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TOKYO FUND SERVICES

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Featuring Gordian Capital | FinCity | Teneo Partners

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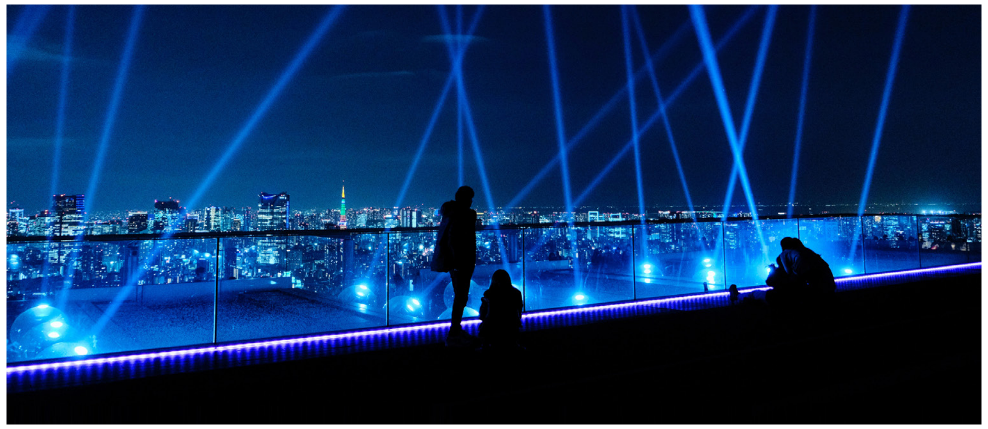

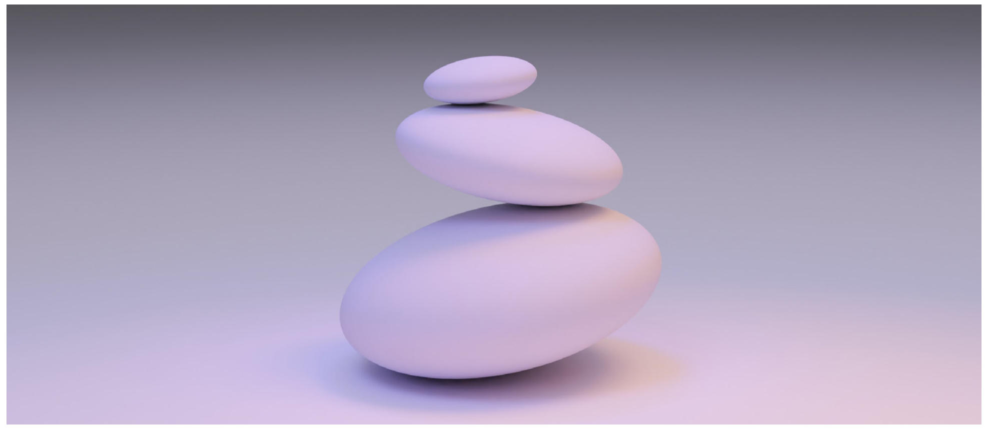

Maximising Japan's domestic strengths

Japan is focusing on utilising its domestic wealth and maximising the investment potential of its ageing population. This translates into opportunities for investment managers looking to grow their footprint in the country and establish a strong Japanese client base. In its endeavours to strengthen its reputation as a financial hub, Japan is also working to help foreign investors discover hidden gems within its capital markets.

Keiichi Aritomo, Executive Director of FinCity.Tokyo, outlines the country's well-known demographic challenge which sees a third of the population being over 65. However, two thirds of Japan's wealth is also in the hands of this group of people, making them very powerful indeed.

"We need to grow Tokyo as a financial centre to address these challenges," Aritomo says, "To do this, we first have to upgrade our investment capabilities. Secondly, we have to ensure the sustainability of our investment. And third, due to the fact that we have quite extensive supply chains, we need to provide sufficient funding for SMEs to make these supply chains more secure, robust and resilient."

