OPALESQUE

# Opalesque Roundtable Series '18

# JAPAN

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# Editor's Note

Japan: How to get to the $18 trillion honey pot: Opalesque Roundtable

Over the next 10-15 years significant amounts of capital from Japanese institutional investors will go into alternative investment vehicles, not only locally and regionally, but also globally.

The non profit Consortium for Japan International Asset Management Center Promotion (JIAM) has been formed with the mission to promote Tokyo as a financial center to attract more alternative and independent asset managers, and also to address some profound financial and social challenges such as having too much cash balance and underutilized household assets; aging society, shrinking population and conservatively allocated public pension funds, and too much dependency on public pension funds whose returns may not be sufficient to compensate for the shrinking and aging society. *The Japanese are finding out that in order to enjoy a stable and healthy retirement, it's important to have a diversified asset management community.*

United States versus Japan

The United States have 320 million people and Japan about 125 million, so about one-third of the size. Both countries are fully functioning democracies. You might not like the results of the US elections, but there are going to be elections. Japan, like the US, has a diversified, fully developed, modern economy. The US has a $19 trillion and Japan a $5 trillion GDP with pharmaceuticals, autos, steelmaking, ship building, financial services - everything that the US does is also done in Japan.

And then, let's look at hedge funds. There are over 10,000 hedge funds in the United States, and 32 hedge funds in Japan. The disparity of 10,000 vs 32 hedge funds is of course a huge problem and a very unfortunate development given that 20 years ago the only place in Asia with a hedge fund industry was Japan. On the other side, if you are one of those 32 firms think about what advantage they have. If you are based in Tokyo and speak Japanese, you actually have 5,000 pension funds within a 20 minute radius you can go and speak to.

The Opalesque 2018 Japan Roundtable, sponsored by international law firm Ogier and its corporate administration services business, Ogier Global (Cayman) Limited, took place in Tokyo with:

1. Keiichi Aritomo, Founder, JIAM (The Consortium for Japan International Asset Management Center Promotion)
2. Masaki Gotoh, Partner, Misaki Capital
3. Douglas Hymas, Managing Director, Country Executive, BNY Mellon - Japan
4. Ed Rogers, Chief Executive Officer and Chief Investment Officer, Rogers Investment Advisors
5. Kate Hodson, Partner, Ogier
6. Fiona Barrie, Director, Ogier Global (Cayman) Limited

The group also discussed:

- How has the Japanese regulator FSA changed over the last years? (page 7,10, 19). The new guidebook on how to open up an investment management business in Japan (page 7). The FSA Fast Track to a license (page 8)
- Benefits of launching a fund on a platform (page 9)
- Many new managers launch in Asia – but where are they based? (page 11-12)
- The explosion of single and multi-family offices in Asia (page 12-13)
- Tax is still an issue in Japan (page 13, 19)
- Paradigm changes: Japan realizes need to support SMEs (page 14), the Chinese challenge (page 15-16, 19), Japan has never been colonized – how this affects the country until now (page 16)
- Japan – the $18 trillion honey pot (page 19, 27). What can foreign investment managers do to manage Japanese money? (page 17). Why capital is the Silver Bullet (page 18). Opportunities for hedge funds and smaller managers in Japan (page 21)
- How to get fundamental changes in Japan (page 20-21). Why Abe's Third Arrow – Structural Reform – is a success (page 21, 25). Why more governance scandals are positive for Japan (page 22-23). Wage inflation and millennials in Japan (page 24). Insiders' views on Abe and changes in Japan. Why the Japanese are optimistic about the demographic crisis (page 25-26).
- Increased flows toward alternatives from Japanese investors (page 27-28). Why there is more support for active than passive managers in Japan.

Enjoy!
Matthias Knab
Knab@Opalesque.com

# Participant Profiles

(LEFT TO RIGHT):
Matthias Knab, Douglas Hymas, Keiichi Aritomo, Masaki Gotoh
Ed Rogers, Kate Hodson, Fiona  Barrie

## Opalesque 2018 Japan Roundtable Sponsor

Ogier

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# Introduction

**Ed Rogers**
Rogers Investment Advisors

I have been in Asia for 30 years and have worked in the financial services industry for 28 of those years, in jobs ranging from proprietary trader, to head of prime services sales. For the past 12 years I have been running Rogers Investment Advisors and the Wolver Hill group of companies. We are licensed asset management firms in both Tokyo and Hong Kong.

We have three business lines; the first is an O-CIO business. The second one is the O-COO, or platform service, which we run in Tokyo and in Hong Kong. In this business we launch and run asset management vehicles – with a particular focus on alternative investment vehicles, so hedge funds, venture capital, and private equity funds.

We call the last line of business O-BD or outsourced business development. Here we focus on helping hedge funds, long-only, venture capital, and private equity funds, to access Japanese institutional investors.

Matthias, welcome you back to Japan! Over the next 10-15 years we will see significant amounts of capital from Japanese institutional investors heading into alternative investment vehicles, not only locally and regionally, but also globally. We are very excited to participate in the Opalesque Japan Roundtable and that we have an opportunity to discuss Japan in more depth.

**Kate Hodson**
Ogier

I am a partner in Ogier's investment funds team, practicing both Cayman and British Virgin Islands law. I was born in Hong Kong, and have been back and forth spending time in the UK, Guernsey and in Singapore. In total I have been in Hong Kong for about 25 years.

My clients are predominantly based in Asia and a significant part of my practice covers the Japanese funds industry (with those clients being resident in any of Japan, Singapore or Hong Kong).

Ogier has just celebrated its 150th year anniversary, which coincided with its 10 year anniversary in Hong Kong. Ogier provides legal advice on a number of offshore laws, including Cayman, BVI, Guernsey, Jersey and Luxembourg and also has representative offices in Shanghai and Tokyo. In Hong Kong we have a large investment funds practice with two partners and eleven associates. Japan has been an important market for us, we are one of the only offshore law firms with an office here, headed-up by my colleague Skip Hashimoto.

**Fiona Barrie**
Ogier

My name is Fiona Barrie. I am from Scotland originally with a legal background and I have been working in the financial services industry in the Cayman Islands for 27 years.

I head up Ogier Global (Cayman) Limited. Ogier Global is the fiduciary arm of the Ogier law firm offering trustee and corporate services. I was previously with Ogier Fiduciary Services which was the firm's previous fiduciary business. In 2014 that business was the subject of a management buy-out and became Elian, subsequently acquired in 2016 by the Intertrust Group. I have just recently rejoined Ogier, which earlier this year re-launched its fiduciary business under the Ogier Global banner.

At Ogier Global I'm leading the trust team in the Cayman Islands focusing on Cayman unit trusts and working with managers here in Japan and in Singapore and Hong Kong. We also work with US and European based managers when they wish to enable investment from Japan by setting up a unit trust.

With 27 years' experience in Cayman I have worked with many different aspects of the financial industry there. For the past eight years I have visited Japan on an annual basis and have worked with very large asset managers and also smaller start-up managers on a variety of structures.

I also have experience acting as director on corporate funds, typically where there is a Japanese investment manager or a corporate fund attached to a unit trust structure in a master feeder structure. In the trustee role, and also when acting as director, my focus is on the ongoing governance of the funds.

**Keiichi Aritomo**
JIAM

I am Keiichi Aritomo. I am the Representative Director and Founder of The Consortium for Japan International Asset Management Center Promotion – a shorter version of our organization is named JIAM, which is a not for profit organization. So it is quite unusual that somebody is not making money out of the alternative investment management community, which is me.

[laughter]

With JIAM we are promoting Tokyo as a financial center to attract more alternative and independent asset managers, also to address some profound financial and social challenges such as having too much cash balance and underutilized household assets; aging society, shrinking population and conservatively allocated public pension funds, and too much dependency on public pension funds for retired people. Basically 1 out of 4 Japanese are over 65 years old and pretty much retired, and 67% of those retired persons' income is coming from public pension funds. But public pension funds are not diversifying their asset allocation enough. Their returns may not be sufficient to compensate for the shrinking and aging society.

My background is in management consulting. I was a partner at McKinsey, PwC, Deloitte and worked in eight countries to primarily serve financial services institutions.

I had some exposure to an international business environment. But coming back to Japan, I just couldn't help but to notice that this country is really interesting and exotic, and at the same time I also felt more patriotic about this country and decided to engage myself in this way.

As part of my role with JIAM, one of the things I have been doing is to support the Tokyo Metropolitan Government in shaping our financial center strategy. The Tokyo Metropolitan Government published a document named Tokyo's Financial Big Bang – Vision for Tokyo Global Financial Center, which was drafted by myself and the Tokyo Governor's Advisory Panel. This panel is comprised of advisory panel members and myself as the Deputy Chair, basically orchestrating and coordinating among other members and the Tokyo Metropolitan Government Planning Department to ensure that we are aligned and whatever we are recommending is translated into action.

So this is my JIAM hat, and aside from this I am running a FinTech company named Kensho, which is an artificial intelligence/machine learning and big data enabled analytic engine, primarily based upon capturing geopolitical events and analyzing impact to the market for equities, commodities and currencies, et cetera.

Kensho is utilized by major investment banks such as Goldman Sachs and Morgan Stanley, JPMorgan and also by some of the government agencies such as the CIA in the US, and of course a number of Japanese financial institutions as well.

