Proposals from the

JPX Financial and Capital Market Workshop

～ Toward Creating an Attractive Capital Market ～

December 2013

Japan Exchange Group Inc.

Introduction

In January 2013, we began a new chapter as Japan Exchange Group following the business combination between Tokyo Stock Exchange and Osaka Securities Exchange. We at Japan Exchange Group recognize that we are charged with the mission of maintaining and operating reliable markets, and providing highly convenient, efficient, and transparent exchange markets to support the economic growth of Japan through the financial and capital market. In line with our vision "to become the most preferred exchange in the Asian region that offers creative and high-quality services with a commitment to the public interest and reliability," we strive to enhance the convenience of the market for all investors in the course of our daily operations.

Becoming "the most preferred exchange in the Asian region" is a vision that cannot be realized on our own; we will need the cooperation of all stakeholders, from investors, listed companies, financial institutions, government agencies, to overseas market users. In addition, with economic ties between Japan and Asia set to deepen as the region enters an era of rapid growth, we acknowledged the need to constantly revisit and reexamine the position of the Japanese financial and capital market from a broad perspective.

This was the idea behind forming a panel to bring knowledgeable persons together in August and September 2013 to deliberate on what must be done to enhance the attractiveness of Japan's exchange markets. This paper "Proposals from the Financial and Capital Market Workshop: Toward Creating an Attractive Capital Market" is a compilation of the opinions and viewpoints shared during the discussions.

We hope that these proposals will serve as a reference on how we can invigorate Japan's financial and capital market and spur Japan toward further economic growth. I look forward to working together with market participants to further develop and bring Japan's financial and capital market to the next level.

December 2013

Atsushi Saito

Director & Representative Executive Officer, Group CEO

Japan Exchange Group, Inc.

Overview of Japanese Economy and Financial and Capital Market Workshop Sessions

Session 1

Date/Time:	August 22, 2013 (Thu.) 16:30-18:30
Venue:	Conference Room, 15th floor, TSE Building
Topic:	"Legal systems and discipline to facilitate the creation of an attractive securities market in Japan"

Participants:

Kazuhito Ikeo	Professor of Economics and finance faculty of economics, Keio University (moderator)
Reiko Akiike	Partner & Managing Director, The Boston Consulting Group
Yuri Okina	Research Director, Chief Senior Economist, The Japan Research Institute, Limited
Yusuke Kawamura	Deputy Chairman of the Institute, Daiwa Institute of Research Ltd.
Nobuyuki Kinoshita	Executive Director, Bank of Japan
Bob Takai	President & CEO, Sumitomo Shoji Research Institute, Inc.
Kazuhiro Takei	Attorney-at-Law, Nishimura & Asahi
Noboru Yoshioka	Director, Nikkei Inc., President and CEO, QUICK Corp.
Atsushi Saito	Director & Representative Executive Officer, Group CEO, Japan Exchange Group, Inc.
Kotaro Yamazawa	Senior Executive Officer, Japan Exchange Group, Inc.

Session 2

Date/Time:	September 25, 2013 (Thu.) 10:00-12:00
Venue:	Conference Room, 15th floor, TSE Building
Topic:	"The role of Japan's financial and capital market in harmonizing growth with Asia"

Kazuhito Ikeo	Professor of Economics and finance faculty of economics, Keio University (moderator)
Reiko Akiike	Partner & Managing Director, The Boston Consulting Group
Shujiro Urata	Professor, Graduate School of Asia-Pacific Studies, Waseda University
Yusuke Kawamura	Deputy Chairman of the Institute, Daiwa Institute of Research Ltd.
Nobuyuki Kinoshita	Executive Director, Bank of Japan
Bob Takai	President & CEO, Sumitomo Shoji Research Institute, Inc.

Kazuhiro Takei	Attorney-at-Law, Nishimura & Asahi
Eiji Hirano	Executive Vice President, President, Asia Pacific Region Toyota Financial Services Corporation
Yoshio Wada	Executive Advisor to the Director General and Deputy Director General, Japan International Cooperation Agency (JICA)
Atsushi Saito	Director & Representative Executive Officer, Group CEO, Japan Exchange Group, Inc.
Kotaro Yamazawa	Senior Executive Officer, Japan Exchange Group, Inc.