In its "Global Financial City: Tokyo" Vision 2.0, the Tokyo Metropolitan Government (TMG) details how it aims to build an investment chain that links domestic and international capital demand to worldwide capital supply, against a backdrop of enormous domestic capital demand based on the existence of diverse companies and projects in Japan and domestic capital supply capacity.

Tokyo's strengths include being the world's third largest economy, coupled with approximately ¥1,900 trillion in personal financial assets, high levels of comprehensive strengths as a city, political stability, and firm rule of law.

Establishing Tokyo as a global financial city will involve creating a virtuous cycle of investment and return where asset managers and financial institutions are actively engaged in the market by supplying funds to domestic and foreign companies and projects, all supported by "comprehensive urban functions and enhanced social infrastructure".

Supporting ESG disclosures

One way of advancing Tokyo among international investors sees FinCity.Tokyo and TMG supporting Japanese companies to better disclose their ESG credentials and endeavours.

"There are Japanese companies that aspire to address social issues to improve our society, but they don't have enough capacity and capabilities to engage international investors," says Aritomo, "They don't know the ESG terminology and often don't communicate in English. Therefore, their ESG ratings are low which results in limited traction from overseas investors. One project we have started is to address this issue by helping companies such as these to better communicate in English."

Five companies formed part of this project last year and this year, this number has risen to 15.

Developing this information platform on ESG-related corporate initiatives is one of Japan's major initiatives to further sustainable finance in the country. Companies are being encouraged and supported to disclose ESG-related information on companies in a way that is easy for everyone to use. This will be done, "while taking into account the moves by the government and Japan Exchange Group to establish an information infrastructure and certification framework for green bonds."

Japan also has broader green ambitions and has been promoting transition finance, encouraging investment in supporting high-carbon companies start their journey to becoming greener.

"We are trying to become a hub for transition finance for Asia. Japanese major corporates are already putting together their roadmap for transition finance. These corporates have extensive supply chain connectivity with the vast majority of Asian markets; therefore if other Asian companies get endorsed by Japanese corporates or Japanese regulators for transition financing, it can result in significant support from international institutional investors as well."

Data from the government shows Japan's share of the global sustainable investment market is still just 8%. Therefore, the room for growth here is significant.

In the document quoted earlier, TMG notes how the stimulation of green finance is becoming increasingly important as Tokyo aims to become a global financial center. This, "will accelerate decarbonisation efforts and contribute to sustainable recovery, leading to sustainable economic growth for Tokyo and, ultimately, to the realisation of affluent lifestyles for Tokyo residents," the report says.

Encouraging investment

Japan is home to a significant bulk of household assets, circa ¥1,900 trillion in savings, which are under utilised. Putting this money to work is one of the critical junctures for the country to drive it's financial agenda forward.

"We have sufficient money, but our investors are not sophisticated enough to diversify that investment across their wealth. So that's why we would like to attract long-term oriented investors so that Japanese investors could follow their example," Aritomo says.

International, sophisticated investors can engage the local market, influence and also maybe educate Japanese investors on how to implement a long-term investment strategy. This large accumulation of assets offers asset managers and foreign operators significant business growth opportunities.

Part of the focus is also being placed on supporting emerging managers. Aritomo describes the programme being built to attract emerging managers, called "Emergence Japon," due to be launched in the second quarter of 2023.

"We would like to have a broad range of investors chipping in an amount, for example around $5 million each, to encourage growth within the emerging manager we identify. These managers generate alpha and by investing early, asset owners can achieve some supplementing capabilities in securing the future capacity within their strategies," he says. In its efforts to build this network of managers and investors, FinCity.Tokyo organises a number of events, the most important being the Tokyo Asset Management Forum on November 15. This provides matching opportunities for emerging managers and asset owners and every year, the organisation aims to have preeminent speakers on the agenda in order to elevate the level of information and education being provided.

TMG also provides asset managers with subsidies for outsourcing middle and back office operations. As a result, they have more time to focus on their core investment activities.

Strengthening capital markets

The Japanese market is considerably vast with around 3,800 companies. However, Aritomo explains that a very small portion of these, less than 150, are covered by international equity analysts – leaving 88% of Japanese companies untouched.

