THE CONSORTIUM FOR JAPAN INTERNATIONAL ASSET MANAGEMENT CENTER PROMOTION

The state of the ecosystem of the asset management industry in Tokyo

Issues to be addressed towards the realization of a global financial center

November 2019

JIAM

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1. Foreword

The objectives of this whitepaper
Since the deliberation and announcement of the vision of Tokyo as a Global Financial Center (GFC) in November 2017 by the Tokyo Metropolitan Government (TMG), measures such as the establishment of FinCity.Tokyo, the international promotional body for Tokyo, and the “Tokyo Financial Award” have been implemented.
However, Tokyo’s position in the Global Financial Center Index by Z/Yen Group announced in September 2019 regressed to 6th from 5th which was where Tokyo was at the time of the creation of the GFC vision[1].
It is necessary for Tokyo to regularly assess its position in its journey towards delivering the vision, to share it among stakeholders and also to record it.
This paper attempts to capture the state of play of the ecosystem of the asset management industry which has been identified as an important pillar of the GFC vision including the development of the emerging asset managers[2] and address the issues and challenges.

About the data
In order to secure specificity and objectivity, this paper attempts to capture opinions by market players with different perspectives to present the state of the asset management industry ecosystem in Tokyo as of October 2019.
The data and opinions have been gathered through overseas roadshows, one-to-one meetings, roundtables, seminars both in Japan and abroad and industry surveys which were carried out by the Consortium for Japan International Asset Management Center Promotion (JIAM) over the last 3 years.

2. The current state of the asset management industry ecosystem seen from diverse perspectives

This chapter attempts to present the current state of the asset management industry ecosystem by introducing the opinions and data gathered through JIAM’s interaction with the main market players both domestic and overseas.

2.1. The current state and issues of the ecosystem seen from the eyes of the main domestic players

This section attempts to clarify the inefficiencies in the current asset management industry value chain through the opinions and data gathered.

A) Asset Owners (Institutional Investors)[3]

JIAM approached asset owners (pension funds, financial institutions) to inquire about their use of IT and fund allocation to Emerging Managers and obtained valid responses from 27

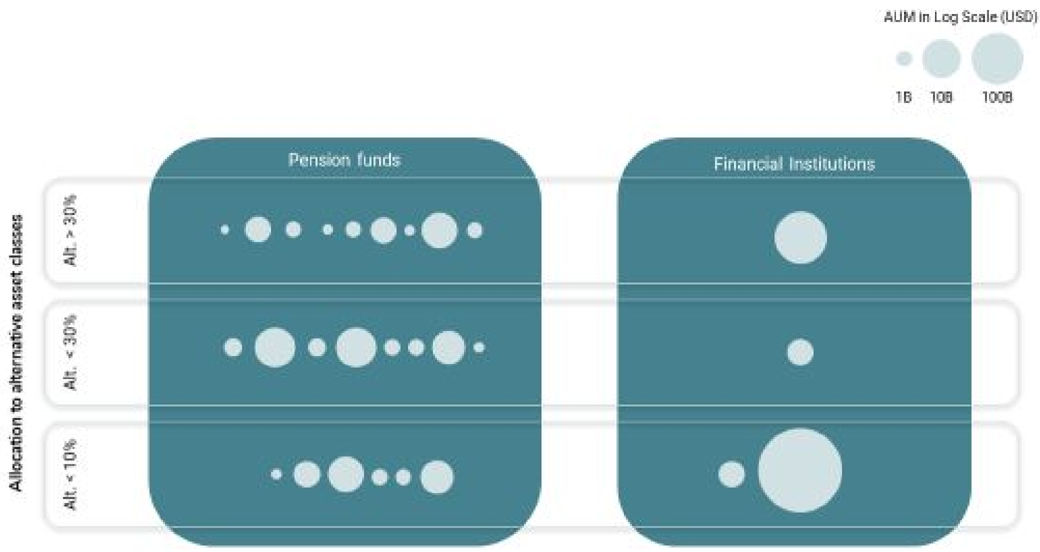
[1] It has to be noted that some of the financial hubs in the ranking have involvement in the calculation of “The Global Financial Centres Index 26” announced by Z/Yen, a UK based thinktank. The calculation was led by City of London Corporation (2007-2010), by Z/Yen in collaboration with Qatar Financial Center Authority (2010-2015) and then by Z/Yen with China Development Institute.

[2] Given the lack of asset managers in Japan compared to other GFCs and of mechanisms of entrusting funds to Emerging Managers which are prevalent in Europe, US and Singapore etc, TMG introduced the Tokyo EMP (Emerging Managers Program) to offer subsidies to domestic institutional investors to establish and manage funds which would invest in EMs.

[3] Please refer to Annex ② for a detailed definition (This Annex is available in Japanese language only)

investors (Chart 1).[4]。

Chart 1- 27 asset owners interviewed



Following are the observations and opinions by these asset owners covering issues such as communication with other players in the ecosystem, fund allocation to Emerging Managers, inefficiencies which are inherent to asset owners and the Tokyo GFC vision.

On performance reports by asset managers

- *"Data definitions by asset managers are inconsistent. It's difficult to aggregate and compare horizontally"*
- *"Would like to see asset managers reduce cost on reporting and client servicing and focus more on investment"*
- *"Ministry of Health, Labor and Welfare (MHLW) who is in charge of supervising pension funds, should clarify asset classes for alternatives in its reporting template"*[5]
- *"Pension Fund Association (PFA) and Corporate Pension Network Council (CPN) should drive data standardization for corporate pension funds and Government Pension Investment Fund (GPIF) for public pension funds"*
- *"How about promoting standardization of reporting formats by strengthening "*

Asset owners are aware of the operational inefficiency due to the lack of uniformity in the performance report formats.

[4] JIAM approached more than 60 corporate pension funds to ask for an interview but many either declined or were able to give little relevant information. We also approached some public pension funds but they were not able to give more than data that is disclosed in the public domain. Chart 1 shows that many investors invest in alternative assets (only 8 of the 27 said that the allocation was less than 10%) but this is a reflection of a "selection bias" which is skewed towards asset owners who are open enough to respond to JIAM'S interview request.

[5] The Pension Fund Association (PFA) compiled and published the "Fiduciary Duty Handbook for Corporate Pension Funds" to support Employees' Pension Funds and Defined Benefit Corporate Pension Funds efficiently run their business.

On communication with asset managers (other than performance reports):

- *"Would welcome direct dialogue with portfolio managers to understand performance instead of hearing just sales talks"*
- *"Financial conglomerates should not be allowed to take advantage in selling pension investment products by leveraging other existing relationships"*

There is a desire by asset owners for unbiased communication with asset managers in order to understand accurately their service and to supervise them.

On communication with trust banks and other players:

- *"Would like to receive data feed from Trust Banks instead of paper or PDF reports"*
- *"Trust Banks' systems are inflexible and expensive to make even insignificant changes, eg asset classification"*
- *"There is probably inaccurate understanding of information security behind the inefficiency in the transfer of data"*
- *"Trust Banks, distributors and pension consultants should all be better versed on technology"*

There is an awareness that the lack of uniformity in report formats and data definition is causing inefficiency in the communication with players other than the asset managers as well.

