

(Provisional Translation)

Hedge Fund Survey Results (2006)

March 2007

Financial Services Agency,
Government of Japan

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Introduction

In 2005, the Financial Services Agency (FSA) conducted its first comprehensive survey of hedge funds and issued a report entitled 'Summary of Hedge Fund Survey Results and the Discussion Points'. This report covered investment, distribution and arrangement activities by financial institutions in Japan over the past five years up to the end of March 2005.

Since then, interest in hedge funds among domestic and overseas regulators and industries has remained high. The FSA conducted a survey to update the results of its last survey as of the end of March 2006.

Method

Questionnaires were sent to the 1,252 financial institutions regulated by the FSA, including banks, insurance companies, securities companies, investment trust management companies and investment advisers (hereinafter 'the surveyed companies') through the FSA, local finance bureaus, the Japan Securities Dealers Association, the Investment Trusts Association and the Japan Securities Investment Advisers Association. These responses were provided on a voluntary basis, as they were in last survey. Some major financial institutions were selected for further interviews on their decision making process on investment, internal investment guidelines, and solicitation and sales policies.

Survey Contents

Survey contents cover the amounts of hedge funds held by the surveyed companies as of March 31, 2006, and the amounts of hedge funds which the surveyed companies had established or distributed during the one-year survey period from April 1, 2005 to March 31, 2006.

The survey items featured in the questionnaire included, among others, names of funds, subscription amount, fund strategies, names of investment managers, places of establishment of funds, terms of funds and amounts of investments, distributions and arrangements.

Definition

In conducting the hedge fund survey, hedge funds were defined as 'the funds that (i) use leverage, (ii) charge a performance fee, and (iii) use hedge fund strategies (including funds of hedge funds).'

1. Survey Results (2006)

The number of financial institutions who invest in hedge funds is 348, and the amount invested therein was 7,438 billion yen as of March 31, 2006. Financial Institutions who sold hedge funds for the period from April 1, 2005 to March 31, 2006(FY2005) constituted 101 institutions, with a total investment of 2,955 billion yen, while financial institutions that launched hedge funds during the same period constituted 64 institutions, representing a total amount of 1,327 billion yen.

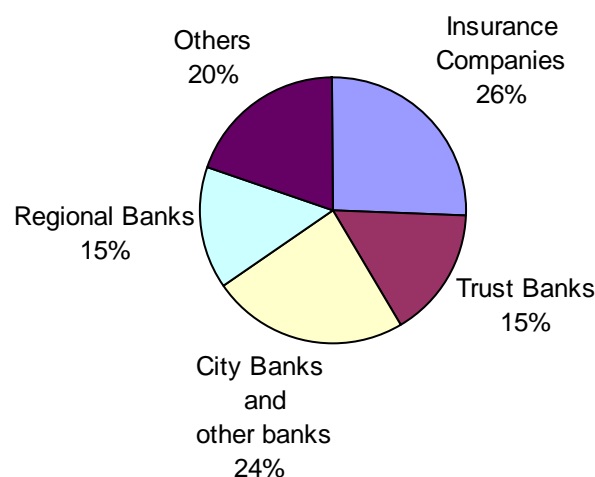
(1) Survey results for investments

348 financial institutions were investing in hedge funds to a total amount of 7.4 trillion yen as of March 31, 2006. There was an increase of 22% compared to the results of last year, as of March 31, 2005

1) Diversification of investors

The breakdown of type of investors shows that there has been a diversification of investors. 26% was invested by life and non-life insurance companies, 15% by trust banks, 24% by major banks ('City Banks') and other banks, 15% by regional banks and 20% by other financial institutions, including cooperative banks.

