

In addition, the rate of increase was high in the United Kingdom, which had introduced Individual Savings Accounts (ISAs)²³ (321% between 1999 and 2015), and the financial center of Switzerland (454% during the same period). As was described in (3), the expansion of Superannuation was the reason for the large increase in Australia (310% during the same period).

In emerging economies, investment fund schemes have been introduced in succession. Countries such as India and China had noticeably high rates of growth of investment funds. China, which became one of the countries tabulated by the IIFA in 2007, had a balance ranking in seventh in the world at the end of 2015. Following the global financial crisis (between 2008 and 2015), China's rate of increase (357%) was the highest among the countries with the top 20 investment funds assets at the end of 2015.

In terms of the totals for 17 emerging economies, while their asset share of the world total was no more than 6.6% at the end of 2015, their rate of increase since the beginning of the 2000s (between the end of 1999 and the end of 2015) reached 1,139%, far outperforming the 179% total for 29 advanced economies.

It can thus be found that the rate of growth of investment funds in emerging economies was high, with some countries newly introducing investment funds, and this contributed to the growth of worldwide investment funds.

²³ ISA is the United Kingdom's savings and investment incentive tax system (system of promoting asset formation) introduced in 1999, and served as a model of Japan's Nippon Individual Savings Account (NISA) system.

Figure 4. Changes in the Assets of Publicly Offered Investment Funds by Country
(Unit of Assets: US\$ Billion)

	1985		1999		2008	Rank	2015		Rate of Increase			
	Assets	Share	Assets	Share	Assets		Assets	Share	85→99	99→15	(08→15)	
Advanced Economy	United States	495.5	63.7%	6,846.3	59.1%	9,602.9	①	17,752.4	52.1%	1282%	159%	85%
	Luxembourg			661.1	5.7%	1,860.8	②	3,141.8	9.2%		375%	69%
	France	84.6	10.9%	656.1	5.7%	1,591.1	③	1,832.1	5.4%	676%	179%	15%
	Ireland			95.2	0.8%	720.5	④	1,629.8	4.8%		1612%	126%
	United Kingdom	29.4	3.8%	375.2	3.2%	527.0	⑤	1,578.4	4.6%	1178%	321%	200%
	Australia	3.3	0.4%	371.2	3.2%	841.1	⑥	1,521.3	4.5%	11149%	310%	81%
	Canada	7.4	1.0%	269.8	2.3%	416.0	⑧	889.6	2.6%	3545%	230%	114%
	Japan	99.0	12.7%	502.8	4.3%	575.3	⑨	813.1	2.4%	408%	62%	41%
	Switzerland			82.5	0.7%	135.1	⑩	457.2	1.3%		454%	239%
	Germany	20.6	2.6%	237.3	2.0%	238.0	⑫	377.0	1.1%	1054%	59%	58%
	Korea	7.1	0.9%	167.2	1.4%	222.0	⑬	343.3	1.0%	2243%	105%	55%
	Sweden			83.3	0.7%	113.3	⑭	280.0	0.8%		236%	147%
	Spain			207.6	1.8%	271.0	⑮	274.7	0.8%		32%	1%
	Italy	16.3	2.1%	475.7	4.1%	263.6	⑯	200.0	0.6%	2820%	-58%	-24%
	Denmark	2.5	0.3%	27.6	0.2%	65.2	⑰	116.7	0.3%	1002%	323%	79%
	Norway			15.1	0.1%	41.2		102.5	0.3%		579%	149%
	Belgium	2.8	0.4%	65.5	0.6%	105.1		92.1	0.3%	2205%	41%	-12%
	Finland			10.3	0.1%	48.8		88.4	0.3%		756%	81%
	Austria			56.3	0.5%	93.3		68.2	0.2%		21%	-27%
	Netherlands	9.1	1.2%	94.5	0.8%	77.4		64.3	0.2%	940%	-32%	-17%
	Taiwan			31.2	0.3%	46.1		63.1	0.2%		103%	37%
	Liechtenstein					20.5		44.9	0.1%			119%
	New Zealand			8.5	0.1%	10.6		41.9	0.1%		393%	295%
	Portugal			19.7	0.2%	13.6		21.6	0.1%		10%	59%
	Czech Republic			1.5	0.0%	5.3		7.8	0.0%		430%	49%
	Slovakia					3.8		6.2	0.0%			60%
	Greece			36.4	0.3%	12.2		4.3	0.0%		-88%	-65%
	Malta					0.0		3.5	0.0%			
	Slovenia					2.1		2.4	0.0%			18%
29 countries	777.6	100.0%	11,397.7	98.4%	17,922.5		31,818.6	93.4%	1366%	179%	78%	
Emerging Economy	China					276.3	⑦	1,263.1	3.7%			357%
	Brazil			117.8	1.0%	479.3	⑪	456.6	1.3%		288%	-5%
	India			13.1	0.1%	62.8	⑰	168.2	0.5%		1187%	168%
	Union of South Africa			18.2	0.2%	69.4	⑱	122.1	0.4%		569%	76%
	Mexico			19.5	0.2%	60.4	⑳	105.9	0.3%		444%	75%
	Chile			4.1	0.0%	17.6		39.9	0.1%		875%	127%
	Poland			0.8	0.0%	17.8		32.3	0.1%		4137%	82%
	Argentina			7.0	0.1%	3.9		16.4	0.0%		135%	325%
	Hungary			1.7	0.0%	9.2		14.3	0.0%		727%	55%
	Turkey					15.4		12.8	0.0%			-17%
	Trinidad and Tobago					0.0		7.0	0.0%			
	Romania					0.3		5.0	0.0%			1445%
	The Philippines			0.1	0.0%	1.3		5.0	0.0%		4198%	298%
	Pakistan					2.0		4.2	0.0%			110%
	Costa Rica					1.1		2.5	0.0%			131%
	Croatia					0.0		2.0	0.0%			
	Bulgaria					0.2		0.4	0.0%			95%
17 countries	0	0	182.2	1.6%	1,017.0		2,257.8	6.6%		1139%	122%	
World Total	777.6	100.0%	11,579.9	100.0%	18,939.5		34,076.4	100.0%	1389%	194%	80%	

Sources: Compiled from IIFA data using figures excluding funds for institutional investors. 1985 data from Nihon Tōshi Shintaku Seido Kenkyūjo, "Sekai Tōshi Shintaku Tōkei Yoran" [Handbook on Global Investment Fund Statistics], Fund Management, 2000 Special Edition.