In Aritomo's view, there are many undervalued, hidden gems in Japan which international investors can benefit from. Japan is the home to the third largest economy in the world, by GDP, and as a result has a broad variety of sectors and industries which can be invested in.

One way of helping these companies appeal more to foreign investors includes carving out a clear CFO role. "Japanese companies are very peculiar. Companies, even large ones, have accountants but not necessarily a CFO. Companies in Japan are very good at accounting in terms of bookkeeping and reconciliation and internal control management, but we need to build out a bigger picture. We want these companies to have a CFO, someone who can design business models, carry out balance sheet optimisation, supply chain finance and data enabled projections," Aritomo outlines.

Aritomo has ambitions for corporate CFOs to become an integral part of Japan's capital markets. This will once again contribute to attracting more capital to Japan.

Through the initiatives detailed here and various other projects, Japan aims to build its reputation as a global financial city to encourage investment and engagement. Such activity will create a vibrant financial community while maximising the potential of domestic ownership and commitment.

Tokyo 2022 beckons offshore funds

ON THE GROUND PRESENCE

Japan continues to offer attractive investment opportunities to global investors. The second largest developed economy provides a comforting rule-of-law backdrop, which should not be taken for granted at the global level. Private market investment origination teams remain quite active. Real estate investment amounts by offshore investors, for example, over the past three years have consistently been over ¥1 trillion annually, despite the Covid-19 disruptions.

Investment opportunities can be found within a wide range of real assets in residential real estate, infrastructure, and commercial real estate, including subsectors such as office buildings, hospitality, logistics, and data centers. The recent yen devaluation has made long term investments in real assets even more attractive. For private equity funds, the opportunities may be more limited in number. Nonetheless, private equity funds with well-staffed origination teams, clear investment strategies, and the patience to find the right investments have been well rewarded. The competition for assets is fierce and new entrants, in both the real estate and private equity space, continue to make inroads.

Recent reports of investments in Japanese startups by Softbank Vision Fund and an investment in a domestic venture capital fund by the Government Pension Investment Fund, the first of its kind, have shone a light on a sector that has garnered the attention of the Kishida administration. The government has established a cabinet-level post in charge of supporting startups. The intent is for the ministries and agencies to work in a coordinated fashion to develop measures to encourage startups and their subsequent growth and to make this the pillar of the government's action plan for a "new capitalism". Pioneering offshore investors, across all stages of venture capital financing, have established a beachhead presence and it is not unusual to find global investors on shareholder lists of Japanese startups. The recent investor and government initiatives have already reinvigorated this investment space and it will likely lead to new investors joining the fray.

On the public markets side, many of the global multi-manager funds and managed account platforms continue to grow their already successful Tokyo-based asset management businesses. As a result of geopolitical concerns, Covid-19 disruptions in the region, and a need for diversification of geographic and strategy risks, more global hedge funds, especially those with multi-strategy, multi-manager teams, have begun to consider a trading presence in Tokyo.

High setup costs and language barriers are a concern but over the last couple of years, many asset managers have taken advantage of government and industry initiatives, including those offered by the Tokyo Metropolitan Government, FinCity Tokyo, and the FSA. That said, an investment in a fully licensed and regulated operation in Japan is a significant one, both in terms of cost and time. As an alternative to setting up a fully licensed operation, Gordian Capital, a specialised and fully licensed asset manager, holding a full Discretionary Investment Management license, an Investment Advisory license and a SEC Registered Investment Adviser license. The firm provides practical solutions to significantly reduce the time, cost, and uncertainties of establishing a regulated base in Tokyo enabling global managers to house key investment professionals on the ground in a fully regulated infrastructure.

Diversifying the investor base

The offshore funds which have considered Japan as an essential destination to diversify their investor base continue to be well rewarded, despite the challenges. The more successful funds have had a long presence in Japan, either by having appropriately licensed fund-raising personnel on the ground or working with independent distributors. Knowledgeable offshore funds have also made it a point of covering different types of investors through multiple distribution channels. That said, fundraising in Japan remains a challenge and requires great effort, determination, and long-term commitment.