**Douglas Hymas**
Bank of New York Mellon

I am Doug Hymas. I am the Country Executive for Bank of New York Mellon here in Tokyo. I have been in Japan for about 26 years, this time. I first came in 1983 and have been associated with Japan ever since then.

I am also a trained lawyer and worked as general counsel for a couple of investment management firms here before moving to my current position. I have been with Bank of New York Mellon for three years, and before that I ran ING's investment management business in Japan. Prior to that I helped established a few businesses for Wells Fargo, and I also had stints with Barclays Global Investors and Citigroup Asset Management, as well.

I currently Co-Chair the Investment Management Committee of the American Chamber in Japan, my second time in this role, and while at ING I served as Chair of the Asset Management Committee for the European Business Council.

**Masaki Gotoh**
Misaki Capital

I am Masaki Gotoh, CIO and Partner of Misaki Capital, which is an independent asset manager that was started about four years ago. I myself have been in the financial industry for about 20 years.

I first started at Goldman Sachs and then Morgan Stanley. After that I worked for a long-short fund here in Japan. I met my current team back at a previous firm and together we have spun off to start Misaki.

Our strategy is traditionally considered activist, but we call ourselves an engagement strategy. We have been running this strategy for a little over 10 years, although, of course, at Misaki for just four of those. We are an independent firm, and having started with only $15 million, we managed to grow to about $600 million now.

It was a timely move given the changes in Japanese corporate governance and the push by the Abe administration to further that goal and we like to think we are helping that initiative in some small way.

**Matthias Knab** I want to start the discussion by diving a little bit deeper in what Keiichi has said about the mission of JIAM, which is promoting Japan as a center for fund managers for finance. This could be a renaissance and maybe also bring managers back to Japan. Can you tell us more about how this is progressing and some of your successes, and what is your ultimate vision?

**Keiichi Aritomo:** You are right, over the last few decades Japan or Tokyo lost its competitive edge against a number of different cities such as Hong Kong and Singapore. We've lost investment professionals in this market since the late 1990's.

We still have people like Ed, Masaki and others who run an investment management business independently from large banking and the insurance institutions, but as I mentioned, **for the Japanese to enjoy a stable and healthy retirement, it's important to have a diversified asset management community.** This is what we are envisioning to achieve in the end, having a more diversified investment community back in Tokyo.

One of the first things we did was to start interviewing with people in this industry. Through the interviews, we obtained insight from a number of different people from the finance sector in Japan. We interviewed with more than 200 people one-on-one in investment management. They gave us a list of things and a number of reasons why Japan is not attractive, why we cannot grow as a financial center.

Interestingly, we heard a lot about regulations or English language or tax, et cetera and trying to find out where exactly those frustrations are coming from, especially when it comes to regulations, *we oftentimes found that what has been described as regulatory challenges was actually resulting from perceptions or a business norm or custom or inertia or incumbency as opposed to actual laws and regulations.*

Another thing is frustration with our regulator which tends to be quite unpopular in the financial services industry. But also here we found that the FSA has been trying to transform themselves. When we actually aggregated and synthesized that feedback and shared it with the FSA two years ago, they were in denial. "Why don't they [the fund managers] talk to us?... This is not necessarily fact-based … it's not true … or, is this statistically significant?" I had to say that yes, it is statistically significant when more than 200 voices were saying so.

And then, why don't they talk to the FSA? Of course, the attitude is that no financial firm here really wants to engage with the regulator on their own or ask questions because they don't want to be under the regulator's radar, or they don't want to offend them. So there was that certain paradigm under which the companies and the regulator were functioning. But then over time the FSA has in a way opened up and found a greater interest and acceptance of what we were saying. For example, they have recently accepted English-based applications or English-based consultations. We now have a **guidebook on how to start an investment management business here in Japan.** There is a brochure that was created together with the Tokyo Metropolitan Government to clarify what kind of licenses are needed, depending on the business model, target investors, and also distribution channel, et cetera.

*We have actually made a lot of improvements over the last two years or so, but such improvements are yet to be acknowleged outside Japan*. That's one of the things we are trying to do, promoting our environment and in fact also our agency for financial services. Nobody is promoting Japanese financial services industry in the Japan, because the FSA is a supervisor by design.

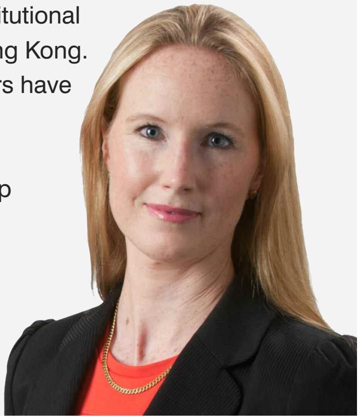
Of course we have the METI, or the Ministry of Economy, Trade and Industry, but they are promoting a range of industries, except the financial services industry. So we are trying to organize the agency to promote Tokyo as a financial center and inspired by, other financial promotional bodies such as Paris Europlace, Luxembourg for Finance and TheCityUK.

**Matthias Knab** Have you seen any specific successes or progress already?

**Keiichi Aritomo:** We have built a strong pipeline in terms of investment management funds contemplating, who are already in the process of opening their presence in Tokyo.

Another thing is the **Emerging Manager Program**, which is going to be launched and subsidized by the Tokyo Metropolitan Government. I have already been in discussion with several asset managers, portfolio managers, highly reputable individuals starting their own hedge fund business in Tokyo. I am observing that we are finding a strong traction in Japan and it's really encouraging as well.

**Kate Hodson:** Ogier has long been active in the Japanese funds market and we have enjoyed working with a number of startup managers here, helping them to launch hedge funds and some private equity funds. For example, we were very fortunate to work with Masaki on the launch of his fund. However, many of the non-institutional managers we work with tend to have based their asset management team in Singapore or in Hong Kong. We get the feeling that a lot of these managers would like to be based in Japan but various factors have counted against this.



There are of course a number of contributors, tax is one of them but it's not the only factor. Set-up costs and time to license can also be an issue. It can take up to 12 months or even as long as 18 months in some cases.

Keiichi do you think that this is something that is specifically being addressed by the regulator?

**Keiichi Aritomo:** You are right, that has probably been one of the biggest issues that it is taking too long, and also the licensing process is quite onerous in Japan. It's a bit controversial, but the FSA has come up with a procedure named **Fast Track**, just like the fast track we know at the airports.

Now, the question is who should be qualified to be on this track? Once you are on the fast track, the FSA will hand hold and take you through the licensing process. Going forward, we need to put a mechanism in place to ensure that there isn't any favoritism and unfairness in for the fast track.

But at the same time, this is also an indication that the FSA is trying to change the situation as well. It's good to have this kind of debate, and it's probably good to have different channels and different processes, but at the same time, I understand those people who are waiting in line while the other firm comes in and cuts in line in front of you and gets licensed quickly.

At this point in time the FSA does not have the capacity to accelerate the entire process, but they are trying to accelerate and prioritize some of the applicants. Possibly this prioritization needs to be improved and become more transparent, because if it's reputation or recommendation based, how do you measure reputation? And who is actually recommending?

**Ed Rogers** It's asset based, isn't it? If you're Legal & General and have got $10 billion, they are going to facilitate you. If you have got $100 million, probably not...

**Keiichi Aritomo:** Not necessarily, for example, we are also meeting with much smaller and even emerging managers. Legal & General Investment Management was recommended by or listed by GPIF. Of course, GPIF prioritized large asset managers with a sizeable AUM and were long-only, et cetera.

But at the moment, this criteria is not necessarily published, and in a way we are a bit concerned about this judgment-based prioritization. This cannot be perfect and we need to also encourage the FSA to change and make some improvements here. That's the current state.

**Masaki Gotoh:** We got our license roughly four years ago and it took us about four months. We didn't have that kind of starting capital but I think it clearly helps to start with more capital than less.

*Starting capital is a good proxy for how much resources the firm has to run the business.* For example, I believe that in this licensing process the FSA is not looking for a hotshot trader that just made $100 million a year back at XYZ Capital, because while that person may be able to make money, he may not know how to manage a business where it's about the operations or compliance as well.

I don't think that FSA would care about the strategy that much. What they care about is if you are protecting the people that you are running money for? From a skill set standpoint of opening a new fund, I think there is still a rather low barrier to entry, but running a whole business successfully in the long term is a different story.

I started the business with five partners, including myself, and we had compliance and we had operations. It was very expensive, granted, and were unable to pay ourselves for years. Only recently, we've started paying ourselves. But the reason was that we spent a lot of resources, not just dollars, but time and people, to build out that infrastructure.

I guess an easier way, not to put a plug in for Ed, is to get on a **platform.** That will accelerate the process immensely. If you want to do it on your own, I think you should also be aware that the FSA is not trying to be restrictive, but their rules and procedures are intended to protect the investor so you have to keep an open mind about the process and proactively gain their trust.

I have friends who are starting up and I basically say the exact same thing to them. It's going to be costly, but that's just the way it works here. They really care about sustainable businesses. They don't want 100 funds and 99 of them going under the next year or two. I think as long as you put that effort and investment in and show them that you are not just trying to make a buck, it can accelerate the process immensely.

**Ed Rogers:** I agree with both Masaki and Keiichi that the FSA today is very different from, let's say, the FSA four years ago. The FSA, has worked very proactively to make Japan a better place for all financial services businesses. I think they are very sincere and honest in that respect and they have tried to make the organization more responsive to foreigners as well as Japanese.