Chart 1: Breakdown of type of investors



2) Top 35 investors accounts for 80% of total investment

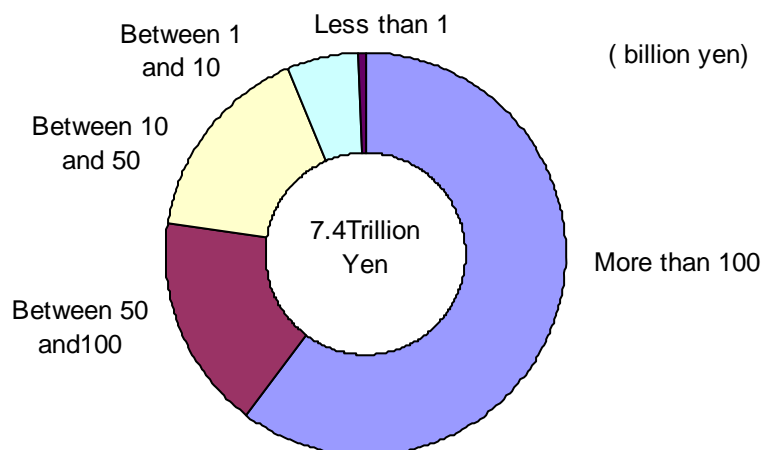
The breakdown of the size of investors shows that 17 financial institutions invest more than 100 billion yen, 18 invest within the range of 50 billion to 100 billion yen, 53 invest with the range of 10 to 50 billion, 135 invest with the range of 1 to 10 billion yen, and 125 invest less than 1 billion.

Chart 2: Breakdown of size of investment

Size of Investment	Number of financial Institution
More than 100 billion yen	17
Between 50 and 100 billion yen	18
Between 10 and 50 billion yen	53
Between 1 and 10 billion yen	135
Less than 1 billion yen	125
Total	348

The 35 financial institutions that invest more than 50 billion yen account for almost 80% of total investment by financial institutions in Japan, meaning that 10% of the total of 348 financial institutions constitutes three-fourths of the total investment, almost 6 trillion yen.

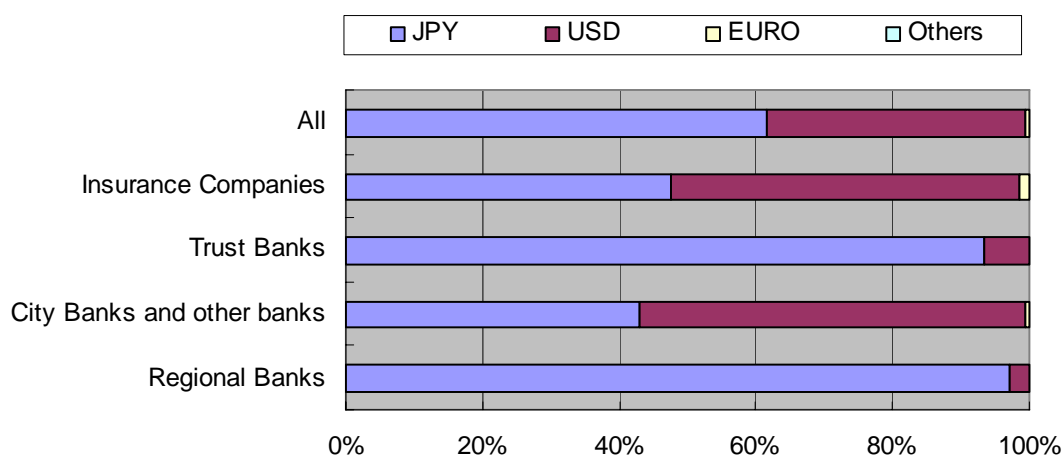
Chart 3: Size of investment



3) Denomination of Hedge Funds

60% of hedge funds are denominated in yen while the remainders are denominated in foreign currencies such as US dollars, euros, British pounds and Australian dollars. US dollar hedge funds predominate among foreign currency denominated funds. Institutional investors such as trust banks and regional banks prefer Yen-denominated hedge funds.

Chart 4: Investment by denomination of funds



(2) Survey results for sales

101 financial institutions sold a total of 3.0 trillion yen in hedge funds to their clients, including financial institutions, corporations, individuals, etc, during the period from April 1, 2005 to Mar 31, 2006. Compared to last year's 2.1 trillion yen total, there has been an increase of 40%.