(5) Diversification of distribution channels

Until around the mid-1980s, distribution channels of investment funds were confined to securities companies(except for direct distributions by some investment fund companies), even in the United States that had the lead in financial liberalization, due to the restrictions of the Glass-Steagall Act. However, from the late 1980s, banks began to distribute funds, and from around the 1990s, independent financial advisors (IFAs) expanded their activity. In around 2000, fund supers²⁴ that

²⁴“Fund super” is a system in which discount brokers have in hand funds from multiple investment fund

utilize IT began to emerge, and the purchase of investment funds via the Internet increased. Additionally, with the expansion of DC pensions from the 1980s, investment via DC plans began to increase consistently.

In the European continent which adopts a universal banking system, banks serve as main distributors of investment funds. Recently, however, it is said that distribution by IFAs have increased, and the use of the Internet has also become more widespread similar to the United States. In the United Kingdom, IFAs occupy a leading position in the distribution of investment funds, although more recently “fund platforms” (a system that allows for the purchase and redemption of numerous funds of multiple fund companies at low cost as well as administering investors’ portfolios) are utilized more frequently.

As described above, the increase in the distributors of investment funds and the multiplication of purchase methods including the Internet (in other words, investors had more means of accessing investment funds) had the effect of promoting investment funds.

Comparison with Japan

In Japan, banks and other financial institutions began distribution of investment funds in 1998, which dramatically increased the linkages between investors and investment funds. At the end of 2015, investment fund assets distributed by registered financial institutions such as banks make up 31% of all publicly offered investment funds.

(6) Product lineup for diverse investment environment

The diversification of investment fund products increased dramatically by the introduction of money market funds (MMFs) in the early 1970s. Both equity and bond (long-term bond) funds that had existed from before had a weakness, which was that performance deteriorates when interest rate increases. The addition of MMF, a product that follows suit of the short-term interest rate (if the interest rate increases, the yield of funds also increases), contributed to creating a product lineup for various investment environments. Equity funds, bond funds, and MMFs have been supporting the growth of investment funds.

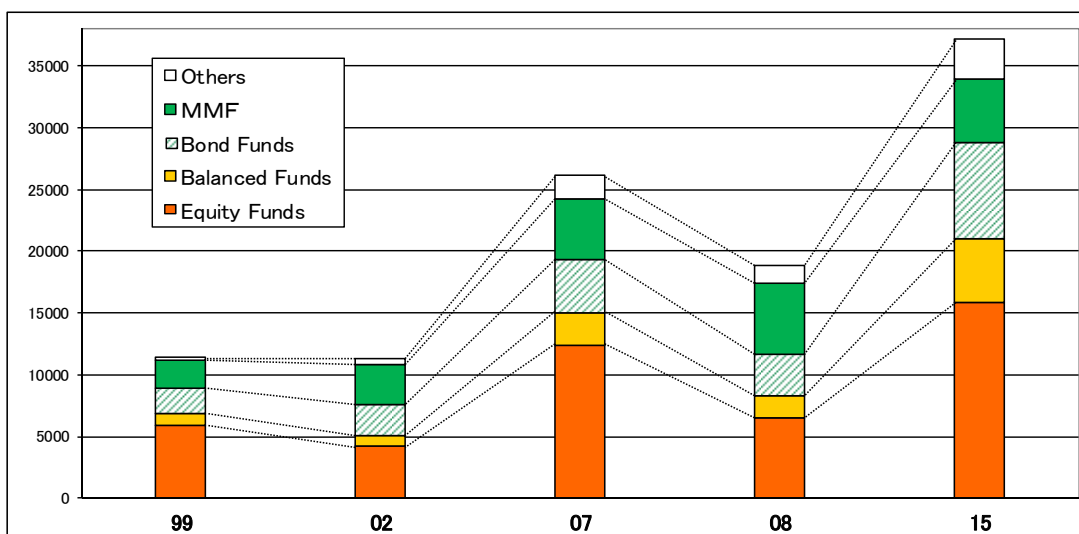
In addition, MMF has served as a product with which investors unaccustomed to risks start securities investment. It has also served as a product that temporarily receives customer funds during equity price turbulence.

The changes in the global investment fund assets by types of product since the end of 1999, i.e., the beginning of the 2000s, are as shown in Figure 5. During the collapse of the IT bubble in the early 2000s (2000 to 2002), increases in bond funds and MMFs offset the decline in equity funds. During the global financial crisis in 2008, the assets of equity funds decreased by as much as 48% from the previous year. However, MMFs absorbed some of the safety-oriented money that flowed

companies and sell them at low cost (named after “supermarket” due to the diversity of the product lineup and low prices).

out of equity funds and kept the rate of decline of total investment funds to 28%. During the period of recovery of securities market conditions through 2015, equity and bond funds have led the growth in investment funds. Furthermore, the increase in target date funds²⁵ in the U.S. DC market and other factors have contributed to significant increases in balanced funds (classified as equity funds in Japan) over the last several years.

Figure 5. Changes in Assets of Worldwide Investment Funds by Types of Products
(Unit: US\$ Billion)



Source: Compiled from IIFA materials. Due to data constraints, 2015 includes private placement investment trusts.

Comparison with Japan

In Japan, medium-term government bond funds developed in 1980 and MMFs launched in 1992 played a certain role in increasing investment funds. However, because bond yields and short-term interest rates also declined during the crash and slowdown of the equity market since the 1990s, domestic bond funds and MMFs were unable to adequately receive the funds that flowed out of equity funds.