We started a platform to help people launch their funds, and you are right, Masaki, there is an economy of scale efficiency that you can achieve that is also addressing that question of business sustainability, and that is something the FSA clearly cares about.

**Let's think for a moment about the ways in which the United States and Japan are similar.** United States is 320 million people, Japan about 125 million people, so about one-third of the size. United States and Japan are both fully functioning democracies in every sense of the word. There is no threat that Japan is going to change from being a democracy, nor is there any chance that America changes its democratic political structure. You might not like the results of the elections, but there are going to be elections.

You have an entrenched rule of law. Japan is a very rule of law-based society. If the FSA says, do this, do this, do this, and we will give you a license. It may not happen as quickly as you want, but you will eventually get a license if you follow the rules. The United States works in the same way.

Secondly, Japan, like the US, has a diversified, fully developed, modern economy. The US has a $19 trillion GDP and Japan a $5 trillion of GDP – there are pharmaceuticals, there are autos, steelmaking, ship building, financial services - everything we do in the United States is also done in Japan. The US and Japan are two of the most modern, diversified, rule-of-law countries in the world.

And then, let's look at hedge funds. **There are over 10,000 hedge funds in the United States, and there are 32 hedge funds in Japan,** of which one is sitting in this room. In the entire world there are fewer than 150 hedge funds that are dedicated Japan-only vehicles. But – that universe mostly exists in Hong Kong and Singapore.

For us to do due diligence of Japanese hedge fund managers, we have to fly to Hong Kong, Singapore the US and Europe. This is one reason why I opened up an office in Hong Kong, because now it only costs me $5 to go and see a hedge fund manager there. Somebody coming from New York or London or Tokyo is spending $200 or $300 per onsite due diligence meeting in Asia, - this is factoring in the costs of flying (and accommodations etc) to Asia from New York or London or Geneva or Zurich.

The disparity of 10,000 vs 32 hedge funds shows what an incredible lack of talent pool there is for anyone here to draw on in Japan.  This is a problem whether you are GPIF and you want a choice of 500 different managers, then you need to allocate a billion dollars minimum to at least 10 managers to start to make it even a tiny dent in your $1.4 trillion of assets, or you are some mid-sized $2 billion pension fund and you just want to get started on your investment program and you are going to start with a $200 million investment, and maybe it's going to be three different allocations or something like that, and your initial investment is only 10 million.

With only 32 hedge funds in Japan there are very few local due diligence options available. This problem is made worse when you consider that Japanese pension funds have no budget available for overseas due diligence.  This is an enormous problem for Japan based investors of all types.

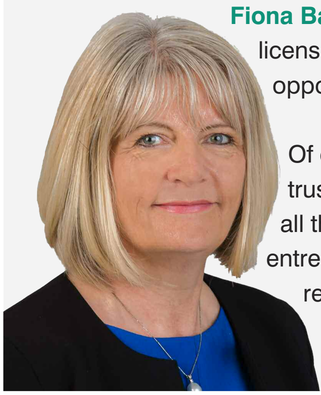
On the other side, if you are one of those 32 firms think about what advantage it is **if you are based here. If you are based in Tokyo and speak Japanese, you actually have 5,000 pension funds within 20 minutes of this office that you can go and speak to.** And those 5,000 pension funds only have 32 hedge funds to go and speak to.

For all the great work that's going on in Japan over the last two years, changes in the attitude of the FSA, movement towards global standards, the reality is, if you look at my rule of one-third size of economy and Japan as a fully developed country with rule of law and democracy, *there ought to be 2,000 or 3,000 hedge funds in Japan*. We need to grow the Japan domestic alternatives industry – Japanese politicians and Japanese regulators and Japanese institutional investors, all know this.

For Japanese regulators, having an attitude such as, "Before I give you a license, I want a guarantee of success – I want to know that your business is going to be around in 10 years' time" is a dangerous approach if we want to come to the point of having 1,000 or even 500 hedge funds in Japan.

In Hong Kong and Singapore, they don't care if you fail. You fail all the time in this space. This is a risk-based business and everyone should acknowledge that. Here in Japan politicians and regulators are going to have to accept that some hedge fund will fail.

Japan from the politicians and regulators' points-of-view is far more interested in somebody who has already got $10 billion in AUM opening in Japan. From the regulators viewpoint this type of firm is most likely not going to go out of business because they ran out of operating capital or because they are not able to fulfill the compliance regulations around this type of business. The focus on attracting established businesses rather than entrepreneurs is a real structural challenge for Japan. Even getting 10, 20, 30 managers would be just a drop in the bucket compared to what we do need – but we need to make sure those first 10, 20 or 30 entrepreneurial managers do set up in Japan.



**Fiona Barrie:** We were fortunate enough to work on a fund for the first manager to obtain the Pro-DIM license a few years ago and there was much anticipation at that time about that new type of license and opportunities for young start up managers.

Of course the regulators are trying to protect the individual investors and are looking, as do we as trustee, at the caliber of the manager and its overall infrastructure , making sure that the manager has all the necessary processes in place. So the regulator has to balance the need to encourage the entrepreneurial spirit of a new and nimble start-up manager against the need to ensure adequate regulatory oversight. I can see the importance of that from the perspective of the trustee and directors.

**Matthias Knab** I wonder, given the JIAM initiative and then also from your platform perspective, has the tide already started to turn? Are there more managers starting up?

**Ed Rogers:** **There are many new managers launching in Asia,** and there are different factors driving this growth. The Dodd-Frank legislation, the Volcker Rule, the growth of risk capital coming out of China and Southeast Asia, all of these things are facilitating launches not only of hedge funds, but all all types of alternative vehicles. *Also, the set-up of a multifamily office in the structure of a hedge fund is becoming very common.*

<u>One of the reasons I opened up an office in Hong Kong was because with my platform there we get up to 40 calls per month from people wanting to launch a new business in Hong Kong.</u> In Tokyo we get two or three enquiries per month.

In Tokyo we get two or three enquiries per month. Now, that figure of two or three per month is already a change from one per quarter a couple of years ago. But I am not seeing a groundswell of interest in the sense that we've got 50 new managers that want to open up in Tokyo. I am sure I don't see all of the business, maybe my platform doesn't get all the phone calls the lawyers would or that the fund administration business of a major Tier 1 firm would get, but again, versus Hong Kong the difference is 10 to 1.

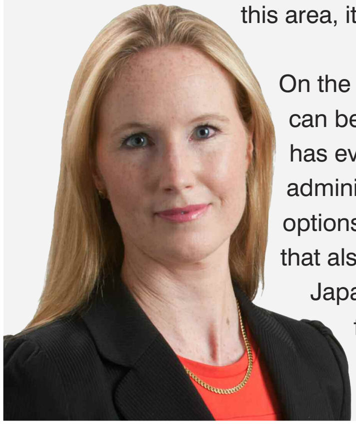
And this is also why I believe that there has to be an Emerging Manager Program and that the government or some domestic institutional investor has to commit to giving 40-50 start-up managers $25 million to $50 millin in assets to manage to encourage these businesses to base themselves here in Japan. If I'd ask Ogier about your new business, how many of those fund managers you deal with are launching with anything more than $500 million? If it's more than 1% of your new client base, I would be surprised, and of course I am not talking about an established firm that's starting a new fund in Asia, but a new fund manager launching with that amount of assets in Asia is almost nonexistent.

90% of local Asian firms launch with less than $100 million, and therefore they cannot offer that business comfort to the FSA that they may like to see to give them a license. That's a fundamental problem. They are going to be happy to see Legal & General on the Fast Track, or some firm with $5 billion or $10 billion or more, but they are never going to fast track a guy who has got $25 million and a dream.

**Kate Hodson:** Ed just touched on another point there which differentiates the industry in Japan as compared to that in Hong Kong and Singapore and that is the lack of family offices.

*The family office is a relatively new concept in Asia, however the sharp rise in the number of high net and ultra-high-net-worth persons (the biggest growth being in China, with Hong Kong and Singapore in its wake) has seen a small explosion of single and multi-family offices in the region.* Hong Kong and Singapore provide a tax-efficient environment governed by common law. In addition the regulatory environment there is mature. We get so many requests from clients in HK, Singapore and China to assist on the set-up of a "family office" – in reality many of these clients want a management company, a fund and perhaps a few separate holding companies for their traditional businesses. These can be tied together with a holding structure that provides some form of succession planning.

Coming out of the investment banks or their own successful entrepreneurial endeavors, the young to middle aged generation are interested in managing their own wealth and often that of others (hence the driver for the family office fund structures I was just talking about). Japan on the other hand is an untapped family office destination. There are the people and the money, however traditionally, wealthy individuals have tended to hold their assets in cash, stocks and property. The emerging new wealth generation are more adept at managing their businesses and assets and perhaps this is a trend which will slowly start to take off here. Based on what Ed just talked about I don't think we should expect to see a rapid expansion in this area, it will likely take some time.



On the other hand there really is a spirit in Hong Kong and Singapore that "things can be done" and they can be done quick (as a lawyer I am used to being told it all needed to happen yesterday). The industry has evolved around that with a number of platform providers, cost effective solutions for fund administration, brokerage etc this means that there are plenty of lower cost and quick to market options. This heightened level of access has lot of positives but it is not without its downsides as with that also comes plenty of outfits with limited sophistication. I don't see this when it comes to our Japanese fund manager clients where the approach is more steady (that is not to say that we don't face the same time demands here – that is just the nature of the world we live in where 24 coverage is expected and this is something we do our best to deliver).

