

Global Financial City: Tokyo
*an interim review of the Advisory
Panel's discussions*

Friday 19th May, 2017

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1. Background and aims

This report summarizes the Advisory Panel members' views of Tokyo's current position as a financial hub. It then sets out measures that could be introduced to improve its standing as a global financial city.

Background

- Japan needs to enhance the role of the asset management sector in order to overcome the following social issues:
 - Ineffective use of household assets
 - Low birthrate and aging population
 - The over reliance of an aging population on public pensions
 - Public pensions have only just begun to invest assets overseas
- In responding to this environment it is important that a wide range of views are considered and a big picture approach adopted. TMG needs to formulate a policy that considers medium to long-term issues in order to achieve 'Global Financial City: Tokyo'.
- The "Advisory Panel for Global Financial City Tokyo" was established in November 2016 and has held four discussions.

Inputs

- Advisory Panel members' views
 - Discussions at Panel meetings
 - Individual meetings with each panel member
- Views were also sought from asset management firms located outside Japan.

Questions to be considered

- What are the strengths, weaknesses, opportunities and threats to Tokyo becoming a global financial city?
- The vision for Tokyo as a global financial city?
- What priority measures should be introduced so that Tokyo can become a global financial city?
- And which among them should TMG concentrate?

2. An assessment of Tokyo's current position as a Global Financial City

Strengths

- Substantial funds
- Secure and stable environment
- Established legal system and business practices*
- Wide range of domestic industries
- Cuisine, arts and culture
- Education standards (up to the end of high school)
- Advanced technology (especially artificial intelligence and robotics)

Current Assessment of Tokyo

- Government and public organizations work in silos which leads to a slow response
- Concerns about earthquakes and radiation
- Lack of English proficiency in government organizations
- The public are not always clear on their obligations, because it is difficult to predict the way in which measures will be implemented by bureaucrats
- There is not an ongoing commitment to previously introduced policy measures
- The speed of implementation of new policies by the government is slow

Weaknesses

Opportunities

- Protectionist policies of countries (e.g. Trump Administration, BREXIT)
- Increased investment opportunities related to growth strategies of the 2020 Olympic and Paralympic Games
- Leadership of Tokyo's Governor
- Leadership of the FSA
- Improvements in the productivity of white collar workers triggered by the low birthrate and aging population

- Lack of accountability
- The possibility that producing a report is the main outcome
- Possible public misunderstanding that wealthier people and foreigners are being treated preferentially
- Negative views of financial businesses
- Measures taken by other Asian countries to promote themselves (e.g. South Korea)
- Japanese nationals living overseas holding negative and outdated views of Japan's financial regulatory authorities

Threat and Impediments

*Business practices can also be a weakness if they are overly structured and lack flexibility.

3. A Vision of Tokyo as a Global Financial City

Vision Smart Financial City Tokyo (Draft)

Asia's Financial Hub

- Utilize Japan's substantial amount of personal funds (1,750 trillion yen) to support Asia's growth.
- Tokyo connects a strong Asian demand for financing with substantial Asian savings including from Japan.
- Tokyo should play a significant role as a financial hub through which a flow of Asian funds supports major businesses, technologies and talented professionals working in financial services.

Gathering people, funds & technology

- Attract financial businesses, technologies and people to Tokyo.
- Become the leading global city where funds are available to be managed by highly-skilled finance professionals.
- Develop highly-skilled people who will work in the Tokyo financial sector over the longer term.

Focus on Asset Management and FinTech

- Tokyo could potentially consider many areas to help it become a global financial city but it is important to prioritize and asset management and Fintech are most likely to lead to success.
- Asset management could become a more successful business to Tokyo than the banking sector.
- Tokyo should present itself as a FinTech friendly city.