On commissioning asset management to Emerging Managers:[6]

- *"Due to the tightening of regulations post AIJ scandal, the burden associated with disclosure for investment in alternative assets is large"*[7]
- *"There is more understanding for alternative investment nowadays but even so, it seems to raise concerns if the allocation ratio is noticeably large"*
- *"Limitation in allocating to Emerging Managers is probably more of a mindset issue rather than a regulatory one"*
- *"Pension fund management is seen more as a component of HR systems than as a return driver by our company. Asset owners who expect high return can probably afford to allocate to Emerging Managers"*
- *"It is difficult to access competent Emerging Managers under the current mainstream FoF (Fund of Funds) or MoM (Manager of Managers) structures"*
- *"We would like to consider if Emerging Managers are able to deliver an annual alpha of more than 5% but it is difficult to define alpha"*
- *"In order to promote fund allocation to Emerging Managers, it would be necessary to raise awareness and knowledge level of asset owners in addition to having a Tokyo Emerging Managers Program"*
- *"Asset owners need a mindset to satisfy themselves with a return on its entire portfolio even if individual Emerging Managers do not generate the expected level of return"*

Although there are many observations pointing out the hurdles against allocating to

[6] The definition of an "Emerging Manager" in this survey is; AUM is below USD 1 million, less than 5 years since the registration as an asset manager and with no financial affiliation with large financial institutions/distributors.

[7] Following the AIJ incident of 2012, to ensure fiduciary duty by Board Members of Employees' Pension Funds, the "Guidelines for role and duty of asset managers for Employees' Pension Funds (MHLW notification)" was amended in September 2012. The same amendments were included in the "Guidelines for role and duty of asset managers for Defined Benefit Pension Funds (MHLW notification)" which was revised in April 2018.

Emerging Managers, few are negative about allocating to Emerging Managers.

On inefficiencies of asset owners:

- *"More autonomy should be given to asset owners by government agencies (both FSA and MHLW)"*
- *"Japanese asset owners, who are not necessarily professionally trained, probably tend to over-prepare themselves for FSA inspection and therefore have a high level of demand for reporting by asset managers"*
- *"Pension funds in Japan tend to focus too much on detailed numbers in adherence to the MHLW monitoring guidelines at the expense of focusing on long term market trends and investment philosophy/ strategies"*

There is awareness by the asset owners that they need to have more ownership in their approach to asset management business and optimization of reporting.

On human resource factor of asset owners:

- *"Asset owners should enhance investment capabilities furthermore through attending independent educational seminars and cross-learning with their peers"*
- *"Job market of Asset Owner CIOs should be established and recognized to match up with advanced markets (eg US, Canada, EU) especially for private pension funds"*
- *"Lack of young talent and clear path in institutional investor role. More effort should be put into development of young talent and its acquisition"*
- *"Asset management is not our sole task and we need to consider people allocation"*

There is an awareness among asset owners for the need of talent development and people allocation in order to enhance their asset management capabilities.

On the "Tokyo as a GFC" vision:

- *"The Financial City Tokyo initiative should reach out to the asset owner community extensively"*
- *"The entry barrier does not seem to be as prohibitive as other developed countries but the problem is that it is not recognized so"*
- *"It is necessary to form a common understanding of what the specific benefits from Tokyo becoming a GFC would be for asset owners"*
- *"For the development of the asset management industry, it is necessary to address a diverse range of challenges, eg enhancing the infrastructure of the asset management industry in addition to a better Tokyo EM*

For advancing the Tokyo as GFC vision, asset owners pointed out the need for those concerned to have a closer dialogue with the asset owner community and to make efforts for asset owners to be on the same page.

Following are the results from JIAM's survey on production of performance reports and allocation to Emerging Managers which were themes with many challenges mentioned by interviewees.

Chart 2: Format of performance reports requested by asset owners to asset managers

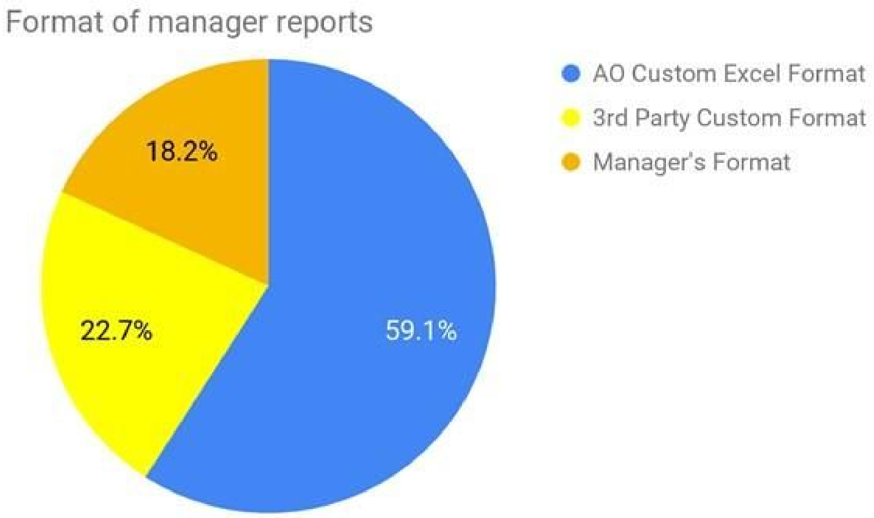
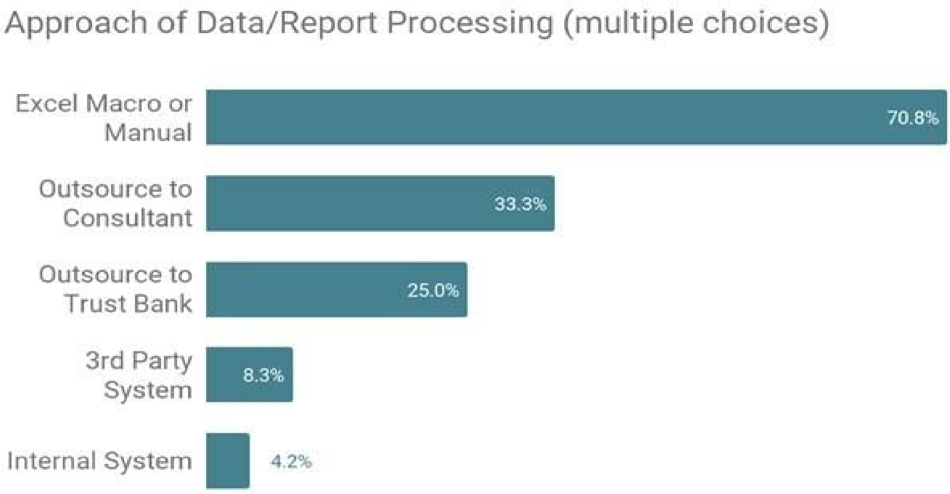


Chart 3: Approach of data/report processing (multiple choice)



More than 80% of the asset owners responded that they expected asset managers to deliver reports in customized format defined by themselves or by third parties (pension consultants, trust banks).

In addition, more than 70% of asset owners are manually processing reports and data and every month spend 4.3 person days on average.