I. Legal systems and discipline for the creation of an attractive securities market in Japan

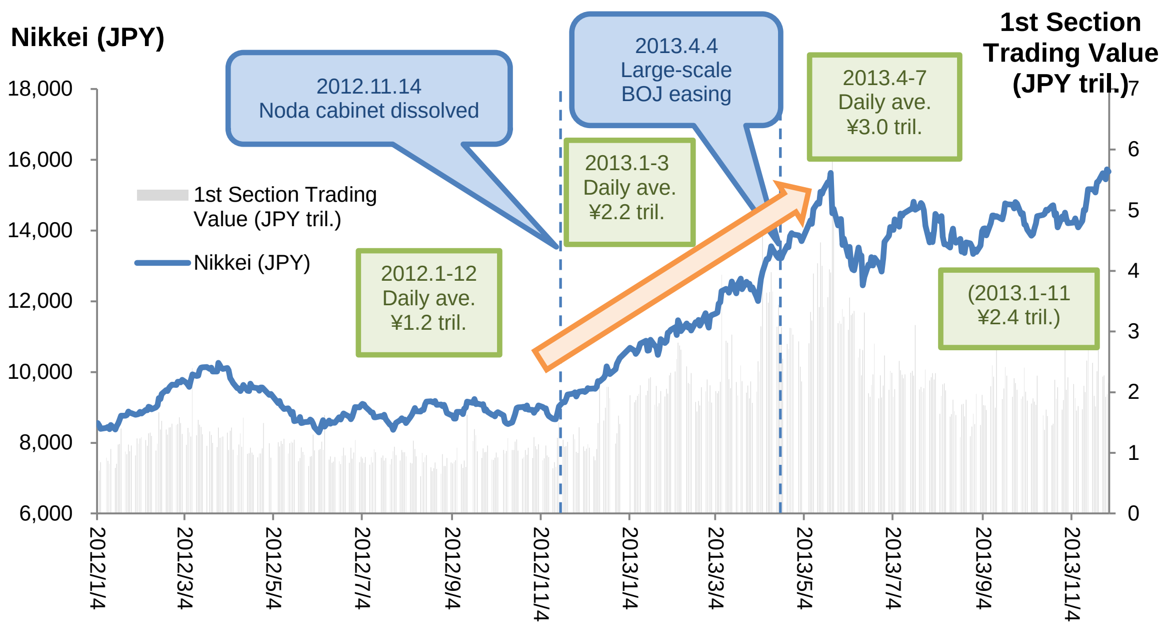
1. Issues Identified by JPX ～～～～～～～～～～～～～～～～～～

For the past few years, the Japanese financial and capital market has been in a prolonged downturn with low stock market prices and trading value. Even as New York, London, Shanghai and other markets recovered to pre-Lehman Shock levels, Japan was left behind without even the slightest hint of a recovery.

It was only from the end of last year until mid-May that we saw a sustained rally in the Japanese stock market. The Liberal Democrats came to power and the market welcomed monetary easing of unprecedented scale. The rally was a result of hopes for Abenomics which drove a strong positive turn in investor sentiment. Trading volume renewed highs on consecutive days and the market showed an exuberance not seen since the bubble era.

However, from August onward, the stock market began to fluctuate. Even though Tokyo was awarded the 2020 Summer Olympics and Paralympics in September, which raised hopes for a profit boost to related industries, uncertainties remained for the economy due to US fiscal problems and the upcoming decision on the consumption tax hike.

<Fig. 1-1 Stock price and trading volume>



(Created by JPX)

Up until May, the stock market surge was driven by hopes for the new administration's growth strategy and a correction in the yen from record highs to more reasonable levels. In other words, while the recent surge was a result of rising hopes for better corporate performance, the market will now seek to evaluate the actual conditions related to these hopes.

Tokyo winning the rights to host the 2020 Summer Olympics and Paralympic Games contributed in no small part toward generating even more positive sentiment and boosting the trend toward risk-on investment. If companies can ride on this wave of positive sentiment to improve profitability, we should be confident of seeing a sustained recovery in the market.