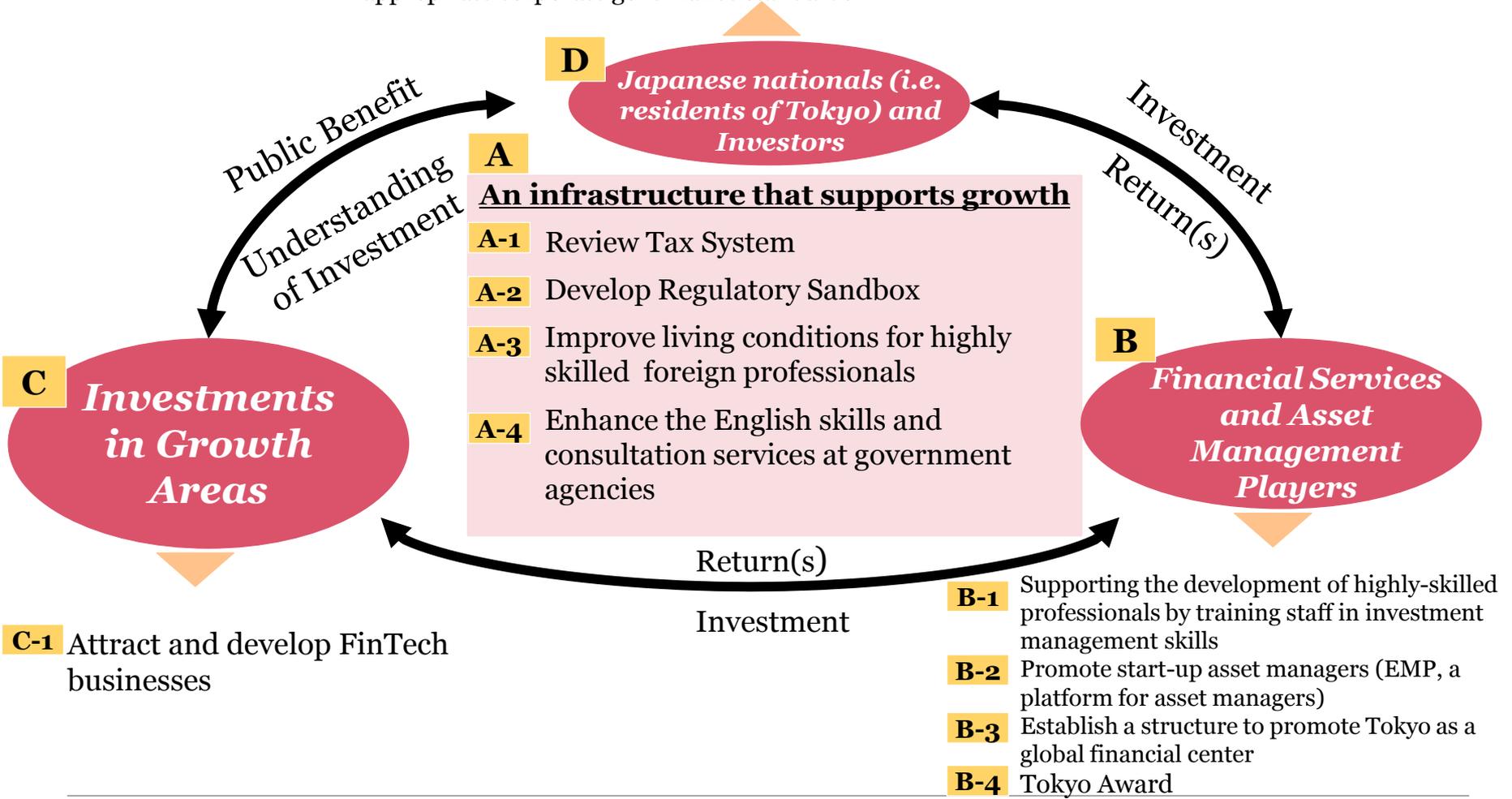
Investor & Customer focused

- Japan's financial institutions should support a more customer focused environment including investment in NISAs.
- They should also thoroughly implement their fiduciary duty responsibilities and this should accelerate the flow of funds from savings to investments.

Source: Views from Advisory Panel Members

4. An Overview of Measures Proposed by the Advisory Panel (1/2)

- D-1** Provision of Investment education to the public as part of a more general program to raise financial literacy
- D-2** Financial institutions fully implement their own fiduciary duty responsibilities and have in place appropriate corporate governance standards



4. An Overview of Measures Proposed by the Advisory Panel (2/2) (Draft)

A summary of the policy proposals that the Advisory Panel considered to be a priority for TMG to consider and take forward.