**Ed Rogers:** In our Hong Kong office, literally once a quarter we get a call from somebody who already has a billion dollars and it's always a family office or maybe it's a multifamily office structure, because the Chinese tend to come in a cluster – there will be some people that are related by birth or marriage and others that have a friendship or business background – and they want to pool those assets and manage them much the way a hedge fund would manage assets. In fact, this is their specific goal, and legally you now have to look like a hedge fund, if you are going to be managing money for more than one person, if it's not a single family office.

So we get calls like that and are seeing the same flow in Hong Kong where people run or want to run hedge fund type structures and hedge fund type money. But in four years of running a platform in Japan, I have never once received a call from somebody who already has a billion dollars and says, "I want to be up and running whether it's a family office, multifamily office, or business structure, and I want to do it at a cheaper cost, so I am going to use your platform to solve those problems" - never once.

**Kate Hodson** And what are the driving factors behind that? Is it just the regulatory regime, tax environment, is it cultural considerations …

**Ed Rogers:** Okay, tax is one issue. It's an unpleasant or awkward one to discuss, but tax plays a role, both from the point of view of the personal owner of the business and also from the business tax itself. So there are two levels you have to look at. And unfortunately, both Hong Kong and Singapore win on both levels; the corporate tax rate is among the lowest on the planet and the personal tax rate as well.

Second, hedge funds, family offices and finance are international businesses. Look at everyone sitting around this table. We all have had international careers and significant multi-cultural business experiences. Maybe born in Japan but worked at a Tier 1 US investment bank to gain experience. Born in Scotland or born in Hong Kong, but of European or English cultural background. Born in America, but lived in Japan for 27 years. This is an international business. Nobody who succeeds in this space is generally anything other than truly multicultural and usually multilingual. This goes to the heart of how Japan remains an inwardly focused country.

Recently a paper was published that said Japan is ranked 11th out of 11 countries in Asia for hospitality to foreign talent and 61 out of 67 countries in the world while number 1 and number 2 are Hong Kong and Singapore. *Japan needs to embrace being an international place of business that is open to foreigners and will treat them as equals.* Until Japan does this we will never get 1,000 hedge fund managers to open in Japan. Japan must be willing to accept the fact that 80% of those 1,000 funds will be run by foreigners.

I would like to ask Doug to comment on this, because with BNY Mellon you see these flows at an aggregate level and you have been working in Japan for a variety of very large Tier 1 institutions for a number of years, but from my side I continue to see smaller firms here struggling, but bigger firms might be having a better chance of growing, frankly, because of that bias towards those larger firms and larger assets.

**Douglas Hymas:** I have been in Japan a long time, and I often describe Japan as a very large ship that takes slow turns. If you are coming to Japan from another country and expect to see a spike or an immediate turn, I recommend lowering those expectations.

But if you have been here a long time and know how things used to be, and you also see the changes happening now, then you also realize that they are significant. When those changes are made, they are permanent and flow through the economy nicely with long-term ramifications. So the slightest little change can actually be quite impactful overall. And because it's still the world's third largest economy, when a certain development gets spread through the economy it can be significant.

I think one of those changes is that focus and attention are being turned towards smaller and medium-sized companies, so-called SMEs, throughout the economy these days, and not just in finance or manufacturing. I believe that Japan has recognized that the failure to allow innovation at a smaller company level has hurt Japan's ability to innovate and to lead innovation. I think the powers that be have seen other countries take over the lead. Apple, for example, when it comes to phones; Tesla is driving some interesting changes – they may not be leading the world necessarily, but I think that firm has some manufacturers here nervous. And in other industries as well, we have seen manufacturing being sort of turned on its ear by some of the innovation that's happened offshore.

If you notice, a lot of the large companies that are very successful that have been around a long time have actually lost their ability to innovate, because they are so entrenched in their current businesses. And the existing leaders often are managers who have been around a long time. They went to the best schools, they have got great training, but they haven't been taught to innovate.

Then you also see younger companies, and some examples would be Rakuten or Fast Retailing. Those are the examples of what larger, stodgier Japanese companies used to be. They were often started by one or two people with a grand vision and then built up into a large company, and now the heirs of management are very well-educated but lack experience taking risk.

From what I have been reading and experiencing over the past five years, I think we are seeing finally a recognition of the need to support SMEs. Now, how does that happen? Will it really carry into the future? I think that has yet to be seen. But I think that, at least at the public conversational level, the need has been acknowledged, and I believe this is significant. I really think it is, and so I believe we will see more and more support for SMEs, and this will also flow through to financial services eventually.

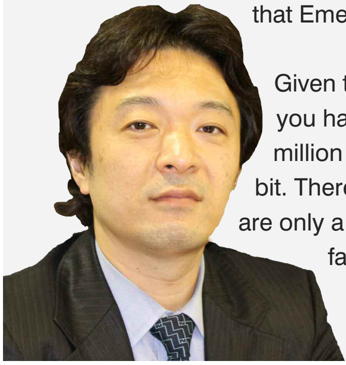
I do like what Masaki said earlier about some of the expectations of the FSA, and it is critical for everyone looking at Japan to understand the FSA's expectations and that they are trying to protect mom and pop and others who have complained to the FSA.

As you may know, the average Japanese consumer complains like nobody's business, and companies differentiate themselves by trying to cater to those complaints. That's why service here is so good, because companies are trying to avoid any potential for complaining. I think that's actually an amazing cultural phenomenon.

But what it also means is that the regulators- – and not just the FSA or the Ministry of Finance, but all regulators here – are protecting the local people from something. That is how they justify their existence. And I think the FSA is trying to make sure that new companies coming onshore do meet their requirements and don't cause too much damage to the locals' preference to maintain harmony in the existing market. That's perhaps diametrically opposed to the idea of innovation, which is essentially **"creative destruction"** – coming up with better ideas and allowing the old ones to die away. It's that dying away part that oftentimes the regulators try to minimize. And so there's a bit of a conflict or dissonance right there.

But having said all that, again, I go back to my original point that things change slowly here but they change. And I think we are finally seeing the regulatory structure here beginning to allow the concept of creative destruction.  If there can be support both from a financial and regulatory perspective for newer businesses coming onshore I think that can build into something pretty important, as long as they see success. At the first sign of failure early on, though, they will retrench. *I think the success rate of the early movers will determine the longer term direction of this effort.*

**Masaki Gotoh:** I think every new industry including the hedge fund industry here in Japan starts small and starts locally. I think if we immediately try to compare ourselves to Hong Kong, Singapore, US or UK for that matter, this does not make a lot of sense as their industries have also developed independently, over time, and under different circumstances. *The financial industry is not a small industry in Japan, but launching a new firm or going independent is relatively new,* and maybe some cultural, regulatory or other reasons haven't supported this yet simply because it is new. But now we have initiatives from JIAM, the Metropolitan Government and the regulators to open up. But what we really need is capital. I think that Emerging Manager Program Keiichi talked about will be a big push.



Given the increasing regulatory costs in our industry, there will always be some financial constraints. If you have $10 million in the bank, that won't last you very long to run the business. But if you have $10 million and somebody is going to match you with another $100 million, that changes the equation quite a bit. There's probably an argument to be made that there are too many hedge funds in the US, but there are only a handful here in Japan. I also agree with Douglas that hopefully we will see successes and few failures of those funds who get those first $100m tickets in order to make the process sustainable.

**Ed Rogers:** I think we also have to acknowledge that **20 years ago the only place there was a hedge fund industry in Asia was in Japan.** Japan had first mover advantage and that's because the economy was of size and it had rule of law, and all those large financial services firms – Goldman Sachs, Morgan Stanley, Deutsche Bank and so on – had proprietary trading groups and there was a great value proposition to owning a hedge fund here, because you could potentially make a significant amount of money for yourself and for your investors.

The legislation changed in the early 2000s, the changes in tax structure and the views on whether offshore funds might be dragged onshore and taxed is what sent a bunch of managers to Hong Kong and Singapore. So, Japan had first mover advantage, but squandered it away through bad regulation.

One reason why I launched my business 12 years ago as Japan's only fund of hedge funds is because I looked at all these numbers and saw an opportunity. My original presentations to the investors said, *"Look, in the United States there probably are too many hedge funds, fine, fair enough, but there is one hedge fund for every $1 billion of turnover a day in the United States, but in Japan, there is one hedge fund for every $100 billion of turnover, which is way too little."* And that was back when there were close to 100 hedge funds based in Japan. The number of funds in Japan has steadily shrunk since then while Hong Kong and Singapore have been the clear winners in the Asian space.

The other consideration is that **in another five to seven years we expect China to be a much more open economy** – it's already twice the size of GDP as Japan, and this is why we put an office in Hong Kong.

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We are getting calls from people in New York that are running $20 billon, $30 billion hedge funds and they are going to go to Hong Kong, and that's going to be their base of operation. And you will never get them to come and move to Japan. *If they make that first plunge, they invest that infrastructure for their regional base in Hong Kong.* And now with Shanghai Connect, this is also their initial step to get into onshore China.