On allocation to Emerging Managers, about 44% of the 27 respondents have some experience in allocating to an Emerging Manager.

Chart 4: Interest in engaging Emerging Managers

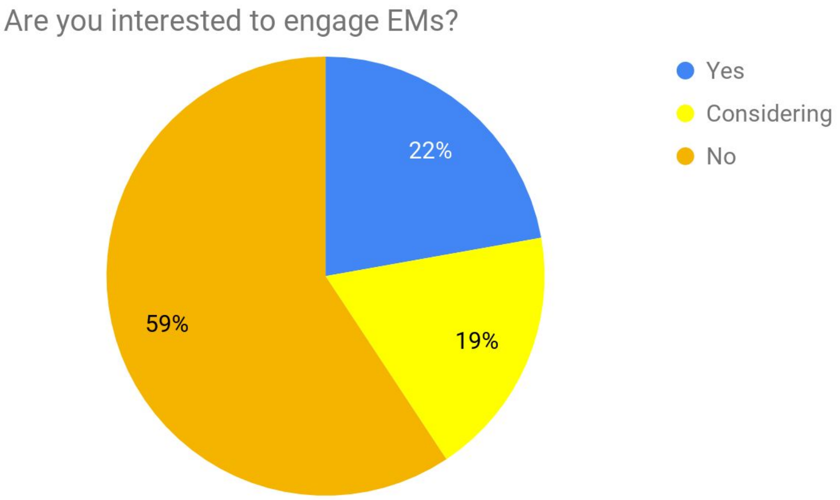


Chart 5: Criteria for allocating funds to Emerging Managers

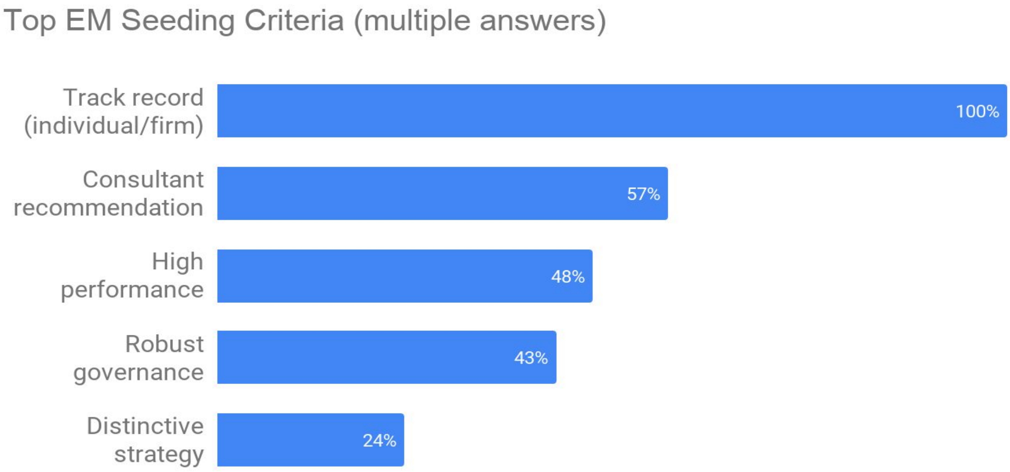


Chart 6: Barriers against allocation to Emerging Managers

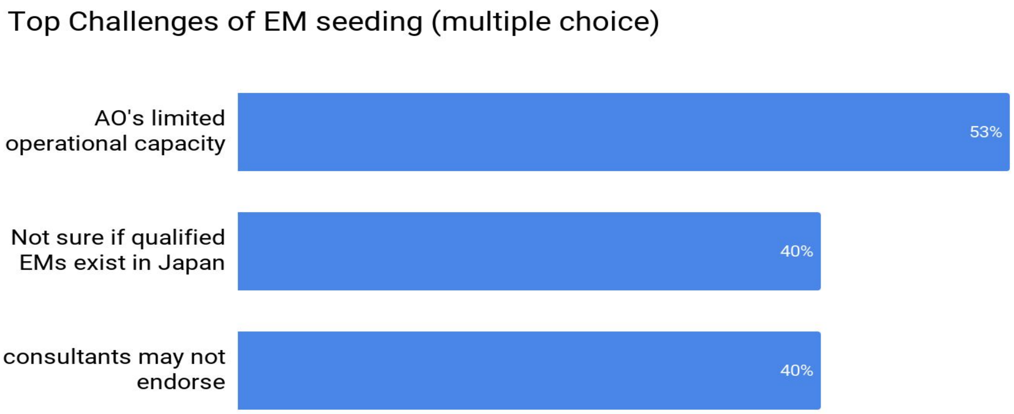
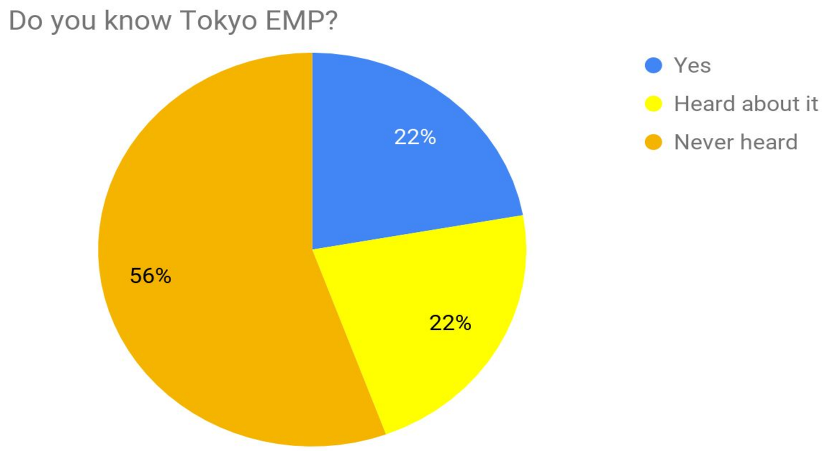


Chart 7: Recognition of Tokyo EMP



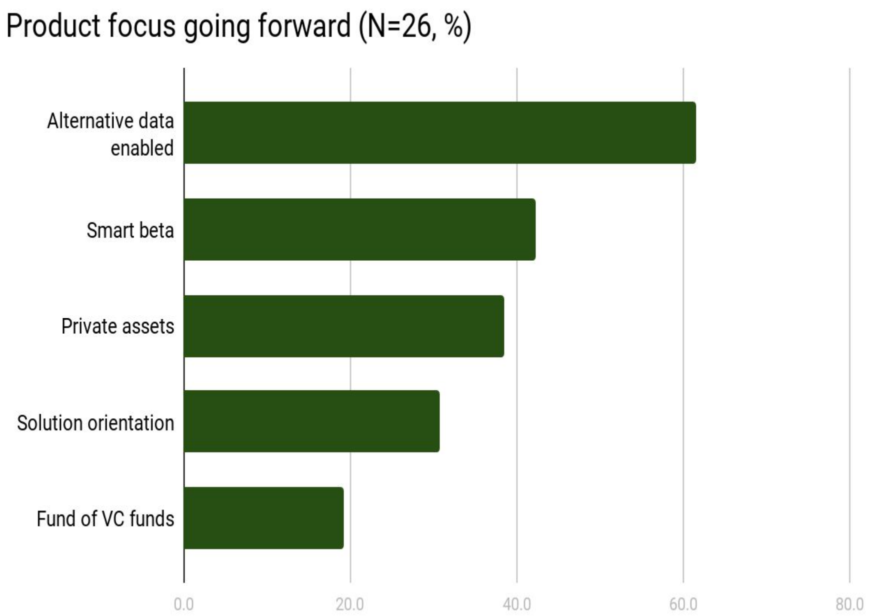
Incumbent Asset Managers

We interviewed a mix of 26 incumbent asset management companies to explore the opportunity for using fintech in order for them to improve efficiency and value-add of their business.