Chart 5: Sales of hedge funds since FY2000

(Trillion Japanese yen)

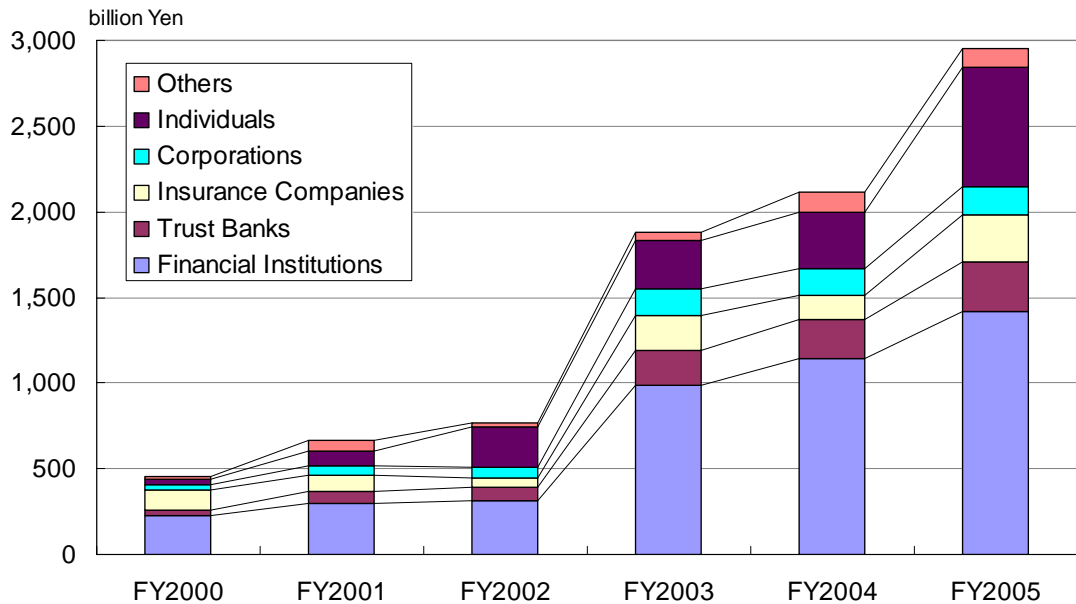
FY2000	2001	FY 2002	FY2003	FY2004	FY 2005	cumulative amount since FY 2000
0.5	0.7	0.8	1.9	2.1	3.0	8.8

1) Sales to individual investors exceed 20%

The breakdown of sales is as follows: 48% were sold to banks including city banks and cooperative banks, 10% to trust banks, 9% to insurance companies, 6% to corporations, 23% to individuals and 4% to others. Sales to individuals increased from 16% of the

total sales in FY 2004 to 23% this fiscal year. According to interviews with some financial institutions, the increase in individual investors is due to larger investment by high net worth individuals based in urban areas and regional business owners, whose invested amounts are often comparable to those of corporate clients.

Chart 6: Distribution by categories of investors



2) Most hedge funds sold in Japan were launched outside Japan

As it was seen in the last survey, more than 50% of hedge funds sold are launched outside of Japan, mainly in the Cayman Islands. 30% of hedge funds sold to financial institutions such as banks, cooperative banks, etc. are based abroad, while 60% of hedge funds sold to insurance companies are based abroad.

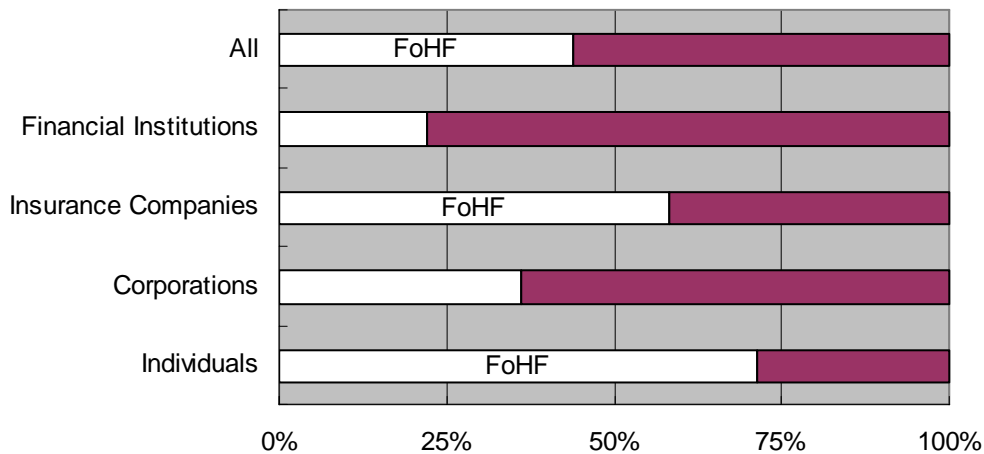
The Cayman Islands dominated among foreign bases, while Bermuda and the British Virgin Islands were home to a few. The major reasons for the Cayman Islands dominance are their lax regulations on financial products, including investment policies, their low costs for launching funds, and the presence of numerous specialists such as lawyers and accountants in the Cayman Islands. Another factor may be that, with regard to public offerings, the Cayman Island authorities established 'The Retail Mutual Funds (Japan) Regulation 2003' in line with the guidelines for disclosure requirements established by the Japanese Securities Dealers Association in Japan.