As is well known, Japan was forced to launch relatively complex products, such as monthly dividend funds (many of which were foreign bond funds that accompanied exchange rate risks), and following the appreciation of the yen, currency selection-type funds in which foreign currencies of high-interest countries served as a source of earnings. In 2016, all fund companies are moving to

²⁵Target date fund is a type of investment trust that incorporates the following theory of life cycle investment (life cycle fund): “Own many risk assets and actively pursue gains while young, and as one nears retirement, increase stable assets.” It is also called “target year fund.” Specifically, investment trust companies prepare multiple funds according to the customers’ planned retirement period (e.g., around every five years such as 2020, 2025, 2030, 2035, etc.), and customers purchase funds close to their retirement period (target date). Each fund adopts a structure in which the weight of risk assets is high until midway and the weight of stable assets gradually increases in the run-up to the target date.

redeem MMFs due to the impacts of the introduction of negative interest rates by the Bank of Japan.

3. Emerging Trends

Up to this point this paper has described the situation of the quantitative increases in global investment funds and the factors that made this possible. This section discusses the qualitative changes in investment funds in the last 30 years, which can be characterized by three major trends: (1) globalization; (2) rising cost consciousness, as reflected in the expansion of ETFs; and (3) advances in IT adoption.

(1) Globalization

In the last 30 years, investment fund industry has seen the globalization of both asset management and asset acquisition (fund distribution).

(i) Asset management in various countries saw rapid increases in overseas investments.

For example, even in the United States which has a large securities market that provides favorable returns, the share of international equity funds in all equity funds increased from 7.1% in 1985 to 25.8% in 2015. In terms of the net sales (sales minus redemption), the sales of international equity funds has been bigger than that of domestic equity funds (or the net redemption has been smaller) since 2005.

Additionally, in Europe where the ratio of overseas investments was originally high as their own markets are relatively small, the ratio of foreign investments has increased even further. For example, in Germany, the ratio of foreign securities investment to publicly offered securities fund assets increased from 52.1% in 1992 to 67.9% in 2015 (only equities: 25.8% to 64.4%).²⁶

In Japan, the ratio of foreign currency-denominated equities and bonds combined increased from 8.8% at the end of 1985 to 58.5% at the end of 2007. At the end of 2015, they stand at 34.5%.²⁷ Needless to say, the increase in overseas investments by Japanese funds reflects the long-term stagnation of domestic equity markets since the 1990s and the super-low yield of domestic bonds.

(ii) Cross-border distribution (acquisition of foreign investors' money) also increased.

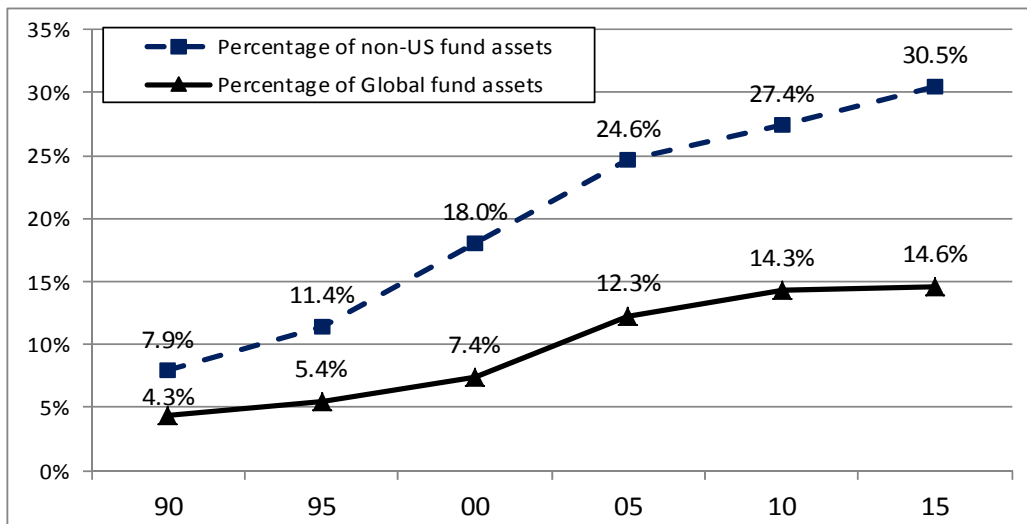
To measure the progress of worldwide fund imports and exports, the assets of funds in the domiciles of offshore funds that are all expected to be sold overseas serve as a reference.

²⁶Calculation based on Bundesbank statistics.

²⁷In Japan, fund of funds has been increasing in recent years. The foreign currency-denominated securities held by yen-denominated master funds are not counted in the foreign currency-denominated assets of the tabulations of JITA. Therefore, it is believed that the actual ratio of foreign currency-denominated securities is higher than 34.5%. Incidentally, based on the product classifications of JITA, equity investment funds at the end of 2015 consisted of 35.9% in funds invested primarily in overseas assets and 23.8% in funds invested in both of domestic and overseas assets.

While the British territory of the Cayman Islands is among the well-known domiciles of offshore funds,²⁸ the author could obtain assets statistics only for the IIFA members, Luxembourg and Ireland. As shown in Figure 6., the ratio of the assets of funds eligible under the Undertakings for Collective Investment in Transferable Securities (UCITS) directive²⁹ established in these two countries to the worldwide investment fundassets has been on an increasing trend. The ratio exceeded 14% at the end of 2015, and the ratio to the fundassets excluding the United States³⁰ whichessentially prohibits the sale of overseas funds (i.e., the investment fundassets of countries where foreign funds can be sold), reached 30%.

Figure 6. Percentage of Fund Assets Domiciled in Luxembourg and Ireland in the World



Source: Compiled from IIFA data

However, the funds of these two countries include, for example, funds that German management companies established in Luxembourg which offers a high degree of freedom over fund design, and then brought back and sold in Germany—in other words, funds intended for sale in their countries (called “round-trip funds”). The European Fund and Asset Management Association (EFAMA) states that round-trip funds accounted for one-fourth of the assets of funds of the aforementioned two

²⁸For example, according to Japan Securities Dealers Association statistics, a breakdown of the foreign investment funds that are publicly offered in Japan by domicile shows 46.1% were domiciled in Luxembourg and 41.5% were domiciled in the Cayman Islands as of the end of March 2015.