Chart 8: Classification of the 26 asset managers interviewed[8]

	Larger asset managers	Independent asset managers
With trust/banking function	5	-
Without trust/banking function	9	12

Chart 9: Investment strategies to focus



Observations on the use of alternative data etc in asset management business:

- Many of the firms who expressed an interest in utilizing alternative data showed concern that the price for using data is expensive whilst the coverage was limited.
- About 75% are of the view that potential for AI use in asset management is being over-rated and that cleaning of data is necessary for effective use.
- About 90% are of the view that data cleaning and purchase cost would be a hurdle in using big data in asset management.

Observations on use of other areas of fintech in asset management business

- ~65% think that index tracking is labor intensive and there is scope for automation.
- ~80% do not consider investment in cryptoassets (cryptocurrency) at this time but 20%

[8] We anticipated a difference in the survey result between asset managers with trust function (ie trust banks) which have a diverse line-up of services and others with a narrower remit in how they deploy technology but there was no difference to be noted.

predicts its adoption into multi-asset strategies in the future.
- ~40% think that investment in tokenized private assets will become possible in the future.

Observations on potential use of fintech in performance report production

- ~90% view manual investor reporting to be intensive especially for large Japanese asset owners whose processes are largely paper based.
- More than 90% consider that standardization of disclosure items in performance reports and use of cloud-based database will contribute to improved competitiveness of the asset management industry.
- On average, 50-75% of performance report for asset owners are being produced manually.
- On average, 30-40% of an FTE's working hours is spent on production of performance reports.
- ~55% say numerous EUC reporting tools are developed by employees. Their employees are refusing to give up these tools.

Observations on potential use of fintech in other business areas

- ~45% expect fintech to be a tool to reduce distribution costs for asset management services, eg view that roboadvisor is a product distribution tool.
- ~50% believe that **regulators** should adopt **RegTech** rather than asset managers (e.g. open API for auditing, utilization of secured chat as opposed to emails, licensing application and fund approval workflow management)
- ~50% believe that blockchain will be useful for efficiency gains only if adopted through the end- to-end investment value chain and that this needs to be led by the regulator or industry associations, not by each company.

Observations on relationship between asset managers and fintech firms/ IT vendors

- ~70% believe that technological advancement will NOT necessarily be disruptive.
- ~50% interested in Fintech as a talent pool than Fintech products per se.
- ~30% were introduced to Fintech by IT vendors but found nothing useful. They would prefer to directly interact with Fintech firms.
- ~50% think that internal resistance is the largest obstacle to adopt advanced technologies, such as fintech. Fintech engineers are expected to inspire employees of large financial institutions

B) Emerging Asset Managers

JIAM interviewed 16 asset management firms who set up their businesses in Tokyo to find out about the hurdles they encountered, their views on Tokyo GFC vision and Tokyo EMP.

Chart 10: Difficulties encountered in the business establishment process

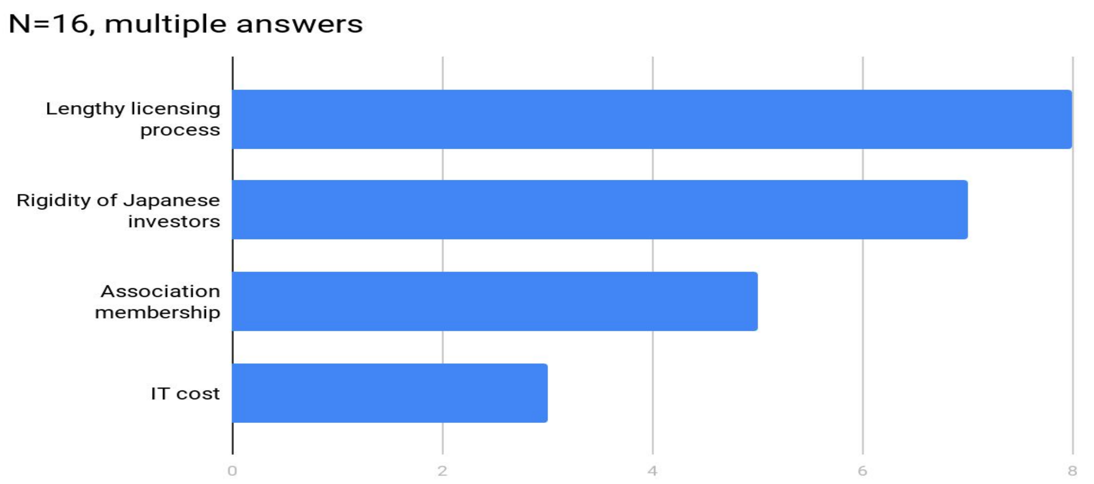
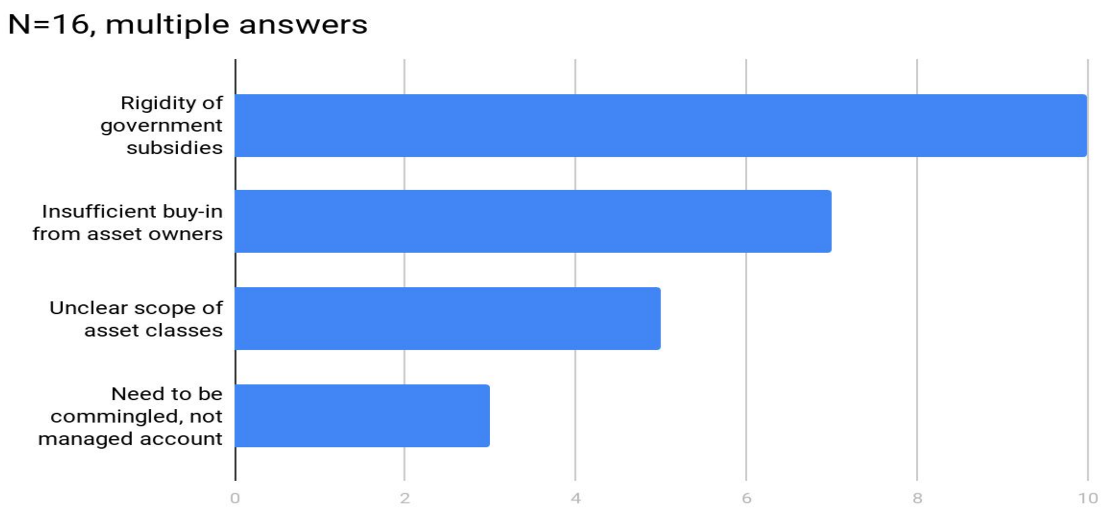


Chart 11: Improvements desired for Tokyo EMP



Emerging asset managers also commented on the registration process at the Kanto Local Finance Bureau (KLFB) and membership process for the Japan Investment Advisers Association (JIAA) as follows.