Pension funds, for example, must make use of regulated fiduciary managers such as trust banks and discretionary investment management (also known as DIM) firms to make their investments. Finding a firm with the necessary language skills, and the traditional as well as broad alternatives investment expertise is much harder than the number of DIMs (around 130) would imply. The large firms have set up separate business units to handle third-party products but many of them have long-established relationships with competing products thereby creating a shelf-space problem for new offshore managers seeking to enter the market. The alternative is to work with independent fiduciary managers, who do not manage their own capital or funds, such as Gordian Capital Japan, with the necessary language, investment expertise, and established relationships.

Corporate pension funds continue to increase their allocations to alternatives. By some accounts, alternatives currently account for over 20% of their assets, up from 8% a decade ago. Given the continued

near-zero interest rates in Japan, real estate and infrastructure funds continue to be popular for their steady income streams. Corporate pension funds tend to have relatively low return targets and the managers are not particularly incentivized to outperform those targets.

If anything, pension fund managers, fearing potential negative impacts on the plan sponsor finances, place priority on controlling investment risk. According to various surveys, returns for the year ending March 2022 averaged 3.5~3.7%. The larger and more sophisticated corporate pension funds, especially those that do not rely on consultants, have allocations to more illiquid private market strategies.

GORDIAN CAPITAL

Gordian Capital Japan is a Tokyo-based asset manager offering operational and infrastructure solutions to support offshore asset managers establish a Tokyo base for research and trading of both public and private-market assets. In addition, in its capacity as fiduciary manager, it invests in offshore funds across a wide range of public and private market strategies on behalf of domestic pension funds. Gordian Capital Japan operates under a Discretionary Investment Management and Advisory license under the Financial Services Agency of Japan. It is also a Registered Investment Advisor with the United States SEC.

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In a career spanning over 21 years at Morgan Stanley in NY and Tokyo, Alvaro was a founding member of the Japan interest-rate derivatives desk covering global macro funds, the Japan Global High Yield trading desk, and the Japan Special Situations Group. Alvaro earned a BSE in Electrical Engineering and Computer Science from Princeton University and an MBA from The University of Chicago.

Gordian Capital

Patience and persistence key to success in Japan

The current environment is creating ripe opportunities for foreign managers seeking looking to raise capital in Japan as local investors and institutions search look for fixed income substitutes to supplement returns. Having a local presence can help elevate their offer, however they have to be patient and persistent as business practice tends to be move at a slower pace.

Historically, Japanese portfolios have been heavily focused on domestic fixed income assets, with these investments representing the lion's share of most holdings. However, this is changing.

Stan Howard, found and director, Teneo Partners, comments: "In spite of the fact that Japanese investors are, relative to US investors, risk averse, the levels of interest rates and bond returns are become too anemic to allow them to reinvest in domestic offerings as their holding mature."

Funds aiming to benefit from this shift and looking to raise capital from institutional investors, having an established presence in Japan can be an important differentiator. For cultural reasons, being physically present can be advantageous.

Howard notes: "Japanese investors place a greater important on establishing a rapport, both on a personal and organizational level rapport with fund managers than in most domiciles. Getting to know the fund manager to whom they are considering an allocation is as important to them as the specifics and outcome of the research and due diligence processes."

But Japan is not only a source of capital, the. The country is also home to numerous investment opportunities. Of the approximately 3,800 listed companies in Japan, it is estimated that around 70% have no analyst coverage. This means that Japan-related hedge funds can gain a distinct advantage by being based locally.

"The proximity to the assets and companies that managers will be investing in is one of the primary considerations," says Howard, "Private asset managers, whether real estate or private equity, need to have both ears and feet on the ground in order to most effectively source the deals and opportunities. Similarly, fund managers that are investing in listed securities need to be able to visit companies regularly. This is particularly the case in Japan where manager strategies tend to be less macro and more bottom-up research driven."