Classification	Proposed Measures	Party(ies) to be Involved		
		TMG	Japan	Private Sector
A) Infrastructure supporting growth	A-1) Review tax system	✓	✓	
	A-2) Develop Regulatory Sandbox	✓	✓	
	A-3) Improve living conditions for highly skilled foreign professionals	✓	✓	✓
	A-4) Enhance the English skills and consultation services at government agencies	✓	✓	
B) Financial Services, Asset Management Players	B-1) Supporting the development of highly-skilled professionals by training staff in investment management skills	✓	✓	✓
	B-2) Promote start-up asset managers (EMP, a platform for asset managers)	✓	✓	✓
	B-3) Establish a structure to promote Tokyo as a global financial center	✓	✓	✓
	B-4) Tokyo Award	✓		✓
C) Invest in Growth Areas	C-1) Attract and develop Fin Tech businesses	✓	✓	✓
D) Japanese nationals (i.e. residents of Tokyo) and investors	D-1) Provision of Investment education to the public as part of a more general program to raise financial literacy	✓	✓	✓
	D-2) Financial institutions fully implement their fiduciary duty responsibilities and have in place appropriate corporate governance standards	✓	✓	✓

✓ :Lead ✓ :Collaborate with Lead to promote measures

5. Summary of the Panel Members' Views: reforms to the Tax System (1/2)

 : Concerns & considerations on items discussed

Items Discussed	Advisory Panel Members' View
<p>A consideration of corporate and regional taxes (including views on national taxes)</p>	<ul style="list-style-type: none"> ● Corporate taxes paid by businesses in Tokyo include an additional local surcharge and at just over 30% are higher than Japan's effective corporate tax (29.97%). But the Japan rate is high when compared with the UK (20.00%), Singapore (17.00%) and Hong Kong (16.50%). The US's corporate tax rate is also high (e.g. New York is 43.83%) but the Trump Administration is indicating they would like to significantly reduce this level. ● Reforming the tax system will not in itself make Tokyo a global financial city, but Japan needs to decide how it wants to position itself against any decision that the U. S. might make to lower its rate. ● TMG cannot alone resolve tax reform issues and must collaborate with the national government. <ul style="list-style-type: none">  It would be very difficult to make amendments to the national tax system that only apply within the Tokyo area and such a measure is unlikely to gain a majority backing in the Diet. TMG should therefore start by making any amendments only to the parts of the tax system for which it has direct responsibility. ● Relocating financial services companies is relatively easy compared with manufacturing firms. A reduced corporate tax rate could result in more foreign financial service businesses moving to Tokyo, especially from the asset management sector, and would likely increase overall tax revenues. <ul style="list-style-type: none">  The public may find it difficult to understand that a reduction in corporate tax rates would only apply to businesses in the financial services sector ● Lower tax rates should be introduced to encourage the growth of new companies whose success is necessary for the revitalization of Japan. ● A consideration of the overall tax base should be undertaken in tandem with any proposed reductions to the tax rate. ● Need to consider how changes to the tax system might be introduced for businesses within the National Strategic Special Zone and Comprehensive Special Zone.
<p>A review of the PE Tax System ^{*1}</p>	<ul style="list-style-type: none"> ● The PE taxation system exposes foreign individuals or entities to double taxation i.e. being taxed on the same assets both in Japan and their home country. These rules are therefore an obstacle to foreign direct investment in Japan and need reform. ● The ratios used by the PE taxation system - "over 25% ownership and over 5% sale" ^{*2} - are impeding overseas direct investment into Japan. <ul style="list-style-type: none">  Adopting preferential measures for foreigners in such a way that the benefits were only accrued to Tokyo then this may not be seen as acceptable.

* 1 An overview of PE taxation : when an individual or entity puts funds into a domestic investment limited partnership and hold 25% or more of the total partnership assets, they are deemed to have a permanent establishment. They therefore become subject to domestic withholding income tax as part of PE taxation rules.

* 2 Taxation on gains from the transfer of a business or other similar equities: a non-resident, foreign or domestic legal entity is subject to domestic withholding income tax if they own 25% or more of equity in a business and then decide to transfer 5% or more of it. The withholding tax applies even if the transaction to transfer the equity takes place overseas.