²⁹UCITS directive eligible funds are funds that have been created in accordance with the UCITS directive, which provide a uniform criteria for promoting mutual sales of investment funds among EU member states.

³⁰ Pursuant to SEC. 7, Paragraph (d) of the Investment Company Act of 1940, in principle, the United States bans the public offering of foreign investment funds. The U.S. stance is that if foreign businesses wish to sell their funds in the United States, then they can establish and sell funds in the United States in line with U.S. laws. According to the *2015 Investment Company Fact Book* published by the ICI, 8% of the 867 investment trust managing companies in the United States at the end of 2014 were foreign companies.

countries at the end of 2014, and funds excluding round-trip funds represent funds truly intended for overseas sales. Based on this understanding, the ratio of imported and exported funds in the world based on the assets of investment funds in the aforementioned two countries were around 11% (14.6% \times 3/4) most recently. As a share of the assets of investment funds of countries excluding the United States where overseas funds can be sold, it was around 23% (30.5% \times 3/4).

EFAMA states that the funds of the two countries are sold to Europe as well as Canada, Japan, Korea, New Zealand, Taiwan, and Hong Kong,³¹ and it is found that UCITS directive eligible funds have been sold to non-European countries (UCITS directive eligible funds are considered to offer reassurance to investors outside of EU as they meet fund manager requirements, regulations on scope of investment and credit risk, disclosure requirements, etc.).

As is well known, in recent years, drawing on the success of the UCITS scheme, there has been an increasing movement to introduce systems to facilitate cross-border distribution of funds also in Asia ((i) Asia Region Funds Passport; (ii) ASEAN fund passport; and (iii) mutual entry system in Chinese and Hong Kong funds).³²

(2) Rising cost consciousness, expansion of ETFs

With investors especially in the United States becoming more conscious of cost, this has translated into a rapid expansion of ETFs. In the United States, the sale of non-ETF no-load funds has also increased.

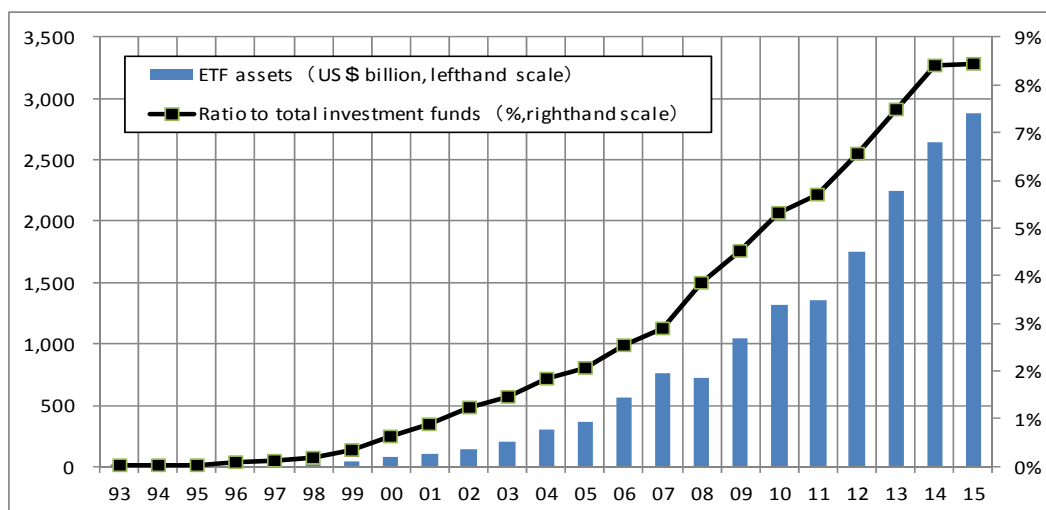
ETFs, which are said to trace their origin to TIPS35 developed by the Toronto Equity Exchange in 1990, expanded rapidly worldwide, particularly since the beginning of the 2000s, as shown in Figure 7. While there was just one time when the assets decreased from the previous year during the 2008 global financial crisis, the flow of funds maintained a surplus even during that period. According to a report by Deutsche Bank from which the author could take continuous statistics, the assets of global ETFs at the end of 2015 reached US\$2.88 trillion³³ and increased by 72-fold since the end of 1999. The share of global ETFs to total investment funds in the world increased from 0.3% at the end of 1999 to 8.4% at the end of 2015.

³¹ EFAMA, FactBook 2015, p. 46 and p. 61.

³² For the Asia Region Funds Passport in which Japan also participates, a memorandum of cooperation was signed among Australia, Japan, Korea, and New Zealand on April 28, 2016.

³³ In IIFA's statistics, the ETF assets at the end of 2015 was US\$2.74 trillion.

Figure7. Changes in the Global ETF Assets and their Ratio to Total Investment Funds



Sources: Compiled using data from Deutsche Bank's "ETF Annual Review & Outlook," January 21, 2016 for 2003 and beyond, and from BlackRock's "ETF Landscape" for 2002 and earlier, as well as IIFA data for all investment funds.

Factors behind the increase in ETFs are considered to include: 1) the low operation cost of funds³⁴ (accordingly, higher returns than traditional index funds can be expected); 2) as the product lineup rapidly expanded from the 2000s, institutional investors and financial advisors (FAs) began to actively utilize ETFs to build up their portfolios; and 3) there are taxation advantages.³⁵

In the United States, many non-ETF funds has also been adopting no-load share classes which have no front-end load or CDSL, and have a 12b-1 fee of 0.25 percent or less. The share of no-load funds to all long-term funds (non-MMF funds) has increased from 44% in 2001 to 66% in 2014.³⁶ Furthermore, the average expense ratios have been declining every year.