Practical steps

Acquiring the appropriate license aligned to their objectives is the first step for a manager setting up in Tokyo. "While this would appear to be self-evident, we have observed managers take advice based on the path of least resistance without understanding the full regulatory landscape. We have for example encountered managers who apply for a Discretionary Management License when their ultimate objective was to raise capital from family offices and high net worth investors for their existing funds. Be sure to find and pay for experienced and sound legal advice," observes Howard.

Managers would also be best placed creating a local organisation which can effectively interact with their offshore counterparts. This includes building a team capable of navigating the cultural divide between Japanese investors and foreign institutions.

Howard suggests: "The subtle issue here is that in many cases, local employees who have spent their careers in foreign investment banks find it difficult to navigate through the maze of the client Japanese institutions. However, the manager also cannot rely exclusively on local employees who are not familiar with the mindset of the offshore head office. Finding that mix and balance could very well be the biggest challenge."

Being persistent and committed is also critical to success in Japan. "Business can be excruciatingly slow to develop in Japan and pressuring potential clients in an attempt to address their immediate issues and initial objections will backfire in this environment. If you do not have patience, do not come," Howard advises.

Overcoming challenges

So, there are significant opportunities for asset managers in Japan – both in terms of raising capital and investing in Japanese assets – However, some challenges remain.

The money in Japan is concentrated within a small number of institutions in Tokyo; these control the vast majority of assets to be allocated to offshore managers. On the surface, this may appear to be an advantage for capital raising but finding the pools of capital within those institutions can be difficult.

Exacerbating the issue is the fact that most of the institutions are HR constrained with only a team of a few people handling the thousands of emails and contacts from managers wishing to introduce and pitch their funds. This constraint often leads to them only evaluate and allocate nearly exclusively to those funds managed by the largest, most widely recognised brand name managers.

This does not mean other managers are not considered at all, but it may not be straightforward. Howard says: "If a manager falls under that top tier, it takes exceptional performance or a differentiated investment approach as well as persistence [in order to succeed]. Having a local presence demonstrates commitment to prospective investors and creates the foundation for developing a relationship with the investors which will lead to breaking through into those allocators."

Teneo Partners provides the necessary local presence on behalf of asset managers through a broad array of capital raising solutions in Japan, from complete fund placement mandates to regulated service offerings and salesforce sponsorships.

Teneo Partners

Teneo Partners offers an array of distribution and marketing solutions for asset managers looking to raise capital from Japanese investors. We provide three principal service offerings.

Comprehensive Fund Placement: active, full-service marketing of offshore funds to Japanese investors
Global Fund Bank: digital data rooms for capital introduction to Japanese investors
Customized Distribution Solutions: innovative offering of unbundled marketing and regulatory support services to asset managers

Teneo Partners is a fully licensed securities company, registered with the JFSA and authorised to engage in the business of Type 1 and Type 2 securities. We work with asset managers across all asset classes and categories. Our business plan as submitted and approved by the Kanto Finance Bureau of the JFSA permits us to market all manner of fund products to all investor categories including, and without limitation to, financial institutions, pensions, corporates, endowments, individual investors, intermediaries and gatekeepers.

Teneo Partners

Stanley Howard

Stanley Howard is Founder, Managing Director and CEO of Teneo Partners. He is a veteran of the fund markets in Japan with over 30 years of experience in dealing with Japanese investors and institutions. He completed his MBA studies at Northwestern University and initially worked at Smith Barney Harris Upham, then Morgan Stanley managing the foreign equity desk in Tokyo. Then, he joined the Tiedemann Investment and then served as the Japan President of Investor Select Advisors. Stan was born and raised in rural Japan, giving him a level of understanding of the culture that few foreigners have.

Teneo Partners

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Functioning as a fully licensed fund distribution partner in Japan, we provide asset managers with complete turn-key support throughout the marketing process, along with ongoing assistance after closing.

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We offer individually tailored service packages for managers who require some assistance in Japan from a regulated distribution partner but do not need the full complement of support services provided through our comprehensive fund placement program.

For further information, visit us at www.teneopartners.com or contact us at inquiry@teneopartners.co.jp
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