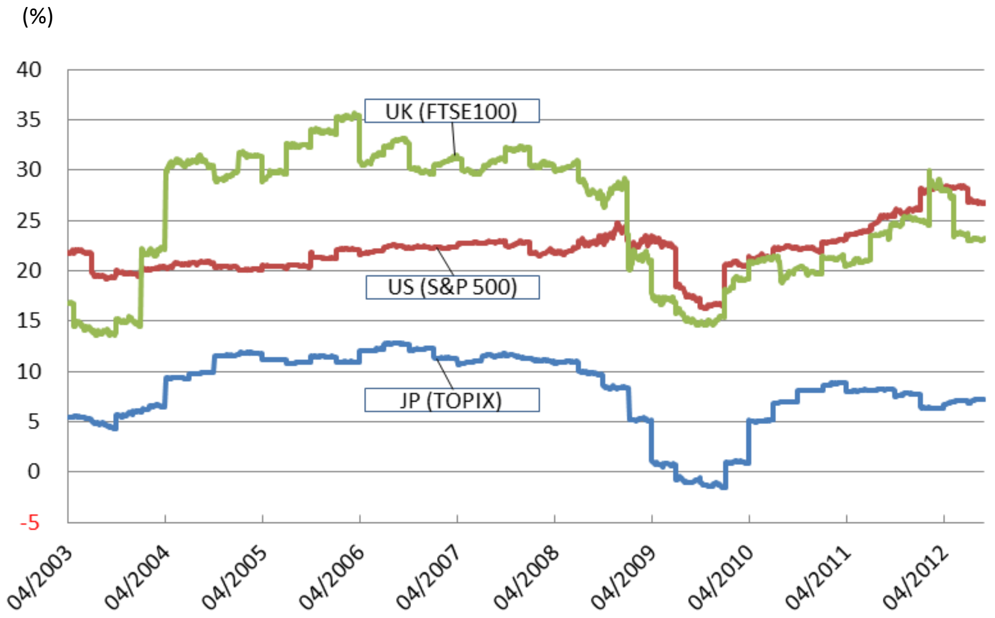
In terms of improving the attractiveness of the Japanese financial and capital market, overseas investors, in particular, often mention the issue of the "low profitability" of Japanese companies. This is the most important issue that must be addressed. At this time when worldwide attention is returning to Japan's financial and capital market, we at JPX believe that, as market operator, there is great significance in deliberating and offering concrete proposals on resolving the problem of "low profitability."

With this perspective, we invited persons well-versed in the topic to workshops to analyze and discuss what needs to be done. We have compiled comments and opinions shared in the workshops into this final proposal for creating an attractive financial and capital market in Japan.