5. Summary of the Panel Members' Views: Reforms to the Tax System (2/2)

: Concerns & considerations on items discussed

Items Discussed

Advisory Panel Members' View

Review of inheritance and gift tax rules

- Inheritance and gift tax rules that apply to foreign nationals living in Japan are very burdensome. An amendment of the law in April 2017 improved the position for shorter-term residents (i.e. foreign nationals living in Japan for 10 years or less out of the last 15 years). But longer-term foreign residents (i.e. those living in Japan for over 10 years out of the last 15 years), will be subject to taxation on all their global assets including those located outside Japan and this can apply for up to of 5 years after their permanent departure from Japan.
 -  Any review of the tax system would need to consider the impact on social inequality and any conflict that might possibly arise.
- Japan's inheritance and gift tax rules for foreign national residents are based only on the number of years they have lived in Japan. The US, the authorities assesses a broader range of factors to establish the 'intent' of a foreign national to stay permanently in the US taking account of factors such as residency length, location of family, voting and the scale of assets in the US etc.
 -  Some suggested that the Japanese system is more clear cut and easier to administer.

Review of Foreign Asset Reporting Requirements

- Under Japan's Foreign Asset Reporting Requirements all tax residents of Japan must itemize every individual asset they own overseas and valued at Yen 100,000 or more and submit this list each year to the Japanese tax authorities. This is particularly burdensome for foreign nationals who may more likely own assets outside of Japan.
 -  Some suggested that this "Foreign Asset Report" although burdensome was not unique to Japan and they said other jurisdictions had similar reporting requirements although with different minimum reporting thresholds.

Other

- Japan's highest marginal income tax rate is higher than many other countries at 55%.
- There is a need to consider the income tax relief for those in employment in a household in order to incentivize more women to take up paid employment.
- There is a lack of predictability to changes made to Japan's tax code and is an obstacle to the emergence of new business. Any tax reforms should be clearly signaled and should not come as a surprise.
- A tax deduction system for R&D expenses is available for service industries from FY2017 but many companies are not unaware of its introduction. Promotional activities to the financial services industry appear not to have been sufficient.

5. Summary of the Panel Members' Views: Developing a Regulatory Sandbox*1

 : Concerns & considerations on items discussed

Items Discussed	Advisory Panel Members' Views
Encourage Collaboration between Industry and Academia	<ul style="list-style-type: none"> ● There needs to be greater collaboration amongst regional bodies, the government, private companies and educational institutions. One of the reasons why Japan has been successful in researching iPSCs and regenerative medicine is that academia's skills have been complemented by the government amending the law which resulted in a more timely approval process. This action has resulted in global companies carrying out research activity in Japan and applying for approvals.
Relaxing regulations affecting venture companies	<ul style="list-style-type: none"> ● The social penalties for 'grey businesses' are significant in Japan. There should be more tolerance for venture companies such as Uber and Airbnb, developing in these grey areas.
Necessity for balance	<ul style="list-style-type: none"> ● A balance needs to be made between areas where rules must be followed strictly and areas where some flexibility is permitted.
An Appealing Strategy	<ul style="list-style-type: none"> ● A Regulatory Sandbox has been introduced in the UK and Singapore but it is not altogether clear which rules have been relaxed. The term, "Sandbox" gives the impression of being industry friendly and many countries are adopting the use of the term as part of a strategy to attract FinTech business.  The measure may lose its appeal unless it is clear what are the benefits and which rules can be relaxed.
Attractive labor market for foreign companies	<ul style="list-style-type: none"> ● Japan's labor law is overprotective and it is necessary to create employment environment which has flexibility and high mobility of labour force.

* 1 Regulatory Sandbox : Also known as a "sandbox for rules" it allows for the temporary relaxation of rules to develop new businesses such as FinTech. It aims to promote innovation by providing room for experimentation and respite from applying existing laws.