Let's go forward five years. China is then say a $13 trillion economy, with a kind of rule by law, but it is multidimensional. And, by the way, 90% of the people who trade in Mainland China are retail investors. The hedge fund industry made an enormous amount of money in the early days by setting itself up to trade against retail investors. Plain and simple, that's where a lot of the alpha came from, and this is really where you are going to want to go. If you want to run a hedge fund, you want to make a boatload of money and to keep it, and this is where, again, the tax structure – the personal tax and the business level tax on the underlying fund – is relevant.

*So, in the overall scheme of things, five to seven years is not a long time, but if Japan within the next one to two years cannot prove that they can bring 100 odd managers back, and that's just the beachhead to the program, by default everybody is going to go to China and Hong Kong, because that's the easier place to make money.* It's also an easier place to keep money and the economy will be able to scale to the extent that you simply can't ignore.

**Douglas Hymas:** Reverting to my point about however small it is, it's still a change that's happening. A few years ago we never heard any regulator here refer to Hong Kong or Singapore in their comparisons with another market. They would only look to the US or Europe, and Asia was almost something beneath them; it wasn't large enough to worry about.

I found it significant two years ago when we began advising the Tokyo Metropolitan Government and then working with the national government on some of these issues that they began to realize that they did need to compare themselves to Singapore and Hong Kong. That was a significant moment when we first saw Singapore and Hong Kong in a document written by the government.

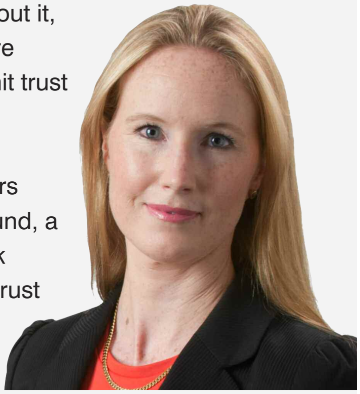
Why was that significant? Because they finally realized that they did have to make a change and start competing within Asia, that just looking to the US and Europe was not the right way to go, and that *they had to be attractive among the Asian alternatives*. I think that's significant.

<u>Couple that with the fact that Japan has never been colonized</u>. Hong Kong, Singapore, Australia-- these places have all been colonized at one point, so they are very accommodating to foreigners. They have been catering to them for many, many years. That's never happened to Japan. Japan was always big enough, strong enough and independent enough that they didn't have to make some of the changes to accommodate the foreigners coming here. Rather, people wanted to be here because the market was so big.

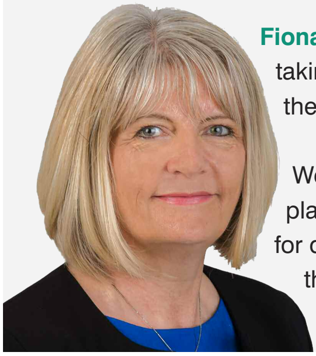
But in the last 20 years Japan's view of itself has changed, I think. They realize now that they need to compete internationally. They are no longer attractive just by being Japan. I think that mentality – that shift of mentality – is significant, and I think it's going to continue.

Who knows how long it will take? Again, as I said, large ships take slow turns, but the direction that it's heading has been set and I think it will continue head in the same direction. If they build consensus among the relevant government individuals who make these decisions and keep going in that direction they see success, it will build on itself and I think we will see the pace of that acceleration increase.

**Kate Hodson:** For all the reasons we are so positive about Japan and in some ways negative about it, there is no question that Japan is attracting a lot of outside interest. We are seeing more and more enquiries, from abroad, in particular from US clients who are looking at opportunities to set up unit trust structures to manage money for Japanese investors.



They are looking for opportunities to co-operate with gate keepers and large institutional allocators including pension funds, to manage funds for Japanese investors. We typically see an offshore fund, a Cayman Islands unit trust, managed by the foreign manager, with an independent trustee or bank trustee and the sole investor is a Japanese distributor, behind which sits a Japanese investment trust with domestic investors.

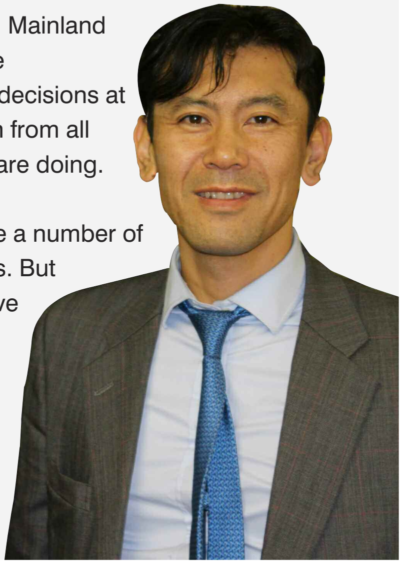


**Fiona Barrie:** This is correct, I have seen over the past few years several European-based managers taking that approach. It takes a long time obviously for them to get traction with Japanese allocators but they are very keen to do that.

We have seen various methods being used; as Kate mentioned, we have seen managers use a platform or bolting a unit trust on to an existing master feeder structure which already has one feeder for domestic money and one for offshore investors. US managers in particular are very keen to get into the Japanese market.

**Keiichi Aritomo:** I always wonder how meaningful it is to benchmark Japan with Hong Kong and Singapore, or China or Korea, or even Luxembourg. Making predictions on government action can be completely different in each place, meaning that you cannot emulate how they operate. In some places it's top-down completely. *Once they start moving, they are fast, but all of a sudden it can stop, and they can change the direction as well. So, speed and agility are important, but consistency is also important.*

In terms of continuity, fairness and consistency, Japan is doing very well, but regarding agility it's as we said rather like a big ship. You cannot go too fast compared to Hong Kong and Singapore as well. Mainland China is amazing. They can move very fast, but it's dictated by a Central Government and the Communist Party and a few people or basically Xi Jinping who can make pretty much all the decisions at this point after the last Chinese Communist Party Congress.  So there are things we can learn from all the different markets, but there is no silver bullet and we cannot emulate what other markets are doing.



The point I am making is that somehow, we have to translate our insight into action. There are a number of different measures we should take, but there's no one simple solution to resolve all the issues. But at this point, having the Tokyo Financial Center Promotion Organization is key. So that we have somebody who has a mandate and responsibility to continuously address growth issues and challenges, impediments and come up with new measures, implementing measures. Otherwise, we end up having a lot of the discussions and case examples without action items.

**Douglas Hymas:** Keiichi, I agree with everything you said except for one point: **I believe there is a silver bullet, and that is money.** I think if we can get money to flow, that's the last thing that is missing. We've been working on improving the environment here for many years – everything from allowing people to bring their nannies from offshore with working visas, to designating a tax-preferenced area inside Tokyo or Nihon-Bashi, to other little things around the edges. But I've maintained for many years that all of that is nibbling around the edges and that the core thing on the inside is allowing money to flow, at least with respect to alternatives.

For other financial services industry there are a few other silver bullets, but for alternative investments and inviting hedge funds and alternative investment managers to come to Tokyo, it's allowing money to flow. <u>The capital is here, but unfortunately there hasn't been enough allocations to that space yet, and I think there needs to be.</u> I think a confluence of events recently can allows that to happen.

I've represented the investment management industry for many years, and if you allow me to use a metaphor and put investment management on a scale, and let's assume passive management is on my left, alternatives on the right and traditional active somewhere in the middle, the middle is being hollowed out. Large volumes are going to the left toward passive, but that means with low interest rates around the world right now, you don't get much "juice" or return from those investments. So, people have to do something else, and I think they are encouraged then to look to the alternative space on the other side in order to juice those returns. I think that's a pretty exciting thing to see. And in order to get that, Japanese investors have to go to dollar- or non-yen assets as well.

*You have a lot of pension funds that are looking offshore now for these returns, and once you put those two together, you'll see a market that traditionally invested conservatively in JGBs or other conservative investments and is now looking for juicier returns and willing to do that now offshore or at least with offshore managers.* It doesn't necessarily mean the money has to be offshore, but they are now looking at foreign managers or foreign investments to get those returns, and that's something fairly unique and quite exciting.

Anyway, I think that a certain convergence over the past few years has helped driving this effort to make capital more available. I don't think the regulators have really caught up to that, though.

I also believe that large pools of assets here that are somewhat influenced by government could also be influenced to allocate money toward alternatives. I think that's good for the investors. I don't think they're selling themselves out like we saw the Tokyo Metropolitan Government do when they put some of its own money into a bank because it wanted money lent to small and medium size companies. It had no business being in that bank business because they know nothing about it, so it went bankrupt, right?

If good allocators allocate money toward the alternative space, that will help drive more managers to come here and will contribute to developing a robust environment, and not just for alternatives managers but also for all the industries and the supporting service providers for them, such as lawyers, accountants, fund administrators, prime brokers, etc.

Once you get that momentum going, and maybe innovation starts happening as well, then Tokyo becomes an important place to be in the world. This is in my view the momentum that needs to develop, and going to my earlier point, a lot of work around the edges has already been done for this type of movement. I think we need to get to the core of the matter, and that is the allocation of capital.

**Ed Rogers:** Can everyone be right?  Keiichi says there are many problems to be solved and Doug says there's only one problem which is cash – write a ticket and you solve the problem.

