Becoming a Global Financial City: *Tokyo must back up words with meaningful actions*

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Each financial market has its unique strengths

A final report of the Global Financial City Tokyo (GFCT) initiative was published last November by Tokyo Metropolitan Government following many detailed meetings to discuss how to grow and enhance the market. IBA Japan is supportive of the introduction of measures to enhance Tokyo's status as a major financial centre and creating an environment where financial businesses, including those from overseas, can develop and grow their businesses in a sustainable way.

Tokyo has been rated by the Global Financial Centres Index (GFCI)within the top five cities for a number of years, coming behind: London, New York, Hong Kong, and Singapore. Thriving global financial centres rely on a range of factors, and GFCI aggregates scores connected with: 'business environment', 'financial sector development', 'infrastructure', 'human capital', and 'reputation and general factors'. The attributes that appear to be significant in supporting successful financial cities can be many and varied and some of the reasons for success are issues that a local or national government and business might have more control over than others. For example, New York is essentially a very large domestic market but because the US dollar acts as a reserve currency this often necessitates having a US presence. London is the preeminent centre in Europe and also covers the Middle East and Africa partly because of its time zone location, the presence of English common law, the supportive regulatory environment, the use of English and the clustering of companies providing supporting products and services.

Asia Pacific is the most competitive geographical region with five cities in the top ten and Shanghai is one place behind Tokyo. Hong Kong initially developed as a financial centre because of trading activity between Asia and Europe but over the last quarter century the emergence of China as a major global economy with double digit growth provided Hong Kong with significant opportunities for growth as a financial gateway. China's growth came at the same as the slump in Japan's fortunes: after a strong period of post-war rapid industrialization the market slowed and the bubble burst. Singapore is perhaps the most self-made of the top five cities inventing itself by putting in place platforms, products and services to meet new demand and this was achieved by having a strong unified government support to back its ambitions and direction. Tokyo lost some of its strength as a financial centre but still has strong fundamentals such as globally recognized major companies (11% of the Fortune 500 companies are Japanese) and large levels of household savings as well as foreign denominated assets.

All the major global financial cities are likely to be making strategic plans to develop and enhance their attractiveness if only to ensure that they hold on to their current ranking. Any significant fall by Tokyo in its positioning is unlikely to be conducive to attracting new business or new opportunities; a falling ranking might however signal a heightened sense of malaise both in the financial centre and across the wider economy. An enhanced position does not always have to be at the expense of another financial centre and being open to working with other Asia centres could potentially be beneficial to both parties.

English is the international business language

We believe that for financial centres to be successful they must seek to respond to important environmental trends and developments and to continually look to ensure that they are being competitive and be self-aware of the areas where they need to improve and take appropriate actions. Japan is alone amongst the top five of not having English as one of the primary languages of communication and in many ways this places Tokyo at a disadvantage. English is the common international business language and is used as a working language across the IBA Japan members many of whom also come from non-English speaking countries. We would encourage the Japanese authorities to build up a pipeline of talented people who can speak English, permit more documentation to be submitted in English for business purposes, to allow regulatory reporting (bringing Japan in line with many other countries) in English and also to consider when thinking about the internationalization of its services, such as BOJ-NET, that they should be provided in English. These measures are likely to help stimulate demand for Japanese products and services and make the startup costs of moving businesses to Japan less burdensome.

Tokyo should play to its strengths: it has large pool of savings
Japan in enhancing is position as a financial centre should play to its strengths and among its major attributes are the depth of its household saving market. Japan has over recent years produced for its pensioners and savers very low yield levels from their savings and way below returns achieved in other markets. In an inflationary environment this out turn is no longer sustainable and investment yields must increase or the standards of living will fall. This situation creates both a challenge but also an opportunity. The low yields achieved in the past mean that there is substantial head room for growth and with a changed set of parameters a more dynamic and vital asset management sector might be achieved. Japan is coming from a fairly 'low base' and needs to develop its capacity in this area. This is one of the proposals that the Global Financial City Tokyo initiative has highlighted: to create a greater cadre of asset management specialists to manage the nation's savings more effectively. A successful buildup of such a skill base could perhaps in the future allow Tokyo to grow further by positioning itself as an important regional centre which could manage the funds of a growing and thriving middle class population across South East Asia.

Capital and financial market reforms
IBA Japan has been supportive of the real progress that has been made to Japan's financial architecture and operating environment. The introduction of the stewardship code, corporate governance code, JPX400, change in the GPIF (and other associated changes) in mandates are important contributions towards creating an attractive and buoyant Tokyo market.

Foreign institutions also play a significant role in creating this buoyancy through their investment in the economy and accounting for over 60% of the JPX's turnover. Overseas investors have made a strong commitment to the Japanese market, but they have certain corporate governance expectations which includes that a company is well run and aware of its risks, and that it is transparent in the information it provides and not favouring any grouping of investors. How a company uses its capital and its return on equity for shareholders are among the issues addressed in the corporate governance code (revised in 2018) which provides an important framework to help raise standards and meet investor expectations.

IBA Japan welcomes the changes that are being made by the FSA to put in place a financial regulatory framework and risk-based supervisory approach that supports the growth of business and the wider economy. We believe significant change has been made and it is important that this change is embedded and cultivated, and that these changes are made clear to stakeholders including those whose views are formed by previous negative encounters.