5. Summary of Panel Members' Views: Improving Living Conditions for Highly Skilled Foreign Nationals

Items Discussed	Advisory Panel Members' Views
Childcare arrangements	<ul style="list-style-type: none">● Childcare facilities in Tokyo are in short supply for everyone and there are long waiting lists. The situation is even more challenging for foreign nationals and additional childcare arrangements need to be put in place.● Provide additional public international school(s) in Tokyo so that the costs of education are less burdensome for foreign residents with families.
Provision of domestic help	<ul style="list-style-type: none">● Make it easier for highly-skilled foreign residents to be able to hire domestic help.
Medical services in English	<ul style="list-style-type: none">● Greater provision of medical services in English.
Smoking policy	<ul style="list-style-type: none">● Consider introducing a non-smoking policy for restaurants in Tokyo.

5. Summary of Panel Members' Views: administration services and consultation desks at government agencies should be provided in English

A-4

Items Discussed	Advisory Panel Members' Views
Provision of Services	<ul style="list-style-type: none">● Financial reporting to the authorities in English should be permissible and there should also be a greater acceptance of the disclosure of information in English.● Financial services firms may have difficulty in understanding entry requirements because these are only set out in Japanese.● There are not enough services provided by the government in both Japanese and English.
Clarify and simplify financial regulations	<ul style="list-style-type: none">● It is not always clear what activities can be outsourced to a third party.● Some people believe that the financial regulations are not transparent and as a result they have a lack of confidence in the regulatory system. If there are needs to make request to the FSA, it is necessary to carry out a detailed analysis of the rules and how they might be applied.
Advance clarity on tax issues	<ul style="list-style-type: none">● There is a system in place that can examine tax implications for new financial product or a particular transaction and set out the tax implications. But the system is not widely used and it should be more widely publicized.

5. Summary of Panel Members' Views: training highly-skilled financial professionals

Items Discussed	Advisory Panel Members' Views
Training for asset managers	<ul style="list-style-type: none">● Employees at asset management firms require a flexible working environment so they can take advantage of courses after work provided, for example, by Tokyo Metropolitan University. These types of opportunities currently exist in New York and London.
Link educational theory with practice	<ul style="list-style-type: none">● In Japan the teaching of the theory behind asset management and the research that is carried out in this area is weak and this needs to be improved. There is a need for courses to more effectively combine the theory with practical experience.● This approach should be delivered through a cross-appointment system^{*1}
Recruitment and Promotion	<ul style="list-style-type: none">● Investment management companies should take a performance-based approach to judge individuals' skills.● Investment managers should be appropriately appraised and promoted based on their skills and competences.● Asset management firms should directly recruit experienced highly-skilled professionals at any point in their career and not just graduate entrants.
Skills required	<ul style="list-style-type: none">● Education and training should be provided in specialized areas such as: AI, robotics, computer science and data science.● People who work or planning to work in the financial sector need to have proficient English so that they can take advantage of being taught by international academic experts or collaborate in international programs.

*1 Cross-appointment system: a system that allows researchers to be employed by two or more organizations including by universities, public research institutions and corporations.

5. Summary of Panel Members' Views Emerging Asset Manager Firms (EMP*1, Asset Management Platforms etc.)

B-2

Items Discussed	Advisory Panel Members' Views
Emerging Asset Manager Program (EMP)	<ul style="list-style-type: none">● Japanese public pension funds set high entry conditions both in terms of experience and the amount of funds that have previously been managed. This in effect means that only large-sized asset management firms are able to become part of the roster.● Japan should consider more diversity in the asset management firms given a mandate as this is likely to result in greater innovation.● There could be resistance from existing players to new entrants but for the good of the sector it is important that these new entrants are encouraged and it is made clear to all why this policy is being adopted.● Large-scale asset management firms who are managing public pension funds are involved in EMP to advance portfolio investment, Japan's public pension funds and asset owners may also provide funds.● TMG should consider putting up seed money to encourage more market entrants.
Transition Manager Program (TMP)	<ul style="list-style-type: none">● In the U.S. there is a framework by which firms who have attained Emerging Manager status can then become a Transition Manager and after gaining further experience become a fully recognized investment manager.
Develop networking among asset management firms	<ul style="list-style-type: none">● Put in place opportunities where all investment managers (regardless of status) are able to network.
Develop investment infrastructure	<ul style="list-style-type: none">● In order to promote efficiencies it may be useful to encourage the outsourcing of middle and back office functions with asset management firms concentrating on the investment strategy and related activities.