<u>On establishing a new asset management firm</u>

- In the process of submitting an application for registration with KLFB[9][10]:
  - *“We were repeatedly instructed to work on the grammar and font of our application documents which has nothing to do with the substance of our competence in managing assets”*
  - *“We were instructed to lengthen our application and to make the business flow chart more complex and increase the number of pages”*
  - *“We had to pay multiple visits to KLFB just to comply with the formality of the registration document”*
  - *“On the other hand, we had never been asked substantial questions such as on our business model, asset management strategies and asset classes”*
- On joining JIAA
  - *“Joining JIAA is supposedly optional but there was pressure from the authorities and JIAA secretariat as if it was a duty to”*[11]
  - *“The dates of the board meeting which discusses new membership applications are not disclosed and it seems as if they are held on an ad hoc basis. The admission process looks opaque and the membership fee of JPY1 million is very expensive”*[12]
  - *“On the other hand, registration with bar associations for ADR as a substitute to accessing JIAA’s ADR instrument can be made at any time and is cheaper”*[13]

The application process to register with KLFB and admission process for JIAA are both seen by asset managers to be formality driven with much scope for improvement.

C) Pension Consultants

JIAM interviewed pension consultants who provide professional advice to pension funds and obtained the following findings and opinions on allocation by pension funds to emerging asset managers and Tokyo EMP.

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[9] Registration application forms specified under Financial Instruments Exchange Law (FIEL) Article 29-2 Clause 1 and the Cabinet Office Ordinance Article 5 and Annex 1 and associated documents such as business outline form specified under FIEL Article 29-2 Clauses 2 and 3 and Cabinet Office Ordinance Article 5 are required.

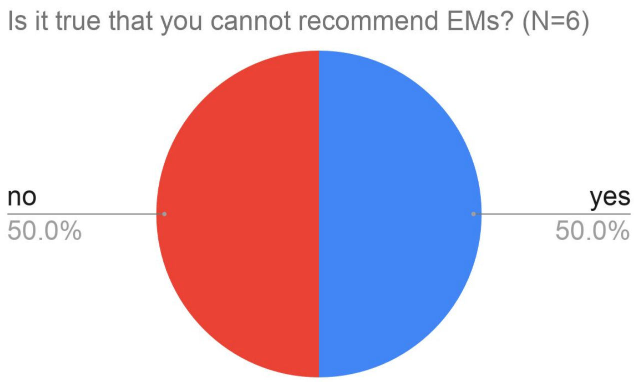
[10] The Q&A page concerning registration of entities of KLFB website states that the standard time required for processing registration applications is 2 months excluding the time spent on pre-consultation and amendment of applications.

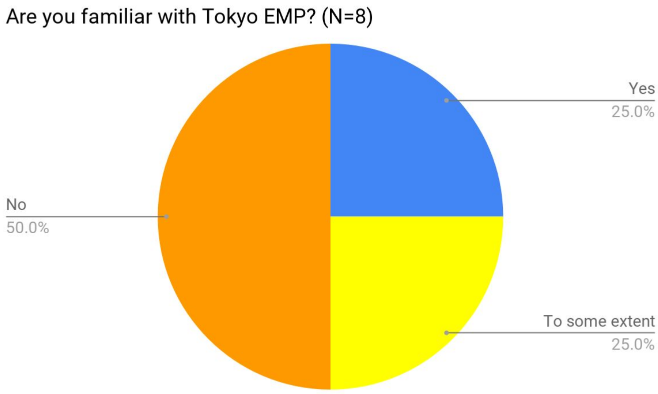
[11] The same KLFB webpage states that joining JIAA is optional in response to a question asking whether it was recommended to join JIAA.

[12] The page explaining admissions (Japanese language page) of the JIAA website states that the board meeting is held on a monthly basis and information on admission process is disclosed. The membership fee is set at JPY1 million for investment managers and JPY200,000 for investment advisory and agency businesses.

[13] The three Tokyo based bar associations(Tokyo Bar Association, Daiichi Tokyo Bar Association and Daini Tokyo Bar Association) charge JPY60,000 (excluding tax) for signing an agreement.

Chart 12: Possibility of recommending emerging managers to clients (n=6)





Comments by consultants who consider it possible to recommend emerging managers

- *“Provided we are satisfied with due diligence we can recommend them”*
- *“We are prepared to treat experience of emerging managers during their time as an individual portfolio manager at a larger asset management firm so that there is some flexibility on the track record criteria”*
- *“There is an element of asset owners using the absence of recommendation by consultants as an excuse for not allocating to emerging managers”*
- *“If we know of any high-caliber portfolio managers who plan to set up shop, we would proactively look for asset owners to act as seed funders”*

These comments demonstrate that there are no deterrents to prohibit pension consultants from recommending emerging asset managers.

Comments by consultants who consider it difficult to recommend emerging managers

- *“Not enough resources to expend on researching emerging asset managers”*
- *“Emerging managers tend to be too small for pension funds of multinational companies with colossal AUM to realistically allocate their funds to”*
- *“Many asset owners do not have sufficient level of expertise to allocate their funds to*

emerging managers"

- *"Without a request by asset owner clients, consultants cannot do any research on emerging managers"*
- *"The risk associated with investing in emerging managers should not be underestimated and consultant firms have professional liability"*
- *"Don't believe there are many emerging managers who would be worthy of considering for recommendation"*
- *"Many of the emerging managers seem to offer hedge fund strategies which has become difficult for us to recommend after the AIJ scandal in 2012"*

There is also a cautious view that there are practical business factors that make it difficult to conduct research/ give recommendations for emerging managers.

Comments on Tokyo EMP

- *"There must be a distributor (eg trust bank) or an incumbent asset manager to raise funds from asset owners for investing in emerging managers but the financial incentive to involve them seems to be lacking"*
- *"How about TMG contracting a consultant firm to provide research on emerging managers for consumption by asset owners?"*
- *"However hard consultants work to evaluation or recommend emerging managers, it is ultimately for asset owners to decide whether to allocate funds"*
- *"Allocating to a single emerging manager can present a larger risk with no distribution of risk therefore a scheme to form a FoF would be desirable with the involvement of existing asset management firms and trust banks"*
- *"Can't GPIF be seed investor by incorporating ESG investment requirement into Tokyo EMP?"*

For Tokyo EMP to function effectively, many comments pointing to the necessity of incentivizing asset owners were obtained.

2.2 The state of the ecosystem seen from the eyes of overseas players and its challenges

Let us review the opinions and comments gathered at the oversea roadshows by JIAM and examine how overseas players including those with an interest in entering Tokyo regard the asset management industry ecosystem and its inefficiencies etc.

Views on entering the Japanese market

- *"The potential business opportunity seems large and entering Japan is an attractive option."*
- *"The economic scale is large with sophisticated technology and it is an attractive market to do business. If there are suitable business opportunities available, we should be able to give consideration."*

The potential business opportunity in the Japanese market is large enough for overseas asset management firms to consider entering the Japanese market.