2. Current Analysis 〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜〜

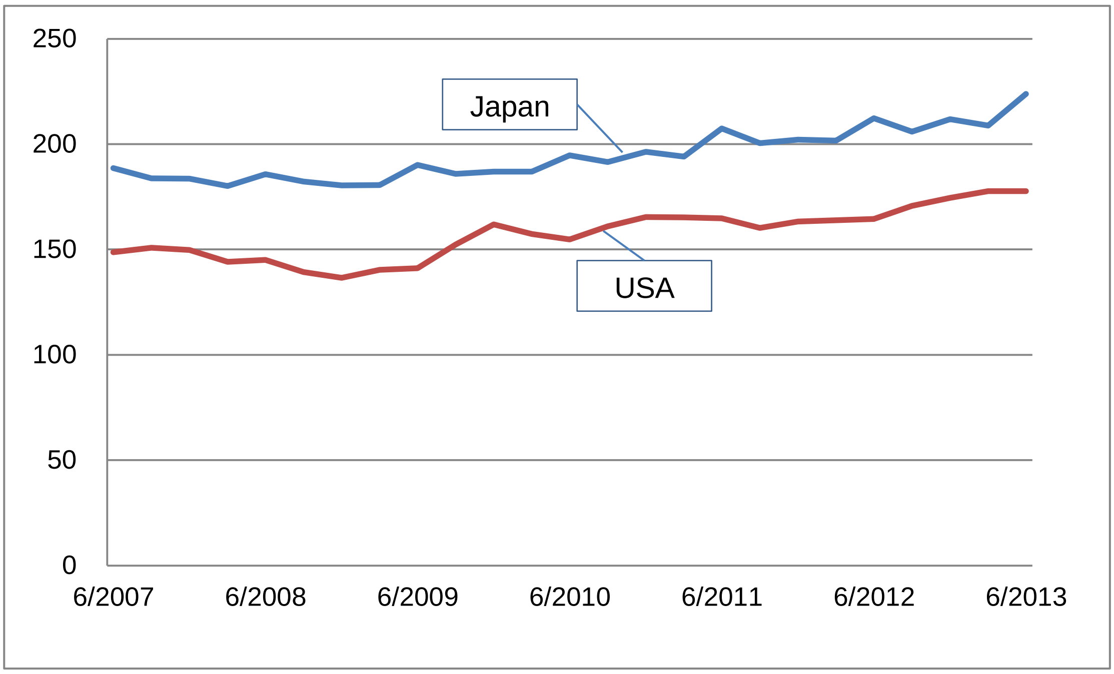
One of the reasons generally given for the low profitability among Japanese companies is that they hold an unnecessarily large amount of cash. According to the Bank of Japan's statistics on fund flows, as of the end of June 2013, the outstanding amount held by companies (excluding financial institutions) in currency and deposits is about JPY 220 trillion, as compared to the USD 1.8 trillion held by US companies. Even if we do not consider the fact that the US economy is much larger than Japan's, a straight comparison shows that Japanese companies hold 20% more in cash reserves than their US counterparts.

<Fig. 1-2 Comparison of ROE in the US, Europe, and Japan>



(Created by JPX based on Bloomberg data)

<Fig. 1-3 Cash and deposits held by US and Japanese companies>



(Created by JPX based on BOJ fund flow statistics and FRB data)

Why is there a need to hold such a large amount in cash and deposits and is it really necessary?

One reason generally given is that "there are no promising projects or investments which would yield reasonable returns," an extremely conservative approach. However, this stance does not help to explain why cash reserves have been maintained over the years. It may be one reason but it is probably not the decisive factor.

Another issue often highlighted is the regulatory framework in Japan. The peculiarities of Japanese bankruptcy and employment laws do not allow companies to swiftly commence bankruptcy proceedings or flexibly adjust employment arrangements. As such, there is the view that companies keep cash in reserve to cover for the costs of possible lawsuits or other exigencies.

Executives are probably faced with the constant pressure of running their companies while making considerations for bankruptcy or employment arrangements if the business is at a mature stage or to be phased out. This constant pressure is also a factor behind already sufficient reserves surging to an excessive level. If a change in the regulatory framework could convince companies to reduce their cash stockpiles and, in turn, bring about greater profitability, then a decision should be made quickly.

Another common explanation is "to prepare for another possible future 'shock'." When the Lehman Shock struck several years ago, companies faced a worldwide shortage of funds and Japanese companies were valued highly for their stability due to their large amounts of cash in reserve. As such, we should not dismiss this viewpoint as unreasonable. However, the cash stockpile began growing long before the crisis. If we consider the fact that Japanese household savings amount to about JPY 850 trillion, we could attribute the tendency toward being overly cautious and the propensity to save amongst the Japanese to a deep-rooted culture from years of dealing with earthquakes and other natural disasters.

If we consider these various factors, we will come to realize that Japanese corporate managers place emphasis on ensuring corporate continuity rather than maximizing corporate value. This is why they place a disproportionate amount of attention to D/E (debt to equity) ratios and credit ratings and hold an abundant amount of cash on hand to maintain peace of mind.

However, we cannot deny that the idea that "it is reasonable to constantly maintain an amount of substantial reserves in preparation for emergency situations such as the Lehman Shock" is puzzling. If companies do not take on some risk, there will be a lower chance of new high growth businesses emerging. Businesses will only shrink and, sooner or later, employment and consumption will gradually decline. The current standard of living will then become difficult to maintain. As such, we think that it should be socially recognized that it is most efficient for companies to maintain their cash reserves at a reasonable level while taking on a certain level of risk in their business operations.