*1 EMP: Emerging Manager Program (Program to develop new asset management firms) The program would financially support a young asset manager

5. Summary of Panel Members' Views: Establishing a B-3 Structure to Promote Tokyo as an International Center

Items Discussed	Advisory Panel Members' Views
The requirement	<ul style="list-style-type: none"> ● Japan has 1,750 trillion Yen of household savings which potentially can be used to encourage economic growth in Asia but it needs skilled asset managers to use these funds effectively. Tokyo should therefore encourage the presence and development of skilled domestic and international asset management firms to undertake this work. ● New asset management firms should be encouraged to locate to Tokyo to become part of a growing and vibrant sector
The Firms	<ul style="list-style-type: none"> ● Tokyo should target foreign asset management and FinTech firms ● The presence and activities of these new firms should help promote innovation and create an ecosystem which encourages overall dynamism
Establish a post to promote Tokyo	<ul style="list-style-type: none"> ● Establish a position with the support of a dedicated organization to promote Tokyo as a financial center akin to the activities undertaken by the Lord Mayor of the City of London. ● A person from the private sector should undertake this role.
Lessons from London	<ul style="list-style-type: none"> ● The CityUK is a British organization to further enhance London as a financial center. It is independent from the City of London Corporation (the municipal authority) but they closely collaborate on activities. ● London believes that in collaborating with other financial centers it can create additional business opportunities.
Provision of information to the Public	<ul style="list-style-type: none"> ● Taking the steps necessary to support Tokyo's ambition to be a global financial center needs the support of the public and providing them with sufficient information is important in obtaining their backing. ● Tokyo needs to provide appropriate information to foreign nationals to make them more informed and fill any perception gaps about doing business in Japan. ● Promotion activity needs to highlight successful examples of foreign businesses who have been successful in Japan including the types of businesses they undertake and the products they sell. The approach needs to be different to typical PR campaigns conducted by governmental bodies.

5. Summary of Panel Members' Discussion on Measures: the Tokyo Award

B-4

Items Discussed	Advisory Panel Members' Views
Establish concept and themes for Award	<ul style="list-style-type: none">● Establish the Tokyo Award in a field related to finance. It should be positioned as a prestigious honor and similar to the Nobel Prize.● Consider that the prize should be awarded to those who have provided a solution to practical financial problems faced by the public. It could mirror the approach adopted by Singapore and have the public (both Tokyo residents and overseas' visitors to the city) identify the problems they would like to see resolved.● The aim of the Tokyo Award would be to raise the profile of the city as a global financial center and influence highly-skilled professionals to consider moving to Japan and thereby accelerating the increase in the talent pool.
Prize for award winners	<ul style="list-style-type: none">● Consider that the prize should be both a monetary amount and provide a business opportunity, such as providing a platform for the winner to work alongside major corporations.

5. Summary of Panel Members' Views: Attracting and Developing FinTech (1/2)

C-1

Items Discussed	Advisory Panel Members' Views
Attract FinTech related firms	<ul style="list-style-type: none">● Attract FinTech firms and venture firms related to AI, robotics and ecosystems.● Attract venture capital firms that encourage innovation including FinTech.
Match venture capital and FinTech firms	<ul style="list-style-type: none">● Provide an environment (similar to a scheme in Singapore) that allows for the matching of venture capital firms with FinTech firms and highly skilled people.● Promote collaboration between financial institutions and FinTech firms. (There are examples of a service or a system being developed over a short time period through the collaborative efforts of participants attending an event).● Support investment in open API so that FinTech firms and banks can cooperate more easily.● Support investment in research and development (R&D) that allows FinTech firms to carry out 'proof experiments' in a secure environment to improve the security measures that are crucial to the success of FinTech.
Develop ecosystems	<ul style="list-style-type: none">● Tokyo could become a place where people come to observe major developments in Fintech through the use of a Regulatory Sandbox and the relaxation of measures within the special economic zones.● The establishment of an incubation facility will promote the cultivation of expert knowledge as result of people from the Bank of Japan, the Japanese Bankers Association, asset management firms and academia working together.● A Tech Center has been established as part of a partnership programme involving Cornell University in New York City and combines expert knowledge from academia and business.● In Cambridge in the U.S., venture firms, venture capital firms and research institutes have clustered together and this environment has fostered innovation. In a similar way Tokyo should encourage the development of such a cluster from which firms can smoothly launch financial services businesses.