3) 40% of hedge funds sold are 'funds of hedge funds(FoHF)'

As for the type of hedge funds sold, 40% of hedge funds sold in Japan are 'funds of

hedge funds (FoHFs).’ 20% of hedge funds sold to financial institutions such as banks, cooperative banks), 60% of hedge funds sold to insurance companies are FoHFs. Also, 70% of hedge funds sold to individual investors are FoHFs.

Chart 8: Distribution of funds of hedge funds (FoHF) by categories of investors



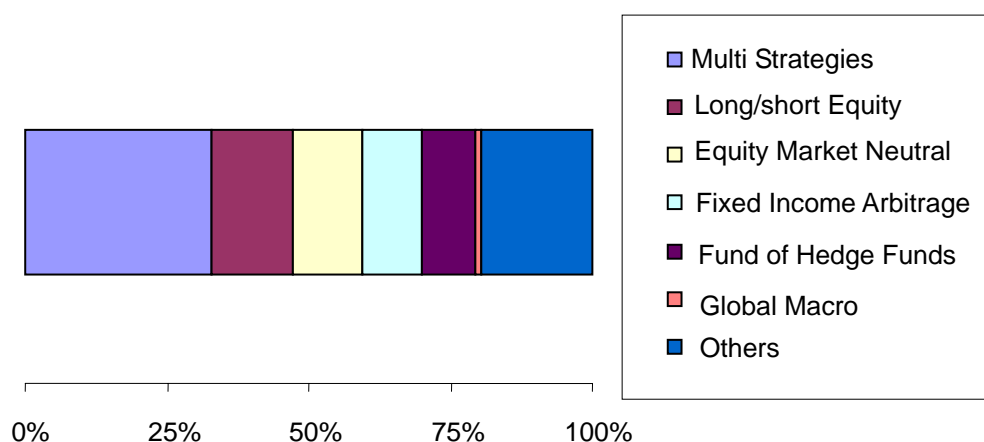
According to the results of interviews with distributors, regional banks and cooperative banks showed movement in redeeming FoHFs for risk management pursuant to the new capital adequacy requirements (Basel II) to be implemented from March 2007. On the other hand, it would appear that big investors such as insurance companies continue to have a preference for investing FoHFs, mainly because they appreciate the professional management skills of gatekeepers.

As for disclosure issues related to FoHFs, some investors request portfolio valuations by third parties or auditors. Regarding the double fee structure of FoHFs, several institutional investors do not consider this to be a problem as long as investment performances are in line with their expectations.

4) Multi-strategies and long/short equity accounts for close to a half of total sales

The breakdown of strategy of hedge funds sold by distributors in Japan is as follows: 33% are multi-strategy, 14% are long-short equity, 12% are equity market neutral, 11% are fixed income arbitrage. Others include long-short currency, event-driven and indices.

Chart 9: Strategies of hedge funds sold by distributors in Japan



2. Our Regulatory Approaches

There is no regulation and supervision tailored to hedge funds in Japan. However, the FSA, under its general regulatory framework, closely monitor the activities of hedge funds in light of investor protection, market integrity and systemic risk.