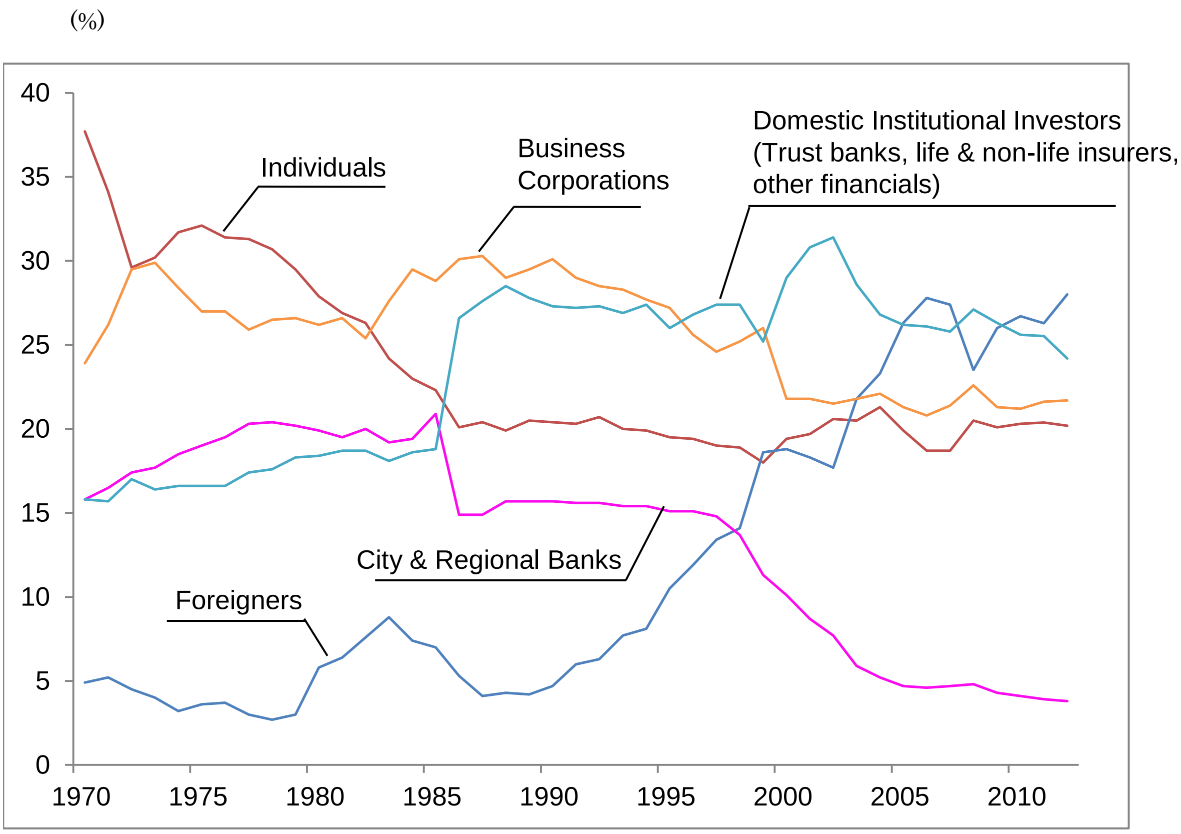
The ones to effect a change in the stance of managers of Japanese companies should be its shareholders. Normally, if there are no prospective investments, then it would naturally give rise to calls for some form of shareholder returns. Similarly, shareholders would logically raise objections if the company were to place focus on corporate continuity rather than shareholder value. However, Japanese shareholders do not normally express such discontent.

It is often reported that foreign investors account for about 60% to 70% share of trading in Japan's financial and capital market, however, their ownership ratio remains at around 30%. As such, Japanese still make up the shareholder majority. Even though the presence of activist investors has increased recently, they remain the minority and have yet to develop a presence that is strong enough to change the entire landscape.

In particular, a situation which is known as the Japanese business practice of cross shareholdings is, in a sense, an arrangement that combines all aspects of management wisdom that comes naturally to the Japanese who are known to place great emphasis on maintaining harmony and not want to stir up trouble. This is how Japanese companies have come to sustain good relationships with their clients and business partners and further ensure corporate continuity.