Inflexible labour market regulations
There are other elements of the business environment that are less conducive to a vibrant international financial city. Labour market regulations in Japan have been developed in an environment where lifetime employment and promotion based on seniority is the norm and

therefore in any labour disputes the only recourse of action for an employee is to demand reinstatement; there is no monetary severance regime. Workers' rights are important but the current labour rules are depressing the opportunities available to the wider working age population. The overly restrictive labour requirements mean that international companies sometimes have to decide whether to create jobs in Japan or decide to may be better to invest elsewhere because the Japanese labour regulations can be substantial and create 'tail liabilities' compared with the situation in competitor markets.

Other labour rules such as the definition of manager and non-manager roles and the restrictions on working arrangements have been designed to support employees working in traditional industries. Foreign banks employ many highly-paid professional, self-starting individuals who have large degrees of autonomy working on projects across different time zones, but the working time arrangements designed to protect workers who do not enjoy these levels of independence also apply to them. This 'one size fits all' approach has and will continue to result in these types of jobs either not being created in Japan or cut back, and these are often lynchpin roles for a financial business around which their success depends. This issue and a number of other measures are creating an environment which is not compatible with being a global financial city; we suggest a more targeted approach to labour market regulations for international financial services companies perhaps through the usage of special economic zone measures.

Taxation: a disincentive to foreign residents staying in Japan over the long term
Foreign nationals working in the finance and other industries come to Tokyo knowing that they will pay substantially more income tax than they would in neigbouring financial centres; in Japan there is an upper marginal rate of 55% compared with less than half of that in Hong Kong or Singapore. IBA Japan accepts that foreign nationals should be treated in the same way as Japanese nationals, and the costs associated with living in the capital of a major developed country are likely to be higher than in a city state. When the tax regime appears to be unfair to foreign workers this then becomes a problem.

The inheritance and gift tax regime until last year meant that anyone moving to live and work in Japan was by that action immediately liable to paying Japanese taxes at a top marginal rate of 55% on all their global assets, including any residence they may already own in their home country. This punitive regime was introduced in 2013 and years disincentivised people moving to Japan to work. Whilst they were changed for shorter term residents in 2017 they still apply to foreign nationals living in Japan longer than 10 years and cover everything they own, including items accumulated that have no connection with a person's association with Japan. Similar rules do not apply in many other developed countries and do not apply to Japanese residents who live overseas. The message it sends to foreign workers and investors is: *we want to discourage you from living in Japan over 10 years.* Other public policy financial issues which are seen as unfair include the cap on the contributions foreign nationals can take from their payments into Japan's national pension scheme if they decide not to retire in Japan: it is set at JPY2 million and unvested.

A coordinated strategy of the overall impact of various measures therefore needs to be part of the policy making process. If the goal is to enhance Tokyo as a financial centre then policy makers need to be aware for example, that introducing a visa category for highly skilled professional to encourage them to move to Japan is likely to be undermined by a tax regime that would mean once they moved to Japan all their global assets would be liable to Japanese inheritance and gift tax. A joined-up approach for businesses and individuals is required and both municipal and national governments need to be more conscious of the wider impact of proposed and existing measures and to co-ordinate appropriately.

We have observed various cases of Japan sending out mixed policy messages on its receptiveness to grow as a financial centres including a mismatch between high level aspirations of being the major financial centre in Asia and the actions undertaken and proposed by different authorities. This fragmented approach is very different to the unified vision and delivery that financial global cities such as Singapore have adopted and made them so successful in a relatively short period of time.

We believe that it is important that Tokyo plays to its financial strengths and we support growing the expertise in asset management in Japan and we also note the aspiration to grow the FinTech industry. The final GFCT report describes setting out a vision towards a 'Big Bang' and we believe some of the issues discussed and raised in the report including reforms to labour market regulations, appropriate taxation reforms and investment friendly initiatives are key to creating the right environment.

In creating the conditions for a 'big bang' the authorities need to factor in that markets are dynamic and technological innovation – especially regarding FinTech - is happening at a ferocious speed. International investors and financial businesses will want to see signals that substantive measures, such as some of the topics highlighted above, will be introduced and will allow them build up confidence so that they can trust and believe Tokyo's ambitious aspirations.

Tokyo is considering putting in place a financial promotion body to take forward its various initiatives. We would encourage that this is much more than a marketing unit but like successful bodies in financial centres in some other countries, is the focal point and engine room that inspires the innovation and changes required to enhance and maintain Tokyo's position as a financial centre. Complacency in its current positioning is not an option if Tokyo wants to continue to be a top five financial centre. Talking and planning must result in actions which need to be visible, publicised, and also be communicated in English.

There have been few announcements in English since the November GFCT report was published and international investors want to know will this be a 'big bang' or will it follow the course of previous relaunches of Tokyo as a financial centre: these might be characterised as '*lots of talk but no significant action*'. If this were the outcome it would have a significant and long-term impact as the takeaway for international investors would be: Tokyo, despite its best efforts, could not introduce enhancements. It therefore is unlikely that it will be able to do so also in the future (at least over the short and medium term), unless there is some other significant change.

We therefore urge Tokyo not to be modest in shining a light on the work it is doing. We would encourage an outward and internationally focused communications strategy in English, which regularly updates on the steps being taken towards achieving the 'big bang' effect. The messaging must be action orientated: what policies are changing, what money is being available, what activities are taking place. Momentum needs to be built up over the next month, next quarter and next year. Creating this momentum will, if backed by appropriate actions, build further momentum and belief, excitement, trust, and confidence.

IBA Japan comprises 56 foreign banks and securities companies from 22 different countries. We want to continue to work with our business partners in Japan and with the authorities to build a stronger and enhanced financial centre and seek to provide supportive, constructive and honest input and feedback on the initiative's proposals and progress.