5. Summary of Panel Members' Views: Attracting and Developing FinTech (2/2)

Items Discussed	Advisory Panel Members' Views
Become a city associated some feature	<ul style="list-style-type: none">● Establish Tokyo as center renowned for a special feature. For example, a cryptocurrency to be known as the “Tokyo Coin”, or position it as a global data center, building on Tokyo’s reputation as a safe and reliable city● Technology has been developed in Japan to high standards but these standards have not become global ones. A new business model is necessary which would work in other Asian countries that have high populations and allow the leveraging off the economy of scale across national borders.● The existence of a ‘start up friendly’ city ranking indicates that the image associated with a city is an important part of the overall branding strategy.● Put in place a facility or platform where overseas’ tourists would be able to experience impressive examples of FinTech developed in Japan.
Attract diverse talent	<ul style="list-style-type: none">● Many companies that established themselves in Silicon Valley and displayed entrepreneurial spirit were able to draw on talented people from a diverse range of backgrounds. Tokyo should also aim to foster an environment that can harness the creativity and skills from people from diverse groups including the LGBT community and from particular countries including engineer trained computer programmers from Israel and India.
Crowdfunding	<ul style="list-style-type: none">● Crowdfunding in Japan can be classified into three types: donation, purchase and investment. ‘Purchase’ type crowdfunding is based on an empathy among funders to the purpose of the funding; this approach sits well with the Japanese psyche and “purchase” crowdfunding has potential to grow further.● A person who raises financing through crowdfunding can set out to their potential investors how they plan to use the money raised

5. Summary of Panel Members' Views: Improving Financial Literacy and investment skills amongst the public

D-1

Items Discussed	Advisory Panel Members' Views
Raising Financial literacy	<ul style="list-style-type: none">● Financial literacy levels amongst the general public needs improvement. Raising levels of understanding could result in more engagement with Japan's financial services industry and its vitalization.● Collaboration amongst different groups is an important part of the process that will raise basic financial knowledge.
Practical product based learning	<ul style="list-style-type: none">● The public is more likely to learn about financial products and services through the experience of purchasing products like a NISA, rather than some formal type of education.
Learning about investing in products as part of the primary and secondary school curriculum	<ul style="list-style-type: none">● Primary and junior high school pupils should be taught fractions and learn about basic concepts connected with finance in mathematics classes.● There would be positive benefits if high school pupils had the opportunity to study economics.● Intel, the computer company, provides pro bono classes in programming at a primary school in Saitama. It would be beneficial for corporations to provide opportunities for school children to be taught about investing in products.
Attract foreign nationals	<ul style="list-style-type: none">● The presence of more foreign residents (including at primary schools), may positively alter Japanese people's perceptions and view of foreigners and may have an overall good influence.● Providing highly-gifted children from developing countries with educational opportunities in Japan will enhance their educational opportunities and may also inspire Japanese children.

5. Summary of Panel Members' Views : the thorough implementation of Fiduciary Duty Responsibilities and Corporate Governance

D-2

Items Discussed

Advisory Panel Members' Views

Align the interests of client and asset management firms

- The growth of the asset management sector will require it to gain the confidence of the public by delivering successful investment strategies and taking responsibility for its fiduciary duties.
- The interests of the customer and investor and the financial firm should be aligned to attract both domestic and international investors. This includes the quantitative outcomes achieved and the quality of the service provided.
- There needs to be greater transparency surrounding the costs, including the commission, paid by a customer.

Highlight the positive impact of the corporate governance and stewardship codes

- The corporate governance and stewardship codes have had a positive impact but it is important to promote wider uptake and encourage thorough implementation.

6. Next Steps for the Advisory Panel

- Outline Tokyo's vision as a global financial city
- Clarify what actions TMG, the government and the private sector should take for each proposal
- Identify issues where more policy development is required and carry out this additional analysis
- Identify any other issues that should be considered