Comments on comparison (eg taxation) with other jurisdictions

- *“If the effective tax rate for the special economic zone could be brought down to around 20%, it should be competitive enough vis-à-vis Hong Kong and Singapore.”*
- *“The high level of personal income tax is a source of concern and I count the number of my days in Japan carefully so that I don’t get taxed in Japan”*
- *“For foreigners the high level of inheritance tax is a critical issue and we fear of dying in Japan where the taxation rate is high”*
- *“We hear about the Tokyo Economic Special Zone but no one seems to know what incentives are being made available”*

The taxation level of corporate tax, personal income tax, inheritance tax etc is being mentioned as an important factor for foreign asset management firms on deciding whether to enter Japan

Views on the administrative processes for entering into business

- *“It is hard to obtain a full picture of the necessary processes for launching an asset management business in Japan which makes it difficult to build a business plan for entering the market”*
- *“Different layers of rules and regulation including self-regulated rules of the asset management industry exist and it is time-consuming to collect and interpret them in a comprehensive way”*
- *“The registration requirements for a financial instruments business are very unique to Japan and as the documentation is mostly in Japanese it is difficult to understand the registration process”*
- *“Would like to have a dedicated desk by the government to support new entrants as you would find in UK, Singapore, Hong Kong etc”*[14]
- *“We cannot make enquiries or submit application via email or online from abroad which makes it costly as we need to stay in Japan, contract work to specialists etc”*[15]
- *“Would like FSA and KLFB etc to hold briefing sessions abroad on registration processes”*
- *“It usually takes around 2-3 months to complete registration in Hong Kong but we hear that it could take as long as 1-2 years in Japan “*
- *“The fast track program offered by FSA is a welcome one but we don’t know how effective they are and how one can make use of it”*
- *“Even if the registration application process is improved under FSA’s leadership, it is hard to imagine that the officials handling the paperwork become more flexible in their approach”*
- *“The present paper based application process should be replaced by an online registration process”*

There are many comments on the opaqueness and inefficiency of the registration process and request for improving it as it is challenging to even consider business planning.

Comments on the inefficiency in sales activities towards asset owners

- *“It is very hard to meet asset owners such as pension funds on business visits to Japan which we make to consider entry into the Japanese market”*

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[14] TMG runs a “Financial One-Stop Support Service”designed to support overseas financial services firms etc by providing support for administrative processes in collaboration with FSA and comprehensive consulting services free of charge.

[15] Although it is not possible to conclude full circle of registration as a financial instrument business, the “Financial One-Stop Support Service” by TMG accepts email and telephone enquiries.

- *"We need events to enable access to many asset owners at one place which is being held in overseas markets frequently"*
- *"Registration as a Financial Instrument Business is necessary just to have a casual discussion with asset owners such as pension funds in order to evaluate business prospect which makes it difficult to consider the possibility of entering the market[16]"*
- *"The biggest problem is that we cannot have a dialogue with an investor in Japan without registration under the Financial Instrument and Exchange Law. We had to therefore give up our plan for entering Japan[17]"*
- *"Although there are programs by public pension funds to welcome entry by new asset managers, the eligibility criteria such as performance and asset under management are high which makes it difficult for small and medium sized asset managers to make use of them"*
- *"Realistically speaking, it is hard to win a contract to manage assets from an asset owner without having a recommendation by pension consultants etc"*
- *"In addition to the large number of turf-conscious players, the excessive number of players such as gatekeepers surrounding the pension funds is an impediment against entering the Japanese market"*
- *"It is hard work to do business with pension funds. We would like the onerous reporting requirement and unrealistic demand for securing liquidity relaxed"*
- *"Regional banks have large asset under management and could be highly attractive institutional investors but they are dispersed geographically and not easy to communicate with in English, making contact very difficult"*
- *"We feel that the level of understanding of alternative investment, emerging market investment and infrastructure investment is low"*

There is a view that efficient business development is difficult in approaching asset owners due to various hurdles.

Opinions on outsourcing of business processes

- *"Compliance with voluntary rules by trade association requires much time and cost and there is considerable burden on mid/back office work"*
- *"There are standards unique to Japan such as the calculation of Net Asset Value (NAV) of investment trusts which make it difficult to make use of IT systems and professionals of global standard"*
- *"Outsourcing of compliance function is not possible which makes operation in Japan too costly for a smaller asset management firm[18]"*
- *"It is desirable to have a mechanism whereby mid/back office function may be outsourced and we can concentrate on asset management activities[19]"*

There is a strong call for enabling outsourcing of middle/back office functions and compliance in order to improve business efficiency.

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[16] A Financial Instrument Business license would be necessary for overseas asset management firms to hold meetings which involves soliciting of sales of an overseas domiciled investment trust. However if the asset management firm merely explains its company outline,services and performance, registration as a Financial Instrument Business is not necessarily a must.
[17] Same as above
[18] FSA's views are that compliance function may be outsourced in some cases for investment management, investment management for qualified investors, investment advisory and investment agency businesses. Outsourcing is not necessarily forbidden by law.
[19] There are already service providers who can contract mid/back office functions of asset management firms. As of September 2019 there are 9 service provider who were eligible for using the "Subsidy for the outsourcing of middle and back office function" program.

<u>Opinions on securing finance professionals</u>

- *"There is a dearth of experienced and bilingual professionals in the asset management business which increases personnel cost"*
- *"There is a lack of compliance professionals with deep knowledge on asset management business. There may be a need for an industry-wide compliance professional development program"*

There is an absolute lack of bilingual financial and compliance professionals and an increased burden on personnel cost as a result.

3. Remaining challenges against the realization of GFC Tokyo

This chapter will review the challenges facing the realization of the Tokyo as a GFC vision based on the opinions and data gathered in previous chapters from both Japanese and overseas players. We will give particular focus to asset management industry and fintech which are the two strategic pillars of the GFC Tokyo vision and identify the barriers against their growth.

3.1 Promotion of entries by emerging asset managers and support for their growth

In order to vitalize the asset management sector and secure its sustainable growth, it is crucial for emerging asset management firms to actively enter the market and to expand their business. However, this does not seem to have happened in the eyes of emerging asset managers and the asset owners who are their potential clients. Based on the opinions and data gathered from the various players, we consider the following as impediments.

<u>Establishment and entry by Japanese and overseas emerging asset managers</u>

The difficulty in obtaining comprehensive and accurate information to form the basis of business planning upon setting up an asset management firm in Japan was mentioned by many.

Without an accurate understanding of Financial Instruments Exchange Law and related legislation, rules and regulations set by trade associations and industry customs and a business plan based on this knowledge, it is impossible to calculate business cost or to predict revenue.

Particularly for overseas financial institutions, the limitation in gathering information which is often available in Japanese language only, inaccurate information and its interpretation are often in circulation, raising the cost to ascertain the accuracy of information. There are cases where firms give up entry into Japan at the very early stage of planning.
Inefficiency in the application process for registering as an asset manager with KFLB was also pointed out. Despite the standard processing time being set for 2 months, as this does not include time spent in pre-consultation and amendment of documents prior to submission, it is hard to know how long the process would take.

The communication between the applicant and officials which is devoted to formality of the documents and the paper-based application process itself adds up to the inefficiency. Not only does it add up to the cost but also to difficulty in projecting the timescale and budget for entering the Japanese market.