I think both are right. Meanwhile the Japanese government would prefer to see billion dollar day-one entities that have a 10-year business life guaranteed. And by the way, many of those businesses are already in Japan: Fidelity is here, Blackstone is here. Goldman Sachs and Morgan Stanley or BNY Mellon have been here for decades. Those larger businesses can of course access very large types of domestic clients here.

*But again, is there a danger that we start to lose more-and-more of these large businesses to China?* I think the answer is yes. And so, even just to protect what we have now as far as our financial services, Japan needs to change. We have to change many laws so that you can have a maid, or your wife, or spouse, work full time in Japan. And then there is the issue of the **inheritance tax law** which I think is a major challenge. No CEO who already made $5 million, much less $10 million or $15 million is ever going to move here. Why?  Because if you were to die in Japan you would give 50% of your wealth over in taxes. Because of this, no CEO of any global company with a decent size will ever come to this country to manage any business. Forget financial services, but you also won't come here to run an airline company or a software company. You're not going to get senior Google, senior LinkedIn or other senior people from any of those IT companies because if they don't die here themselves, they also can't afford to have a relative in the United States die where they would inherit money, and half of it goes to the Japanese government.

The tax accountants and tax lawyers have made it very clear that that could happen. Your father-in-law passes away in North America and wants to leave your wife $10 million, and if half of that will go to the Japanese government, that will stop CEOs and in the end stop Japan from even maintaining its position in Asia. This tax issue is not just about financial services, that's across all industries.

As far as our industry is concerned, if our goal is to get from 32 to 500 hedge funds, the only short simple answer, and here I am with Doug and Gotoh-san, is that you have to source investor capital from Japan. You have to give cash to this industry and support the small and medium size businesses at least to the point where they have enough operating capital so that the regulators feel comfortable giving them licenses; otherwise it's just not going to work. That's the closest thing to a silver bullet.

There are all these other issues to be addressed if those businesses are going to grow and become successful. Because when these businesses grow and they become successful, the owners may move offshore. As Gotoh-san would know, I seeded his former firm 18 years ago when they had less than $25 million at launch, and by the time they get to be a $1 billion or $2 billion assets under management company, the management was moving offshore for individual, personal reasons and that's just what's going to happen and will continue to happen if they don't solve those other problems as well.

We have to solve both in the short term capital issue and write those checks to support those businesses. *Remember there's $18 trillion sitting on the sidelines, so it's really a minuscule amount of money to say we're going to put $5 billion or $10 billion in helping to launch 50 to 100 new fund management businesses.*

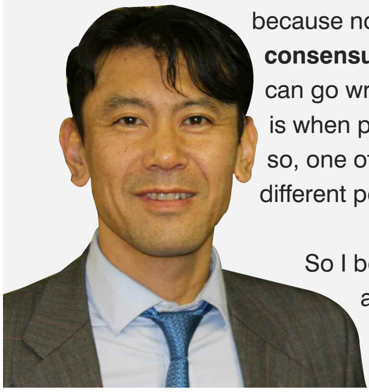
Regarding long term structural change, I agree with Doug and Gotoh-san that we are seeing those effects. The FSA is a completely different institution to deal with now than it was 5-10 years ago, much more progressive. There's a 127 million people, it's a slow moving super-tanker and not a speedboat like Hong Kong or Singapore for all the political and other reasons. This is a question of a country versus city-states. But if Japan's government doesn't find a way to start to subsidize these businesses in the short term, there's not going to be a long term because China will win.

**Keiichi Aritomo:** The Japanese government has a lot of money and Tokyo itself is quite significant. The Tokyo Metropolitan Government's income or GDP is larger than many European countries. However, I am also beginning to understand how complicated it is to allocate money differently.

On one hand, the locals here will all know an amusement park outside of Tokyo named Summerland, which operates throughout the year, but 70% to 80% of visitors are concentrated from July through September. Well, it's called Summerland, but it operates throughout the year and is burning cash. It's a gigantic estate. I went there with my family in the winter. All the amusement facilities were empty, so pretty much my family members were the only ones there and we didn't have to wait in line. The kids enjoyed it, but it was really empty and a bit depressing as well.

The park is indirectly owned by the Tokyo Metropolitan Government and directly owned by the Oi Horse Racing Course which is making a lot of money and giving a lot of funding to this empty amusement park and a significant funding source for the Tokyo Metropolitan Government as well.

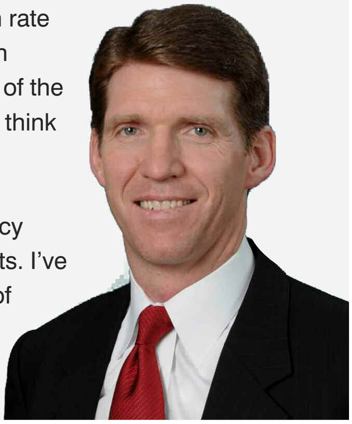
So, there are these loopholes in this government, but we have to maneuver and identify these hidden potential sources of funding somewhere in the government. But it requires some kind of art, because these are also part of the bureaucracy as well. In the US you have many billionaires with a long history of public spending and influence, and while I agree that the silver bullet might be an unleashing wealth, we also have to explore carefully or patiently how to make it happen because no single individual can make any meaningful decision in this country. Japan is a **very consensus-driven country,** and based upon consensus, decisions on things such as the Inheritance Tax can go wrong. They have revised the Inheritance Tax five years ago and made it even worse. The danger is when panels are formed with people having similar perspectives, for example lifetime employees. And so, one of the first things Tokyo Metropolitan Governor Koike did was to invite foreigners to express a different perspective in addition to bureaucrats and professors.



So I believe we have to involve more international people in the government decision making process as this can potentially avoid doing something really short sighted.

**Douglas Hymas:** This is a very good point, and I would just echo that. Your comment about consensus decision-making reminded me of my wife and myself choosing new furniture. I was being deferential to her so, "You pick what you want." "Oh no, you get what you want." -- we actually ended up compromising on something that neither of us liked, and we didn't admit it until after it was delivered. And I said, "You know, I never really did like this." She goes, "Well I don't either." So we sat down and tried to figure out how do we ended up buying stuff we don't like? And I think such things happen often.

<ins>Getting fundamental change here in Japan is hard because it requires consensus, and oftentimes it also has to be crisis-driven</ins>. Now there's a bit of a crisis going on with the aging of society and the low birth rate here a discussion is ongoing about how to stimulate growth – how to rejuvenate the economy with stagnant population growth and an aging society. These issues are creating a crisis among some of the leaders and policy makers. They have to do something rather extreme to make a difference, and I think that's helping to open up the realm of possibility for change.



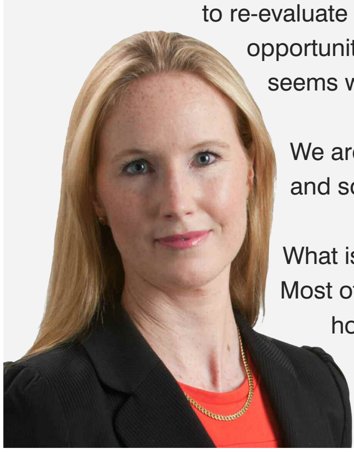
Also, from a personal level I see a fundamental difference in the way government leaders and policy makers are approaching these decisions: They now ask foreigners to help weigh in on these points. I've been asked many times, and I know my fellow colleagues who chair committees with Chambers of Commerce have been asked the same thing, "Help us understand how we can make a change."

That didn't happen as much until five years ago. Now they are really opening up and saying, "Hey, we've got to compete. We need to make fundamental changes and really be innovative here."

I think the **Abe Administration** has helped encourage that. A lot of people also complain that Abe's third arrow, structural reform, hasn't really made any progress, but others would argue, and I would be in that camp, that if you look behind the scenes at what the ministries are doing, they are making very minor changes behind the scenes, which is very Japanese in their approach. They don't want to be out in the front. They don't want to be doing things on a big level that would make the headlines. Instead, they are making very small fundamental changes that over time could make a huge difference in 5, 10, 20 years – so there are clearly longer term positive impacts. And I think that's another reason to be bullish on the changes that are taking place during the Abe Administration.

But many people and some parts of the media are probably looking for quick spikes and statistics that we can put in the headlines. I don't think they are there, but the little things that are happening are setting the foundation for growth. So on the one hand the consensus approach and the "nibbling around the edges" approach slows change, but on the other hand an atmosphere of needing to improve and secure the economy from impending crisis helps policy makers force change. It is a very positive sign to see the government reaching out to foreigners to get additional advice.

**Kate Hodson:** With the **improved performance of hedge funds** over the last year I think allocators now have an opportunity to re-evaluate how they want to be diversified and to consider increasing their allocations in this sector. There is opportunity there but there also continues to be competition. And from the discussions in this forum it seems we are more or less agreed that we want more competition.



We are living in a world where it's all about innovation. You don't drive innovation without competition, and so it will be good for Japan.

What is promising is that we are starting to see more enquiries again from new managers in Japan. Most of the funds I have worked with over this last year have been with the big institutions, security houses, not many startup managers. We'll have to see how that pans-out in 2018 but we are probably more bullish about this than we were at the start of 2017.

**Fiona Barrie:** Agreed, we are seeing some different types of structures being proposed, including hedge funds with an element of private equity built into the same structure. Also, some creativity around fee structures as managers try to attract and accommodate allocators.