Underlying this is the fact that securities companies and FAs are shifting their business models from commission-based to fee-based (rather than receiving a sales commission at the time of selling a fund or receiving sales cost called "12b-1" every year from the fund, a separate fee for the customers' asset is received every year from the customer directly similar to a wrap account). Therefore, some regard that there is not necessarily a significant decrease in the total costs of customers.³⁷

³⁴On the reasons why ETF costs are low, see: Kohji Sugita, "Hassoku kara 40 nen wo Mukaeru Indekusu Fando: Sono Kiseki to Kongo no Tenkai" [40th Year of the Index Fund: Its Path and Future], Japan Securities Research Institute, <http://www.jsri.or.jp/publish/topics/pdf/1601_01.pdf>.

³⁵ETFs' tax advantages: because redemption does not involve the sale of securities like conventional funds (in kind redemption), there usually occurs no capital gains within a fund (which means there is no capital gain distribution to investors (accordingly, investors can defer capital gain taxation until they sell the ETFs they hold).

³⁶From ICI materials.

³⁷For example, in a report prepared by Strategic Insight (a research and consulting company specializing

Moreover, the recent rise in “Robo-advisors” seems to demonstrate the preference for low cost.

(3) Advances in IT adoption

The investment fund business has rapidly incorporated the use of IT.

In the area of asset management, the industry has developed quantitative methods which make full use of computers. More recently, progress is being made in the development and use of indexes that utilize “smart beta” (e.g., corporate profit-weighted index rather than market capitalization-weighted index, dividend yield-weighted index and index weighted by “factors” such as value, low volatility and momentum.).

In the area of fund distribution, “fund supers” were introduced in the 1990s in the United States. In recent years, social media is utilized actively for sales promotions. It goes without saying that advances in IT have enabled the emergence of Robo-advisor as a means of providing basic financial advice.

On the other hand, as is well known, addressing the negative consequences of IT adoption, i.e., cyber security issues, also poses a major challenge for the investment fund business.³⁸

4. Future Challenges

Global investment funds thus underwent a considerable transformation both quantitatively and qualitatively over the last 30 years. In the years to come, PricewaterhouseCoopers (PwC), for example, in its “Asset Management 2020 A Brave New World” released in 2014, states that the asset management industry will place itself at the center of the financial business, and estimates that the assets of global investment funds will increase from US\$27 trillion in 2012 to US\$41 trillion in 2020.

In this context, what challenges will face investment fund industry?

The challenges will likely include: (1) the eternal theme of how investment funds will contribute to investors; (2) how investment funds that have grown large will fulfill social responsibility; and (3) how the industry will be able to expand businesses.

in investment funds based in the United States) in 2011 at the request of EFAMA (“Fund Fees in Europe: Analyzing Investment Management Fees, Distribution Fees, and Operating Expenses”), it is stated: “The average European-domiciled retail equity mutual fund has a total expense ratio of 1.75% whereas a U.S. retail equity mutual fund has a total expense ratio of 0.95%...the roughly 0.80% difference between European TER for retail equity funds and U.S. equity funds can be significantly explained by placement and categorization of ‘wrapper fees’ that are charged in addition to the TER.” (p. 11).

³⁸In 2015, a cyber security working group was established in the IIFA. ICI Global (international organization of ICI in the United States) carries out its own unique fact-finding surveys on cyber security measures in the investment fund industry and holds seminars around the world.

(1) How will investment funds contribute to investors?

This section deals with: (i) securing investment returns; (2) improving returns of investors; (3) providing added value other than investment gains; (4) fulfilling fiduciary duty; and (5) promoting sales of cross-border funds.

(i) How to secure investment returns (in the difficult investment environment)

As is well known, expected returns on equities and bonds have declined worldwide in recent years (sometimes referred to as “new normal,” in the sense that this is a new normal state different from the past).

Figure 2 shows that equity prices have risen in the last 30 years. However, the situation up to 1999 and the situation in the 2000s and later are, in fact, entirely different. For example, U.S. equities rose by 596% in 14 years through 1999, whereas they rose by only 39% in the subsequent 16 years through 2015. (Though not solely because of this, the rate of growth of the assets of global investment funds slowed down from 1,389% in 1985 to 1999, to 194% in 1999 to 2015, as shown in Figure 4.)

Similarly, the yield on bonds has declined as shown in Figure 2. For example, the yield on U.S. ten-year government bonds decreased from an average of 8.29% through 1999, to an average of 3.67% in 2000 to 2015 and to below 2% more recently.

As expected returns on securities decrease, how can investment funds offer favorable performance exceeding that of bank deposits?

(A) Unchanging relative relationship of returns (deposits < bonds < equities)

What can be said first of all is that even if absolute returns on securities decline, the relative relationship of risks and returns to bank deposits remain unchanged.

In other words, as investment in securities has risks, it remains unchanged that the average return on bonds is higher than deposits, and that the average return on equities is even higher. Therefore, it can be presumed that investment funds can maintain higher returns than deposits with respect of long-term averages.

Accordingly, it is considered feasible to encourage investors to continue to invest in funds as long-term investment instruments, upon providing sufficient explanation that these products have risks.

(B) Contribution to increasing corporate value as institutional investors

Secondly, with regard to equities, a major component of investments by funds, fund companies' activity as institutional investors such as rigorous selection of equities and execution of stewardship including the exercise of voting rights will contribute to increase the value of corporate equities (return on equity in short), and thereby, to improve the performance of investment funds.

Index investing simply based on market capitalization may not adequately fulfill the capital allocation function expected for securities markets, namely, to help procure capital for high-earning companies and urge low-earning companies to leave the market. Therefore, it is ideal that active

management funds in which fund managers and analysts select equities based on independent judgment and analysis from a mid-to long-term perspective deliver high investment performance and gain the endorsement of investors.

(C) Use of Artificial Intelligence

The increasing use of IT in asset management of funds is as described in 3. (3). It seems that the use of IT, however, has so far been centered on quant investment based on mass processing of existing data, and has not gone so far as utilizing creative artificial intelligence (AI).

The *Financial Times* recently reported that major UK asset management companies are jointly looking into trading illiquid securities directly with each other utilizing blockchain used in bitcoin.³⁹ While this is an example of using AI in trading, AI can also be utilized on investment fronts, such as asset allocation and equity selection, and thereby, contribute to improving investment performance.