The comments received from the main players suggest that there is much room for improvement in the inefficiency observed at a stage before the emerging managers actually start their business.

Among such inefficiencies, there are items which require large scale measure including changes in related legislation. But there are also improvements that can be made by just communicating more accurate information on the state of the asset management ecosystem. For example, some overseas players seem to think that outsourcing of compliance work is not allowed in Japan which is not true. Continuous efforts to send out accurate information would be worthwhile to reduce the cost for foreign businesses to enter Japan.

<u>Asset allocation to emerging asset management firms by asset owners</u>

The next challenge for asset managers who have established themselves and entered the Japanese market as a member of the asset management ecosystem is to win mandates from asset owners and grow their business.

In building their business in Japan, providing service to the institutional investors would be a more realistic goal compared to servicing the retail investors which would require intensive administration and management of daily flows of funds and support to the sales channels.
Having said that, the views introduced by the emerging asset managers both domestic and overseas and asset owners show the high hurdles facing emerging asset managers in winning mandates from asset owners such as pension funds or even approaching them in the outset.

Despite having obtained the necessary Financial Instruments Business license and completed the necessary preparation, without winning asset management mandates, there is no way for emerging managers to thrive or for further new players to enter the market. The hurdles facing emerging managers in approaching asset owners could also be a bottleneck to stifle the wider asset management industry ecosystem.

Conversely no one in the asset management ecosystem is actively blocking asset owners from entrusting management of their assets to emerging asset managers as seen in the views by asset owners, pension consultants etc in the previous chapter. In fact, there are views that active use of emerging asset managers contribute not only to the management of asset by asset owners but also for the growth of the wider asset management ecosystem. It is the lack of awareness for the economic significance by asset owners in adopting a new approach, absence of rating by a pension consultant and the lack of economic incentives to motivate incumbent asset managers and distributors to actively support emerging asset managers which hinder the asset owners from allocating funds to emerging managers.

The Tokyo EMP is an attempt to provide incentives to asset owners and gatekeepers etc to encourage allocation of funds to emerging managers. However the current program is not sufficiently known by players in the market and there are comments suggesting that the incentive and flexibility of the program in its current form are not attractive enough. There is room for better publicity and for improving the mechanics of the program.

Efficient running of emerging asset management firms

For emerging asset management firms to successfully grow their business not only would they need asset allocation by investors but also creation of an efficient business operation mechanics.

It is natural to think of saving cost for activities that don't contribute to creating added value and competitive edge, ie investment decisions and sales activities, and in this vein, emerging managers commented that they would like to use outsourcing services of middle and back office functions.

One issue which was raised as an area of frustration by many overseas player was the lack of compliance specialists in Japan and the cost for hiring one. As it is necessary for compliance staff at foreign financial institutions to be fluent in English, this further narrows the talent pool.

The lack of compliance specialists not only affects business operation but also could become an issue in registering as a Financial Instruments Business and the need for development of specialists and promotion of outsourcing are challenges that need to be addressed by the wider asset management ecosystem. One solution may be to use the underutilized talent pool such as retired specialists and women who left the workforce for family reasons. Such wider initiative may be difficult to be addressed by individual firms and would require an industry wide effort involving TMG and industry organizations.

3.2 Deployment of fintech by asset management firms

Fintech not only improves the user experience of financial services users on an individual level but also has potential to improve efficiency of financial service firms and asset management firms would also be a beneficiary.

Especially, use of fintech by asset management firms not only contributes to optimizationof business and operation and resulting cost reduction but also has the potential to improve expected return as it can broaden the potential of asset management activities. However comments raised by players including asset managers reveal that fintech is not being broadly used by the asset management industry yet.

Use of fintech in producing asset management performance reports

Opinions by asset owners and incumbent asset managers suggest that there is a large degree of manual work in producing performance reports and in its utilization and that there is a common awareness about the inefficiency.

Tasks such as the calculation of the market value of asset under management, investment return over a given period and its analysis lend well to automation and there are views that anticipate the use of blockchain in these tasks in the future.

However, causes that were pointed out for preventing the use of fintech in these fields do not relate to cost or technological issues but the lack of standardization of data formats and

definition of data across the industry which cannot be tackled by individual firms.
If alignment of definition and standardization of data can be achieved under the leadership by regulators and/or trade associations, it is possible for the use of fintech to increase and efficiency of the asset management industry is improved as a result.

Use of fintech to advance asset management capabilities of asset management firms

In terms of the use of advancing asset management capabilities with fintech, the use of alternative data as a source for improved return and the use of AI in analyzing such data are pointed out as the areas with highest expectation by asset managers.

The level of data cleaning and the difficulty in verifying correlation with asset management performance are seen as concerns impeding the use in addition to the high cost.

Since these issues do not accrue to any diseconomy between players, they are likely tobe solved with the increased use of technology. But as pointed out by some respondents it is necessary for asset management firms to use such technologies albeit on a pilot basis in order to make an economic case to parties who are against the use and also to introduce external knowledge.

4. Conclusion

Taking into account all the data and views that had been obtained through JIAM's activities, many in the asset management industry, including those that are yet to enter Japan, recognize the inefficiencies and aspects requiring improvement in the ecosystem. On the other hand, many such players neither intend to obstruct the effective working of an ecosystem nor want efficiencies to be untouched but seem to believe that the elimination of inefficiencies should be of benefit not just to the ecosystem but to themselves too.

However, many of the inefficiencies are better placed to be solved fundamentally and effectively as a horizontal industry-wide effort rather than being dealt with individually by each player.

For example, in addressing issues such as the inefficiency associated with the production of fund performance reports or the lack of bilingual specialists in compliance, actions by individual firms could bring the best possible outcome for individual cases but not for the improvement for the entire ecosystem.

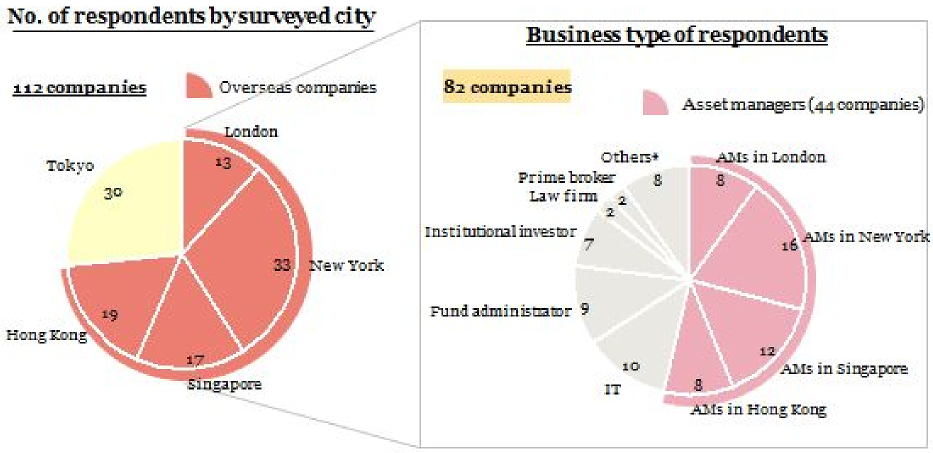
In addition, the misunderstanding surrounding the legality of outsourcing of business functions and the lack of information on utilizing emerging asset management firms, suggest that there are still many players whose decision making may have been made based on inaccurate or insufficient information. Of course, individuals can strive to collect accurate information but a more industry-wide concerted approach to information dissemination should lead to a more efficient and effective outcome.
In delivering the Global Financial City Tokyo vision, it goes without saying that an industry-wide approach in acting on the various policy measures would be necessary to expect any outcome. Aligning the behavior of the main players to the optimization of the wider ecosystem may be needed.