Since the 1990s, there has been reduced cross shareholding due to developments such as financial institutions unwinding their shareholdings, and companies now have to respond to a variety of opinions from their many shareholders instead of just a select group. However, the basic approach of the corporate management mindset toward shareholders has remained largely unchanged.

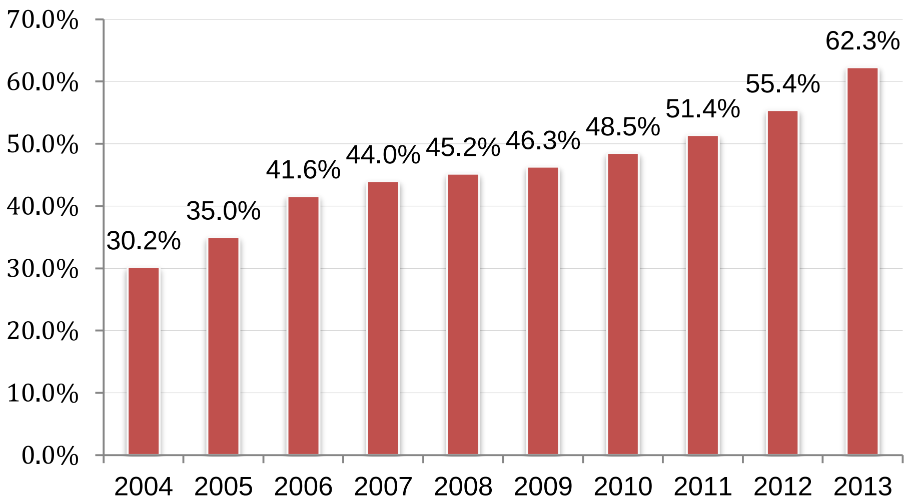
<Fig. 1-4　Shareownership by Category>



(Source: 2012 Shareownership Survey, TSE)

In terms of enhancing corporate governance, we have been advocating the merits of appointing outside directors to speak for shareholders and regulatory measures are being made with the planned amendments to the Companies Act and other laws. Statistics from TSE reveal that, as of the end of August 2013, 62% of 1st Section companies have appointed outside directors, and 47% have independent outside directors who are not likely to have conflicts of interest with general investors. Both these figures have risen significantly by about 7% and 8% respectively and indicate a growing trend toward appointing outside directors.

<Fig. 1-5 Appointment of Outside Directors>



(Source: "Appointment of Outside Directors at Companies Listed on Tokyo Stock Exchange," TSE)

(Note) From 2004-2009, includes JASDAQ-listed companies.

However, if the appointment of outside directors is only conducted in form, it cannot be said to contribute to a change in the mindset of corporate managers toward management efficiency or to consider shareholder interests. In other words, even at companies that appoint outside directors, there would be very few cases of outside directors expressing opinions to corporate management even if they held opposing views. It is a problem if the outside director feels obliged as a person appointed by the management and does not have a strong sense of purpose in their role to speak out against them. There is also opinion that shareholders do not have a clear understanding of outside directors and their role in speaking for them and representing their position. This could be due, in some part, to the vague position and role of outside directors in the legal system and incentives for their appointment, such as their decisions having legal effect to a certain extent (for example, US laws which consider and respect the decision of an outside director in litigation, for instance in a shareholder derivative suit), being insufficient.

In light of the above situation, the factors for not addressing or rectifying the low profitability of Japanese corporations are:

1. The negative incentive of having to hold a large amount of cash due to peculiarities in the bankruptcy and employment laws.
2. A lack of public awareness on the role of outside directors in speaking for shareholders, and a legal system that does not facilitate outside directors to fulfill their roles.
3. The view that the role of corporate management is to ensure the sustainability and survivability of the company rather than to offer appropriate returns to people who provide risk money.
4. Cross shareholdings and similar arrangements give rise to a tendency for cosy relationships between companies and their large Japanese shareholders, which creates a situation where they do not feel the need to strongly request the company to raise profitability.

These are probably the aspects that need to be addressed.