As regards modern investment theories, 60 years having passed since the unveiling of the diversified investment theory by Harry Markowitz in the 1950s and over 50 years since the emergence of the capital asset pricing model (CAPM) by William Sharpe. In this light, we may see that the advent of technological innovations has been slow in the world of asset management compared to manufacturing or other industries. In the meantime, the investment environment has changed dramatically—notably, the use of new investment tools including derivatives has spread, while returns on securities have fallen as was discussed earlier and effectiveness of international diversified investments have diminished.

The world of goods and services has seen a whirlwind of technological innovations including the use of AI. Against this backdrop, it is time that the world of asset management (while “factor investment”⁴⁰ has been developed and utilized) also sees further breakthrough innovations.⁴¹

(ii) Improving returns of investors

No matter how hard asset managers work to deliver good fund performance, unless the main party—investors—experience successes, investment funds will not grow. Because investors have a tendency to buy funds at high and sell at low, there is the problem of returns of investors being less than the returns of funds.

For example, even in the United States which is considered that peoples have relatively high investment expertise in the world, according to Morningstar’s analysis, U.S. investors’ investments in long-term investment funds over a ten-year period until the end of 2015 had a weighted annual

³⁹*Financial Times*, February 8, 2016.

⁴⁰An investment method that focuses not on asset classes such as equities and bonds but on factors including value, volatility, size, and momentum.

⁴¹The January 21, 2016 *Financial Times*, in its Big Read column, published a front-page article with Robert Wigglesworth’s signature titled, “Search for a super-algo.” The article quotes, “Eventually the time will come that no human investment manager will be able to beat the computer” and “Artificial intelligence can help you find patterns a human would never see. That can give you a huge edge.”

average return of 4.35%, falling below the average return of long-term funds of 4.88%.⁴² In addition, a recent *Financial Times* article reported about an analysis made by Goethe University in Germany, which found that the return on investment of small investors' investments in ETFs substantially underperformed the market average (because they bought and sold ETFs frequently and the timing was bad).⁴³

The reason that return of investors are lower than the return of funds is because (i) the average purchase cost of investors is higher than the average price of funds or (ii) investors' average redemption price is lower than the average price of funds, or both.

To improve this situation, periodic investments on a regular basis should be promoted further. If investors continue to make fixed-amount investments, the average purchase cost of investors can be made lower than the average price of funds due to the effects of dollar cost averaging (small quantities are bought at high prices and large quantities are bought at low prices)⁴⁴. In other words, (though the issue of redemption in (ii) remains) the return of investors could be made higher than the return of funds.

Because DC is a type of compulsory periodic investment, its promotion will also contribute to increasing the return of investors. In fact, the Morningstar article referenced above indicated that return of investors on target date funds that often involve continuous purchases through 401(k) plans had a 5.16% ten-year average return, exceeding the return of funds of 4.42%.

(iii) Providing additional value other than returns on investment

Investment performance is not the sole added value that investment funds as a financial product can provide to investors. For instance, convenience in investment is also important, and many countries have introduced various investment plans from several decades ago, including arrangements for automatically reinvesting dividends as well as a periodic investment system in which investors can start with small amount investments.

An area that the asset management industry should enhance in the coming years is post-retirement asset management and decumulation services. While asset formation for retirement has been an important theme for many investors, it is considered that as baby boomers retire worldwide and people live longer, the theme of how to efficiently conduct post-retirement asset management and decumulation will become an important issue for many investors.

⁴² "Encouraging Signs for Target-Date Funds," Morningstar, <<http://news.morningstar.com/articlenet/article.aspx?id=748653>>.

⁴³ *Financial Times*, February 1, 2016, <<http://www.ft.com/intl/cms/s/2/0c4278aa-c366-11e5-808f-8231cd71622e.html#axzz46F6hXHyR>>. Original source: Utpal Bhattacharya, Benjamin Loos, Steffen Meyer, Andreas Hackethal and Simon Kaesler, "The Dark Side of ETFs and Index Funds," March 2013.

⁴⁴ Using the Nikkei 225 stock index as an example, the average of the index at the end of year in the 30 years to 2015 was 16,792 yen, whereas the average purchase cost on making fixed amount investment is calculated to be 14,682 yen.

However, asset decumulation is considerably harder than asset formation. Because the circumstances vary significantly by individual, including the size of assets held at retirement, expected income after retirement, risk tolerance, and whether or not they leave inheritance to their children, it is difficult to identify a versatile decumulation formula. Above all, no one knows how long he or she will be alive.

Furthermore, as was noted earlier, there is the issue that while asset formation can be conducted efficiently through fixed-amount accumulation (dollar cost averaging), fixed-amount decumulation of assets whose price fluctuates is inefficient (because small quantities are sold at high prices and large quantities are sold at low prices).

Providing solutions to these issues will be a major theme for the asset management industry.

(iv) Performing fiduciary duty to investors

In recent years, the fiduciary duty of asset management companies to investors has become increasingly emphasized. While the duty of loyalty of asset management companies has been legally provided for in countries such as Japan and the United States, more recently the United States and Europe are strengthening measures to avoid a conflict of interest between distributors and investors.

Specifically, these measures include: (A) Retail Distribution Review (RDR) in the United Kingdom (implemented since the end of 2012); (B) Markets in Financial Instruments Directive II (MiFID II) in the European Union (EU) (to be implemented in January 2018); and (C) the U.S. Department of Labor's introduction of rules applying fiduciary duty also to broker-dealers for retirement investment advice (to be fully implemented in January 2018).

All these measures are designed to prevent a conflict of interest particularly in the context of investment advisory or solicitation activities. The measures prohibit the receipt of commissions from product issuers by advisors including non-independent advisors in (A) and by independent advisors in (B). (C) imposes not only the existing rule of suitability on distributors, but also fiduciary responsibility including duty of loyalty.

The implementation of these measures is likely to promote a shift to the distribution of low cost products. In part of Europe, as the product lineup of distributors will be increasingly constrained, some view that open architecture⁴⁵ that had been undertaken since around 2000 will recede.