Appendix 1 Materials prepared for the Asset Management Working Group of Japan Securities Dealers Association (JSDA)

JIAM conducted a survey covering 112 asset management firms both domestic and foreign for the 8th Asset Management Working Group session held on April 17th 2016 by the Japan Securities Dealers. The below is an extract of this survey to supplement Section 2.2 of this report which provides voices of foreign asset managers on the ecosystem of the Japanese asset management industry.[20]

This survey introduces feedback from 112 Japanese and overseas asset managers on their expectation for JIAM prior to its establishment.

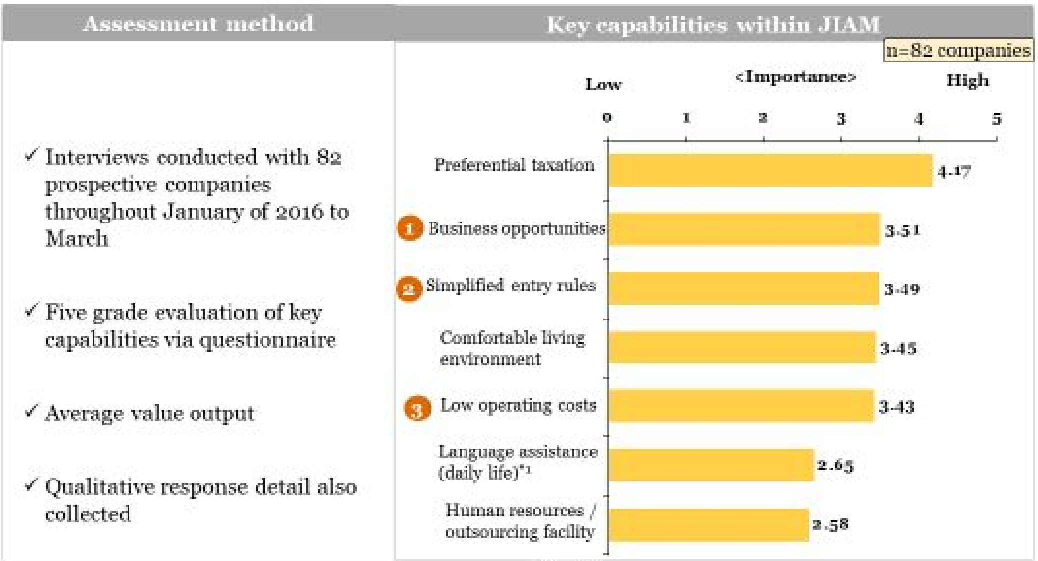
Chart 14 Breakdown of companies interviewed [21]



This survey which asks respondents where they see needs for JIAM seems reflective oftheir priorities in considering entry into the Japanese market. The survey shows that besides preferential taxation, provision of business opportunities, improvement of entry rules, and a reduction in operating costs as important areas for JIAM to intervene.
The survey also highlights “preferential taxation” as the most important theme for JIAM which concurs with the views shown in Chapter 2 of this report and confirms the importance of taxation as a factor for attracting overseas financial services firms.

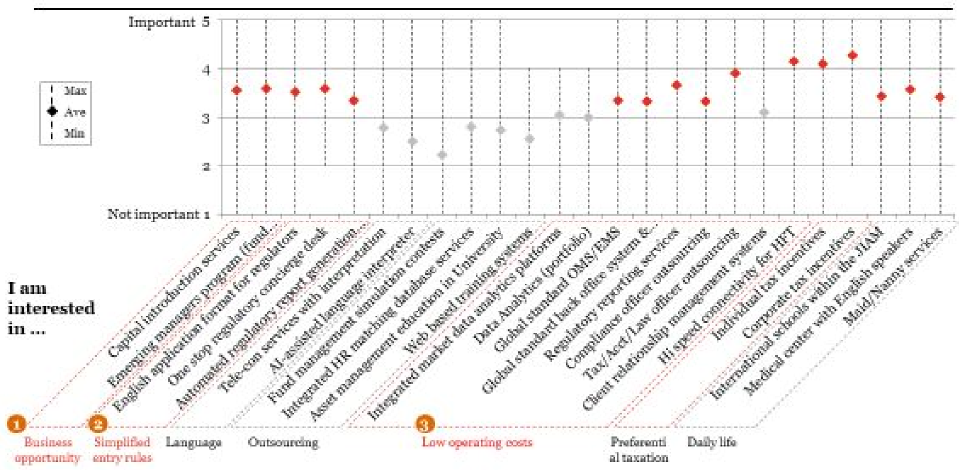
[20] http://www.jsda.or.jp/about/kaigi/chousa/TIFC_kondankai/dai8kai_shisan_shiryou.pdf
[21] Page 19 of Survey for Asset Management Working Group, JSDA

Chart 15-1: Themes which asset managers would like to see JIAM address[22]



*1 Language assistance on market entry are included in "Simplified entry rules"
Source: Target asset manager needs survey

Chart 15-2: Themes which asset managers would like to see JIAM address[23]



Source: Target asset manager needs survey (PwC)

On "business opportunities" which was cited as the second most important factor after "preferential taxation" the survey presents a comparison between entry programs for small to medium asset managers offered by US and Japanese asset owners. It concludes "Unlike Japan, in the US many public pension funds provide small to medium managers

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with easily accessible entry programs and reduced entry requirements including track record".

Chart 16:Comparison between Entry Programs for Emerging Managers in Japan and US [24]

	Pension fund	Entry program's AuM	Track record	Outstanding AuM	Other requirements
Entry programs for managers in Japan	GPIF	Not disclosed	More than 3 year track record of asset classes	More than JPY30B in principle	• Focusing on active and passive investment in foreign equities
	Local government officials	–	More than 3 year track record of asset classes	More than JPY100B	• Credit rating of asset managers more than BBB
	Pension fund association	–	More than 5 year track record	More than JPY100B (FoF JPY300B)	–
	National public service	–	More than 5 year track record	More than JPY10B	• Over 20 employees • Average work experience of more than 3 years
Entry program for emerging managers in theUS	NY state common requirement fund	$5.2B (3% of total)	Less than 5 year track record	Less than $1B	• Track record of less than 12 years
	CalPERS	$3B (1% of total)	No restriction	Less than $2B	• Investment only within the US for PE, and within California (for RE)
	NYC public pension fund	$14B (9% of total)	Less than 3 year track record	Less than $2B	–
	Illinois State Board of Investment	$1.3B (9% of total)	No restriction	Less than $100B	–
	North Carolina pension fund	Less than $0.5B (1% of total)	No restriction	$0.1~2B	–

Source: Each pension fund's website

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