Based on this understanding of the current situation, we went on to consider concrete measures toward improving the profitability of Japanese corporations.

3. Proposals ～～～～～～～～～～～～～～～～～～～

① The negative incentive of having to hold a large amount of cash due to peculiarities in the bankruptcy and employment laws

If the legal system is causing companies to hold excessively large amounts in cash and deposits, which in turn impacts upon corporate profitability, then the most straightforward way would be to amend the necessary regulations. For example, we could refer to the German legal system and amend the regulations related to corporate restructuring and employment practices so that prior estimates can be made for the amount of funds to be kept in reserve for possible future crises. Accordingly, this would lessen the negative incentive for maintaining excess cash and deposits.

② A lack of public awareness on the role of outside directors in speaking for shareholders, and a legal system that does not facilitate outside directors to fulfill their roles

Presently, the position of outside directors is not clearly defined and there is a possibility that both shareholders and companies are not sufficiently cognizant of the nature of the role that outside directors should fulfill. Rather than simply having an audit or advisory function, they should probably fulfill a role which entails placing greater focus on the perspectives of shareholders in checking on business execution by company management, whether their activities are in conflict with the interests of shareholders and whether the company is conducting business that generates returns for shareholders.

In order to achieve this, we should revisit the role of outside directors in ensuring that company management conducts proper supervision of business execution, or refraining from being too conservative and turning down revenue expansion opportunities. There is a need for more proactive moves to allow outside directors, in their individual capacities, to further fulfill the expectations of shareholders and society.

If an outside director is required to commit his/her time to a single company, it would become unrealistic for a single person to hold multiple outside directorships, and this will lead to concerns over the lack of eligible persons.

However, if outside directors are highly capable of making decisions as representatives of shareholders, they should effectively be viewed as their spokespersons. As a result, it may be worthwhile to consider establishing a legal framework that regards board approval of a management decision as having obtained quasi-shareholder approval.

If outside directors fulfill such a check function and management decisions become viewed as appropriate in this way, this would significantly lower the risk of shareholder derivative suits even at companies that are constantly exposed to such risk. The legal infrastructure in the US provides for litigation committees that involve outside directors. In this way, the system considers and respects the decision of an outside director fulfilling checking functions and this is taken into account when the legal responsibility of the management is considered. If a similar framework is implemented in Japan, company management would then be able to take on substantial risk to develop new businesses and as a result create better conditions for improving overall corporate profitability. This process would allow the appointment of outside directors to have a positive effect on bringing Japanese companies out of low profitability.

The upcoming amendments to the Companies Act involve the addition of independence requirements for outside directors such as not being from the parent company and not having blood relations, and the introduction of a "supervisory/audit committee company," a new governance structure for stock companies. While we welcome these regulatory changes to facilitate the supervision of business execution by outside directors as spokespersons for shareholders, we think that there should be an effort to continually modify the legal infrastructure and regulations to make conditions even more conducive.

③ The view that the role of corporate management is to ensure the sustainability and survivability of the company, rather than to offer appropriate returns to people who provide risk money

If it were a problem in the legal framework like in 1 and 2 above, amending laws would improve conditions, but if the issue is due in part to awareness or understanding, it would not be as easy to resolve. However, in terms of constructing an environment to facilitate management from shareholder perspectives and urge a move away from conservative thinking, it may be effective to encourage the active implementation of incentives based on company stock (e.g., performance shares, restricted stocks, and such equity incentive compensation plans widely adopted in the US and Europe). Having corporate managers hold equity would make them shareholders and they would probably become more aware of shareholder value in the course of managing the company.

④ Cross shareholdings and similar arrangements give rise to a tendency for cosy relationships between companies and their large Japanese shareholders, which creates a situation where they do not feel the need to strongly request the company to raise profitability.

With regard to this aspect, social pressure is increasing on non-stable shareholders to voice their opinions. In particular, this refers to pension funds and other institutional investors that hold large amounts of shares in the company. This must begin with an exchange of views on concrete management strategy with company management. Once a channel for communication is established based on a set of rules, company management will feel substantial pressure to raise profitability.