**Douglas Hymas:** I just want to support something Kate said. I heard Mizuno-san of **GPIF** saying that evidence he has seen signs that *sometimes new managers often perform better than entrenched large managers* because they are more nimble, and so the GPIF actively seeks out new managers. I thought that was an interesting statement, especially for a fund that's so large that it's actually hard for them to monitor smaller managers, but he said he would like a way to do that. Now, I don't know whether GPIF will do it themselves or will use allocators. The latter would make more sense. But I think it is significant that this idea is being shared by the CIO of the largest and most influential fund in Japan. It also bodes well for the development of new managers here and will support the trend.

**Matthias Knab** Masaki, at our Roundtables we also like to hear from managers what opportunities you see within your strategy.

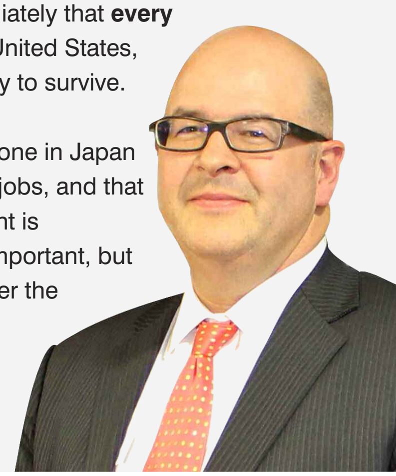
**Masaki Gotoh:** Well, first of all, we are very bottom-up fundamentally driven, so we operate on a company-by-company, stock-by-stock, business-by-business and we do not make any macro bets on the economy, for example,

I'm trying not to talk my own book, but we have been doing this well before Abe-san when corporate governance was terrible and companies chose to talk to you if they wanted to and cared about shareholders out of necessity rather than out of any real concern for their returns, and that has clearly changed in the last several years. It's again our big boat metaphor that I will bring up again. When Abe-san implemented the first changes in 2013, many people from outside the country were looking for Japanese corporate governance to become like the US overnight, but it doesn't happen that way. It takes time, but as Doug said, all these little initiatives have over time helped to improve the mindset for companies to care about all of their stakeholders, shareholders included.

Some people argue if all these **scandals** we saw around Toshiba or more recently Kobe Steel, Toray, Mitsubishi Materials, Subaru, Nissan are signs of failure of corporate governance. I say it's actually the other way around: it's because of corporate governance that these are now coming to light. They probably would've stayed hidden 5 or 10 years ago and *I wouldn't be surprised if we see more of these.* So, there are going to be plenty of scandals whose seeds were planted well before Abe-san.

But I think the point is the fact that what's driving these scandals isn't some greedy individual or individuals that want to make money. It's going back to that community and the sense of consensus building that we discussed. These people probably felt that they were doing their job. They likely didn't realize that what they were being asked to do was improper or illegal. I suspect they were doing so because they were being told to do so, and they were being told by somebody else who had been told by somebody else, who had been doing that for the last few decades.

**Ed Rogers:** Can I jump in for a moment? As an American, I feel we need to point out immediately that **every single one of these scandals in Japan has nothing to do with personal enrichment.** In United States, it's almost always about personal enrichment. In Japan, it's about trying to help the company to survive.



15 to 20 years ago you never would have heard about any of these scandals because everyone in Japan was in agreement that you did what you could to help the company survive, and that saved jobs, and that was important for the community. Again, the whole multi-stakeholder view of what's important is changing. I completely agree the idea that corporate governance of some sort is relatively important, but this now also means that you know how to admit it when things go wrong ,and that was never the case here.

**Masaki Gotoh:** And it's why the way they're trying to address corporate governance here, the reasons why all these different things that are going on aren't about controlling CEOs who take excessive risk like in the US. It's trying to encourage CEOs to take more risk and care more about returns (and capital deployed to generate them). The whole **ROE** theme similarly is about taking more risk, think about returns and the capital they put in to get those returns. It's very simple and something that is obvious in other developed countries but was foreign to most Japanese corporate managers until recently.

**Ed Rogers:** I came to Japan 30 years ago. I love the idioms, they can tell you so many things about a culture and country at so many different levels. In America "the early bird gets the worm". That is the driving focus of American culture on a personal and a professional level: Be aggressive, take a risk, and you get the big fat juicy worm.

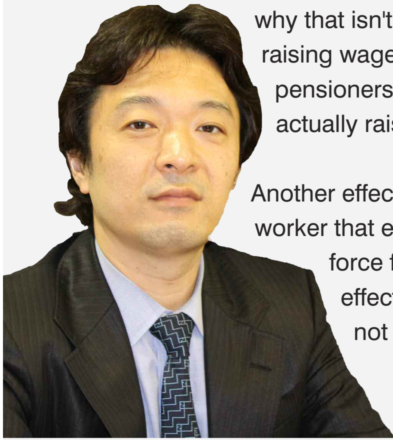
In Japan, there are two phrases; one is "Deru kui wa utareru" which means *the nail that sticks out gets hammered down.* So, the second you take a risk, somebody is going to whack your head in. The other, which may be more appropriate even for this particular situation, is, "Ishibashi wo tataite wataru". What this translates as, *"You need to check the stone bridge multiple times. Poke it with a stick before you dare to crossover."* What does this all mean – the Japanese don't hate small businesses, they don't hate entrepreneurs – they hate failure. And so there is an anti-entrepreneur bias, which dramatically affects the alternative investment industry here.

There are really a thousand little changes that we have to start to see, whether Japan is embracing corporate governance changes or tax changes, but is is difficult to make all those changes happen at once. The community consensus building process usually does require a crisis to kick it into high gear. I think in Japan's history there were maybe only three such points in time – Commodore Perry in 1853; the end of World War II in 1945, and arguably somewhere in 1989 and 1991 when the post-World War II economic structure collapsed with the stock index going from 39,000 to a bottom of 6,000.

*But we also need to acknowledge that the first two out of those three were military, existential crises, whereas now, the crisis is a much more slower burn. The population is disappearing, a thousand people a week smaller. GPIF is in draw down. There is more money going out every month than coming in, but all of those do not constitute a sudden, violent, observable change or threat. It's rather a slow drip, drip, drip of failure.*

This isn't pressing people for immediate and unavoidable changes. I mean, the cannon balls in 1853 were real, as was the devastation and the defeat in 1945. Those were observable crises, but now we have been staggering along for 20-odd years with most people not willing to admit there is a crisis here, but at some point it will be clear. Financially, the crisis is coming. Demographically, the crisis is coming.

*There is an exploding population of people over the age of 90. The biggest threat to Japan within 10 to 15 years is that up to 30% of the population may suffer some form of dementia. Right now, there are two taxpayers for every one retiree. In a matter of decades, there is going to be one tax payer for every one retiree. That is a crisis because the country will go bankrupt if changes aren't made, and therefore there is a reason why reform needs to start with things like the financial services. If you can't manage your money effectively, you're going to go broke a lot faster and a lot more painfully.*



**Masaki Gotoh:** But let me express one macro call here about changes in the economy. One of the things we and all economists have been waiting for is inflation, and specifically **wage inflation.** People continually talk about why that isn't happening, whereas from our perspective on the ground, the companies that we see are raising wages. These are companies across the board of all sizes in differing industries. If you exclude the pensioners, the people who are retiring – because they are skewing the averages – companies are actually raising wages.

Another effect is that the workers who entered the workforce in 2000 is on a different scale than the same worker that entered in 1980. But as that aging population who enjoyed the 80s starts to leave the working force from mandatory retirement, you'll actually see wage hikes across the board. And this effectually is being accelerated by the fact that the working population is shrinking. So inflation is not something --

**Ed Rogers:** Sorry to interrupt, are these seniority based or performance-based raises?

**Masaki Gotoh:** A little bit of both. Admittedly it's probably still a little bit seniority based, but let me also point out that the younger workforce are less dependent on the outdated lifetime employment system. Those scandals are happening because these whistle blowers are not as religiously loyal as the older generation. The **millennials** care about a lot of different things and loyalty to the firm is probably less than before, in a good way. They care about other issues. ESG, for example, has become much more important.

The millennials are a global phenomenon and we're probably going to see changes first here in Japan seeing that the population pyramid is changing most drastically. The millennials also spend differently. So we are seeing a lot of changes and even more will come in the next 5 or 10 years as the people that were enjoying the late '80's retire and will be out of the workforce. This will give another boost regarding change, whether it be corporate governance, whether it be how the economy works, or how people spend or save their money.

Admittedly, I don't know exactly what the future will be like, but it's going to be different. So the current situation which is death by a thousand cuts will hopefully start to change.

**Ed Rogers:** What is your view on the recent election and the LDP victory over Kibo no To? What do you think that implies as far as voting patterns and ruling this with the political entity of the voters to support change? Are they demanding change or in re-electing Abe? Or, have we got another 5 to 10 years to wait before Abe's generation moves out of power?

**Masaki Gotoh:** I try not to talk too much about politics, but I was supportive of Abe-san, not because of anything other than the fact that I want to make sure that we continue on the current path, which I think is the right path.

And for that matter we don't have any other alternative because clearly the other party is in disarray. I also think that we have become more patient. I mean, before Abe-san, we went through a revolving door of PMs and nothing changed during that period. Now we've got a leader who has understood the problems, has accepted a lot of outside help and although we may debate his nationalist orientation, he has been a driver for change.