(1) Investor Protection

In case of hedge funds in form of investment trust and discretionary investment, securities companies and registered financial institutions who solicit and distribute hedge funds and investment trust managers and authorized investment advisors who conduct investment management of hedge funds shall comply with the numerous codes of conducts under the laws and related regulations. The FSA shall take appropriate measures if it finds any problems by way of the inspection and supervision of the companies and personnel.

Under the Financial Instrument and Exchange Law which will be implemented around the summer of 2007, several new treatments for investor protections will be introduced by including wide range of the interest of funds into the definition of the 'deemed securities'. Specifically, companies or persons who distribute or solicit the interest of funds and companies or persons who manage hedge funds assets shall register with the FSA.

(2) Market Integrity

In light of market transparency and fairness, the oversight and investigation are conducted over the market participants, including hedge funds, so as to detect and prevent market abuses such as insider trading and stock price manipulation. Since most of the hedge funds are established overseas, it might entail practical difficulty to apply domestic laws to their activities. In this regard, the FSA has further strengthened bilateral and multilateral cooperative ties among regulators, including IOSCO.

As regards cooperation with overseas regulators, the UK Financial Services Authority (UKFSA) imposed a financial penalty against GLG Partners L.P. (a UK hedge fund) and its former managing director for market abuses involving securities traded in the Japanese market based on the cooperation of investigation between Japan and the UK, such as information provisions.

(3) Systemic Risk

The FSA conducts inspections to check whether financial institutions are implementing adequate risk management and asset evaluations of investment products, including hedge funds. The FSA shall take appropriate measures if it finds any problems through the inspection and supervision of the financial institutions. Under the new capital adequacy requirements (Basel II), which was implemented at the end of March 2007, risks will be weighted according to the funds contents and if the financial institutions cannot ascertain the contents of the fund, the financial institutions are required to hold more net assets than the previous requirements.

(4) Fact Finding Survey

The FSA obtains basic information on hedge funds activities by conducting fact-finding surveys and information exchanges.

1) First comprehensive fact finding survey of hedge funds was conducted in 2005

Based on the 'Program for Further Financial Reform (December 2004)', the FSA conducted its first comprehensive fact finding survey of hedge funds, covering 1,251 financial institutions and issued the report titled 'Summary of Hedge Fund Survey Results and the Discussion Points' on December 2005. This report covered investment, distribution and arrangement activities by financial institutions in Japan over last five years as of the end of March 2005.

2) Exchange of opinions with industrial sectors

The FSA implements fact finding studies of hedge funds through interviews with

investment management companies and prime brokers regarding the supervision and surveillance of hedge funds, and holds continual exchanges of opinions with domestic and overseas industrial organizations and financial institutions.

3) Exchanges of information and opinions with foreign regulators

The FSA continues to actively exchange information and opinions with foreign regulators. Among others, the FSA participates in discussions held by international fora such as International Organization of Securities Commissions (IOSCO). Since, the majority of hedge funds distributed in Japan are established and managed overseas, it is crucial to strengthen cooperation with foreign regulators and monitor the activities of hedge funds.

3. IOSCO Activities

The IOSCO, an international organization consisting of 182 securities regulators from 116 countries and regions, establishes principles and guidelines on capital markets. The IOSCO Technical Committee, which consists of major market regulators, conducts surveys of hedge fund activities in members' markets and discusses regulatory issues of consequence to hedge funds.

(1) Reports on hedge funds

In February 2003, the IOSCO issued a report titled 'Regulatory and Investor Protection Issues arising from the Participation by Retail Investors in (Funds-of) Hedge Funds', which focused on the protection of retail investors in hedge fund.

Since then, some countries have introduced regulations on hedge funds and the market environment for hedge fund has changed. Considering this situations, IOSCO issued a report entitled 'The Regulatory Environment for Hedge Funds a Survey and Comparison' in November 2006.'

(2) Future work

The IOSCO is currently planning to establish principles with regard to hedge fund portfolio valuations so as to encourage good practices. The report covers clarifications of procedures and valuation processes, the maintaining of consistency of evaluation policies and regular reviews of the evaluation policy so as to secure the transparency of hedge funds portfolios. The report aims at forming practical principles, by taking into account opinions within the industry.