Typical examples of fiduciary duty involve the relations of physician and patient or lawyer and client. Considering that both physicians and lawyers are high-income earners, the level of fees would not be the crux of fiduciary duty. In this vein, it seems that fiduciary duty does not deny investment business practitioners from earning a legitimate remuneration for their professional skills and services.

Of course, fulfilling fiduciary duty and earning incomes of investment-related businesses should not be incompatible, particularly where asset managers increase the total earnings pie (the investment

⁴⁵In investment fund business, "open architecture" refers to a business style in which sellers and asset managers are connected openly beyond their capital affiliated relations, etc.

return before deduction of costs) (discussed in 4. (1) (i)), and distributors increase the value of their advice and gain trust from customers. A report (published December 2014) regarding a study conducted by the U.K. Financial Conduct Authority (FCA) on RDR two years after its introduction has in fact found that “When choosing an adviser consumers value quality indicators such as trust and reputation over cost.”⁴⁶

(v) Promoting cross-border distribution of investment funds and giving investors access to wide-ranging products

As stated in 3. (1) (ii), cross-border distribution of investment funds are becoming more widespread. However, this movement has been confined to regional blocs, namely, the EU region and certain countries in Asia.

The most ideal situation for investors will be that every investor in the world can freely purchase every fund in the world from every distributor in the world. This would decrease the number of funds in the world, which currently stands at as many as 85,000 funds,⁴⁷ and is expected to lead to cost reduction.

To move in this direction, progress should be made towards importing and exporting funds on a global basis, not only from within the EU and Asian blocs, and towards liberalizing the entry of businesses.⁴⁸

(2) How investment funds will fulfill social responsibility?

This section deals with: (i) contribution of improving the quality of the securities market; (ii) development of ESG investment; and (iii) consideration to the stability of the global financial system.

(i) Contribution to improving the quality of the securities market

In 4. (1) (i) (B), it was stated that institutional investors should contribute to improving the corporate value of listed companies from the perspective of increasing the performance of investment funds.

Needless to say, however, improving the corporate value of listed companies not only benefits investment funds, it also contributes to qualitatively improving the efficiency of securities market in allocating capital. That is, it also translates into fulfilling social responsibility.

To this end, as mentioned earlier, it is ideal that active management offers higher investment outcomes and expands, and that both active and passive management proactively execute the

⁴⁶Europe Economics “Retail Distribution Review Post Implementation Review 16 December 2014” p.37.

⁴⁷According to the IIFA’s tabulation, the number of publicly offered funds at the end of 2015 was 85,773 (100,494 including private placement funds).

⁴⁸From the above perspective, it is significant that the same ETFs are cross-listed on many exchanges in respect to providing the same products to a wide range of people across national borders. ETFs could play a large role in standardizing investment fund products around the world.

stewardship code, including the exercise of voting rights.

(ii) Development of ESG investment

Socially responsible investment (SRI) that gained full traction in around the 1980s has also been called ESG (environment, social, and governance) investment in recent years and is considered part of the responsibilities to be fulfilled by institutional investors.

Today, ESG screening is no longer utilized only by specialized funds,⁴⁹ and is included in the screening for selecting equities by all funds.

(iii) Paying more attention to link to the stability of the global financial system

While protection of investors had been the main objective of the regulations on investment funds, in recent years, especially since the global financial crisis in 2008, regulations are increasingly being adopted from the perspective of maintaining the financial system.

MMF has become subject to stricter regulations of the Financial Stability Board (FSB) in the context of the G20 initiatives. In the United States which has a large MMF market, Securities Exchange Commission rules have already been modified.

With regard to longer-term funds, for example, the IMF has expressed concerns over the impacts on the securities market if there was a large amount of redemption of funds invested in low liquidity assets (e.g., bonds of emerging economies).⁵⁰ There has also been a talk about the impacts of rapidly growing ETFs on price formation in the securities market. Against this backdrop, in 2015, U.S. SEC proposed fund liquidity regulations as well as derivative regulations for regulating leverages.

Such regulatory strengthening is a reflection of how investment funds have grown in size and come to acquire an important standing at the market. In this regard, it is a matter of course that actions are taken to enable investment funds and the market to mutually co-exist and co-prosper.

On the other hand, how to preserve “innovation capacity in an environment of fierce regulations” (statement released after the IIFA 28th Annual Conference in 2012) is another challenge for the industry.

(3) How will investment fund industry be able to expand businesses?

This section will cover: (i) expectations towards emerging economy markets; (ii) use of FinTech; and (iii) product line-up.

(i) Emerging economy markets have significant potential growth in fund business

⁴⁹The smaller amount of Japanese SRI (or ESG) funds relative to the United States and Europe may also have a lot to do with the differences in their screening methods. Whereas the United States and Europe adopt the negative screening method which only eliminates investment candidates that meet the negative criteria (the rest are considered suitable for investment), suitable investments are limited in Japan which uses the positive screening method of selecting only companies that meet the positive criteria as suitable for investment.

⁵⁰ IMF, “Financial Stability Report,” Chapter 3 The Asset Management Industry and Financial Stability, April 2015.

As stated in the opening of this paper, global investment funds increased by 28-fold in the last 30 years. However, as was shown in Figure 4. and noted in 4. (1) (i), the rate of growth has slowed down amid stagnant equity prices since the beginning of the 2000s. In particular, the United States that accounts for half of the global investment fund assets is showing signs of a maturing investment fund market.

In the future, emerging economies are expected to see long-term growths in investment funds.