I don't think that a move in politics or a change in the leading party or its members will change that shift anymore. The slow moving ships, once it starts to turn, doesn't turn back. And so we basically granted him another term. Maybe under any other prime minister where you see your wages flat and price inflation, everything from gasoline to the price of your food on the table higher, he'd be out of a job, but Abe-san is not. The attitude seems to be, "All right, things aren't as great as I wanted them to be, but I'm hopeful that at least, you're trying to do something where everybody else is just complaining."

**Douglas Hymas:** I'd second that. The LDP insiders I've been able to talk with share of my view that Abe was very astute to call the election when he did, with our friend in North Korea rattling his saber and Abe coming out strong. His approval rating which had dropped to 30% went back up to 50%, just temporarily, and that's when he called the election. That was very wisely done. And Abe also realizes that he won the landslide not so much because his policies were strong, but because he had a temporary upswing caused in large part by the opposition's collapse.

And so my question to the insiders was, "Does Abe recognize that or is he going forward with his conservative 'let's change the Constitution' agenda, despite the fact that he didn't actually 'win' the election but rather the other side lost it?" And the message back was, "He's not stupid." He knows from his experience that trying to change the Constitution is a very sensitive topic. And every time he raises it again, the liberal or the communists' liberal side come out again to fight heavily against it, and he sees that. He watches that barometer quite closely, and he's trying to be very, very careful. He still has the goal of getting the Constitution changed, but he realizes he must be very careful and very delicate, that the people have to make this decision and that he shouldn't ram it through.

**Matthias Knab** For the benefit of our readers, can you clarify what constitutional changes you are referring to?

**Douglas Hymas:** Security. Article 9 and a few others. He's trying to open up the Constitution to change, and an important piece of that is recognizing the military. The big issue here in Japan is that the military exists but is deemed to be a self-defense force and therefore not a standing army, but the liberals would say, "Wait, that's still an army" and that you're still violating the Constitution. The current existing self-defense forces have never been officially recognized under the Constitution. There are other aspects of it but that's the big one that everyone is watching most closely.

**Matthias Knab** Clearly North Korea was a blessing in disguise.

**Douglas Hymas:** For Abe, definitely. Timing couldn't have been better.

**Keiichi Aritomo:** Coming back to the theme of change in Japan, this country has been run by mainstream Japanese lifetime employees or bureaucrats, but the situation and the laws are gradually changing, and international-minded people are becoming more vocal or influential as well. There are also some changes on say the seed level in early education. For example my children go to Higashimachi Elementary School where they are surrounded by international children. It's a public school, all the kids speak English, and the teachers don't necessarily understand what the kids are talking about, but they are beginning to catch up as well. Those kids and others like that will grow up and develop diversified perspectives.

Sure, the society is aging, but in a way I also view this as a good crisis because Japan has never really adjusted the productivity of employment, and oftentimes we tend to have too many people to do some simple jobs or activities. But given that the population is shrinking, we have to finally focus on productivity in employment, and when you look at manufacturing, Japan is already very good at that. White collar productivity improvement has been lacking because there were way too many people in the work environment as employed.

*Therefore, in a long run, we are optimistic about this crisis.* It's a good trigger to transform this country's economy. I also believe we will have more qualified foreigners coming because all of the advanced nations are trying to protect themselves from migrants whereas *Japan is encouraging more qualified immigrants.* That is also a good trend.

From a political point of view, I think Abe is pro-continuity and he has unfinished business, so I agree with Masaki that people prefer him to complete whatever he promised to do. While you can express some criticism on the bureaucrats that are running the country, I think that we have to believe in the elites of this country as well. People in Kasumigaseki or Tokyo Metropolitan Government are really diligent, committed and bright. They don't necessarily have financial services industry expertise, and this is why they need support. Sometimes they try to do things by themselves and they may fail – it's neither about their capabilities or commitment, rather, they simply don't have real life business experience in all sectors. That needs to be supplemented by people like ourselves.

**Matthias Knab** We spoke about the potential flows of Japanese money into international alternative investment managers. Is there anything to add there?

**Ed Rogers:** In this particular space, we have seen dramatic interest, I think, but I point again to Kate's earlier comments, there are people that want to do business here. There's a significant number of people mostly that have been at larger firms that have looked at that $18 trillion pot of gold, if you will, and how to access that.

I've known Gotoh san for a long time and watched his startup and his challenge to go from 50 million to 600 million in four years' time, it's crazy. If a manager went through comparable professional experience and career in the United States, whether it's with CalPERS or Texas teachers or New York State or any of the eight leading endowments, he could as well heard, "And you know what? By the time you're 50 I'm ready to write you a check for 150 million and you should be at $3 billion to $4 billion now after four successful years like this."

For all sorts of different reasons as mentioned by Keiichi and Doug and everybody here, it's still a real challenge in this country to experience success as an entrepreneur. To be the Rakuten or SoftBank in the financial services space is still a real challenge. I don't want to be too negative about it, but I'm not convinced yet that we're going to see the checks get written, but not just to 5 or 10 companies. That's nice, but you need a thousand hedge funds here, literally to be credible as a regional powerhouse that Japan ought to be in my opinion. And I'm not sure I see the plan or hear the plan to create that, sorry.

**Douglas Hymas:** I think we are seeing slightly **increased flows toward alternatives generally.** From what I've seen, though, it's going more toward private equity, as Kate was saying earlier, and towards real estate. Not so much toward hedge funds yet because of performance issues recently, right? But I think what we are seeing is a re-orientation toward alternatives and that this momentum is growing. The question is, is this the beginning of a trend that will continue or does it get diverted at some point? I'd like to think that it's going to continue because I think the longer term trend, as I said earlier when I spoke about that balance of assets, is that the middle range is hollowing out, and *there are only two places to go – to passives or toward alternatives – and it can't all go to passives.*

If we couple that with the fact that the government is now focusing on the issue, we might have the seeds for a positive trend. The question is whether those will really sprout and continue.

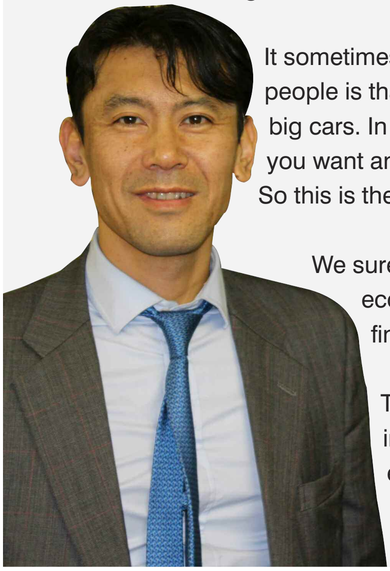
**Masaki Gotoh:** When it comes to the large asset owners, we talk about the GPIF of course, but it's not just them. They are the big one, but also other large owners like the PFA or Japan Post who are changing their attitude toward investment. Many of the other thousands of pension plans will likely be taking the lead from those large institutions that have a lot of capital and who are much more open to alternatives. Of course, I'm sure it's not easy to change internal mindset that quickly, so it's just taking them a little long to deploy it. But the senior people in these larger institutions have all worked in this industry not just in Japan or for Japanese firms, but also US and European financial institutions.

So, it's unlikely that they will be putting all of their money into say ETFs, nor will they put all the assets into plain vanilla active managers, because they know the space just as well as we do. And they are so large that their asset allocation decisions are going to mean more than any individual manager. So, a lot will be from shifting of assets, outside of just plain domestic fixed income to equities shift, which in itself is positive, but also the significant flows into alternatives. I have no worries about that not happening. It's just again, the time horizon for it to happen.

**Keiichi Aritomo:** I think that generally when it comes to the active versus passive discussions that by and large there is **more supportive for active management in Japan** and that active management should probably be a strong pillar when it comes to allocating the national assets to get a better return.

Now, within alternative investments and the discussion on private equity versus hedge funds, we have an issue where there tends to be a profound stigma against hedge funds largely created by the media, including the Nikkei. This is something we need to address somehow. It's not the government but the media negatively campaigning against hedge funds.

So when it comes to education, where do we start? First, we cannot just generalize hedge funds. Not everyone is a Bernie Madoff or the AIJ here in Japan. So, we have to somehow educate our journalists to better describe hedge funds, and sometimes it's even better to use the term "boutique independent investment manager", "adviser" or whatever, instead of hedge fund.



It sometimes helps starting with simple analogies that people can understand. One thing I sometimes tell people is that if they want a car that is both very fast and agile, say a Ferrari or Lamborghini, those are not big cars. In order for them to perform and be nimble, they cannot be too large and too heavy. Similarly, if you want an investment that performs and is agile, don't go after large long-only investment managers. So this is the kind of an analogy I have been using to encourage people to diversify more.

We surely have to do more with education for financial institutions and the mass media. This economy is very peculiar. Commercial bankers have been at the top of the food chain of the financial ecosystem.

Therefore, we need to educate the financial services industry as well to encourage them to invest, move on to start an investment business as well. Socially we have to somehow exercise positive influence.

**Matthias Knab**

In the summer of 2017 in the UK people spoke about an initiative where Members of Parliament were doing some sort of short “internship” at a hedge fund, kind of “working” as a shadow fund manager to better understand how this industry works and what is the value it provides.

I don't know if this actually happened and if MPs were actually “interning”, but when I read about it I thought it's terrific and if such a program really existed it should be copied elsewhere.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