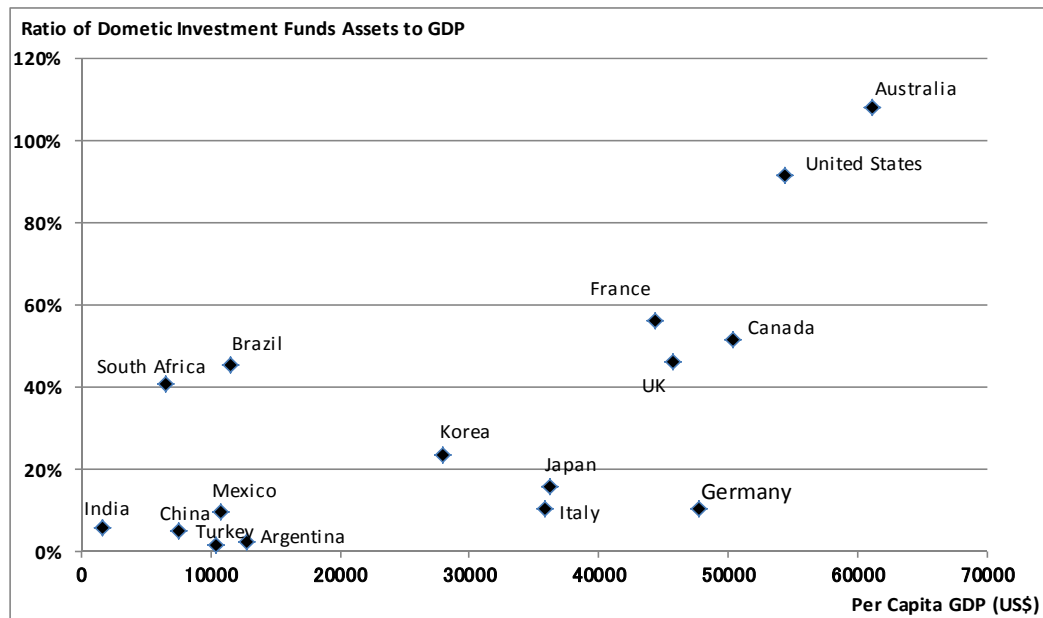
Figure 8. shows the relationship between per capita GDP and the ratio of the investment fund assets to GDP in 16 of the G20 countries for which investment fund assets statistics are available. The figure illustrates that if per capita GDP increases, the ratio of the investment fund assets to GDP also increases.

Accordingly, it is anticipated that countries with high rates of economic growth will see rapid increases in fund assets due to synergistic effects between the growth of the fund assets accompanying GDP growth and increases in the ratio of the fund assets to GDP.

Let us take China as an example. PwC's "The World in 2050" released in January 2011 estimated that in 2050, China will have a GDP of US\$59.5 trillion and a per capita GDP of over US\$40,000 (based on 2009 standard purchasing power parity). If China's ratio of fund assets to GDP in 2050 is 7%, same as now, investment funds would have assets of around US\$4 trillion. However, as noted above, the ratio of the fund assets to GDP is expected to increase with the growth of per capita GDP. If we assume from Figure 8. that they increase to the median between the current UK and Japanese levels (per capita GDP: US\$40,900; ratio of fund assets to GDP: 28%), the size of Chinese funds is calculated at US\$16.7 trillion.

In emerging economies where investment funds are not yet widespread, funds are expected to grow by a factor several times greater than the rate of economic growth.

**Figure 8. Relationship between Per Capita GDP and
Ratio of Investment Fund Assets to GDP in G20 Countries (As of
2014)**



Note: As Germany and Italy often establish funds outside of their countries, such as in Luxembourg, and bring them into their countries, domestic fund assets are on the small side.

Sources: Investment fund assets data from IIFA; GDP and population data from the IMF's "World Economic Outlook Database October 2015."

(ii) Use of FinTech

3. (3) stated that the world of investment funds has already been seeing advances in IT. In addition, the use of AI for improving management performance was touched upon in 4. (1) (i) (C).

It is a matter of course that the fund industry should make full use of FinTech for distribution and product development too. It is well known that since 2013, the Alibaba group and other organizations in China have already collected vast amounts of funding for MMF through the Internet.⁵¹

It is also forecasted that advances in FinTech will recreate the map of the fund industry. The aforementioned PwC report, "Asset Management 2020" predicts that IT companies, such as Google, Facebook, and Amazon, will enter the fund industry.

In the past, fund companies were comprised of independent companies that were originally asset management companies, as well as companies with parent companies in the broad financial industry, including banks and insurance companies. In the future, competitors of an entirely different nature may enter the industry, and to compete with these companies, existing companies may be forced to fundamentally re-evaluate the added values they are providing to investors.

⁵¹The assets of Chinese MMF at the end of 2015 reached US\$684.4 billion.

(iii) Are MMFs disappearing in Japan and elsewhere? Is it a good trend?

As super-low interest rates persist worldwide, MMFs have remained stagnant (the ratio of MMFs to the entire global investment fund assets decreased from 30.6% at the end of 2008 to 13.6% at the end of 2015). In Japan, the MMFs of all fund companies are being redeemed under negative interest rates.

Nevertheless, as stated in 2.(6), MMFs that were developed in the 1970s strengthened the product lineup of investment funds as products that can withstand interest rate hikes, and together with equity and bond investment funds, supported the growth of global investment funds over several decades.

MMFs still exist in the United States and Europe despite the adverse environment. In Japan, while it is a matter of course to have selection and concentration at the level of individual companies, it is ideal if the industry as a whole has a product lineup for diverse investment environment. Once the climate has changed, MMFs should be restored to enhance the product lineup.

Conclusion

This paper discussed the changes in global investment funds and their future challenges.

While the last 30 years were covered in this paper, global investment funds in fact have a history spanning at least a century and a half.⁵² Up through the present, they have overcome numerous trials including the Baring Crisis of 1890, the Great Depression of 1929, and the global financial crisis of 2008.

The 22nd IIFA Annual Conference was held in Montreal, Canada in the midst of the crisis immediately following the collapse of Lehman Brothers in 2008. As stated in its final communiqué, “the investment fund industry is no stranger to crisis, given its long history.” It is expected that, just as in the past, investment funds will continue to develop as an indispensable tool for worldwide investors to save for retirement and participate in the global securities markets.

⁵²There are two leading theories regarding the beginning of global investment funds: a theory that the Foreign and Colonial Government Trust established in Britain in 1868 was the world’s first investment fund; and a theory that the Eendragt Maakt Magt established in the Netherlands in 1774 was the first investment fund. In recent years, U.S.ICI has been publishing in its Investment Company Fact Book’s “Significant Events in Fund History” that the latter is the world’s first investment fund.