Another important aspect for fostering rulemaking by each institutional investor is to change the governance structures of the institutional investors themselves. It will be necessary to create an environment where the principles of competition apply and where the final beneficiary has access to material for selecting asset managers such as a set of guidelines on the investment strategy.

A Japanese version of the stewardship code is currently under discussion, and we would welcome discussions made with a focus on enhancing corporate value from the medium- to long-term perspective, including raising the profitability of Japanese corporations. In addition, we look forward to them not just being changes to the formal or structural aspects but instead forming a set of rules that consider various aspects. They should also bear substantial significance, rather than just emphasizing several superficial criteria such as holding meetings with company management several times a year. However, communication will not serve the long-term goal of enhancing corporate value if institutional investors simply voice their opinions without a proper understanding of the efforts of company management and the challenges they face. As such, we hope that the Japanese stewardship code will not become simply a feedback channel comprised of one-way traffic from institutional investors to listed companies, but also look forward to it driving a trend toward more flexible asset management practices and procedures at institutional investors.

In addition to the proposals on the above 1. to 4., the workshops offered some highly interesting perspectives on how to invigorate the capital market.

For example, in relation to the factors behind the low profitability of Japanese corporations, from the point of view of a prospective buyer in an M&A deal, there was a comment that the rules on the possible courses of action by acquisition targets or tax treatment on capital gains are not necessarily clear, and it does not encourage them to consider an M&A deal. As a result, the already rare opportunities to utilize cash and deposits are getting even rarer and there is over competition in certain fields due to an influx of new players, which in turn gives rise to a negative impact on corporate profitability.

On this aspect, while it is important to make provisions for measures against various damages arising due to a coercive takeover, it is also important that the rules for such measures make economic sense. As such, we think that it is necessary that we refer to similar rules and measures in countries like Germany and the US and develop a framework that is consistent, and modify it so that prospective buyers can anticipate subsequent action by the acquisition target and resultant tax treatment.

With regard to insider trading regulations, there was a comment that the bizarre situation in Japan makes it very hard for officer-level persons at major Japanese companies to buy stocks. In Japan, the law recognizes a decision as insider information at an extremely early stage, and depending on the field, an officer may constantly be exposed to insider information. This law effectively excludes an entire group of high-worth investors from the market. While there are ETFs and other products, these may not necessarily be sufficient to satisfy their investment needs.

It is evident from the discussion on the stewardship code that there is a certain consensus on the importance of communication among fund managers and companies. However, the current insider trading regulations in Japan would severely restrict the information that the company is able to share. As such, while the insider trading regulations are poised to become even stricter toward information dissemination by listed companies, there was the opinion that if there were moves, such as discussions on the stewardship code, seeking to encourage the flow of information from listed companies to institutional investors, then there would also need to be discussions on how to strike a balance between the two sets of regulations.

Besides these, on the general opinion toward stocks, there was a comment that investing in stocks seems to have negative connotations of improper intent. In particular, many politicians are subject to such criticism. On the other hand, there are calls for people to take on risk by investing in stocks and contribute to a more dynamic and lively financial and capital market. These two messages are highly contradictory. To change this misguided perception of participation in the stock market, there must be a dedicated effort in proper financial education.

For example, honest poverty is often viewed as a virtue, particularly in Japanese society, and being attached to money still has negative connotations. Even today, Japanese society has low regard for receiving dividend because it is viewed as gaining profit without work. Obtaining returns from investments which involve risk is extremely logical and natural as an economic activity and, in fact, is a highly intellectual process of value creation. While we acknowledge the importance of conducting financial education in a structured, consistent manner, we could also consider the option of calling upon politicians and thought leaders to come forth to say in the media that investing in stocks is a highly intellectual economic activity, and urge people to invest and hold stocks because it would help to make Japanese society even more affluent.

Incidentally, interest in the market among retail investors is growing with the impending launch of the NISA program in January next year. Such developments create welcome excitement in the market. We should view these moves not as temporary measures but as part of the larger effort toward broadening the domestic and overseas investor base over the long-term, which would then truly invigorate the market. In order to achieve this, we must continue to dedicate our energies toward raising the attractiveness of the Japanese market by raising the profitability of listed companies, to transform the market and enhance its appeal for all investors.

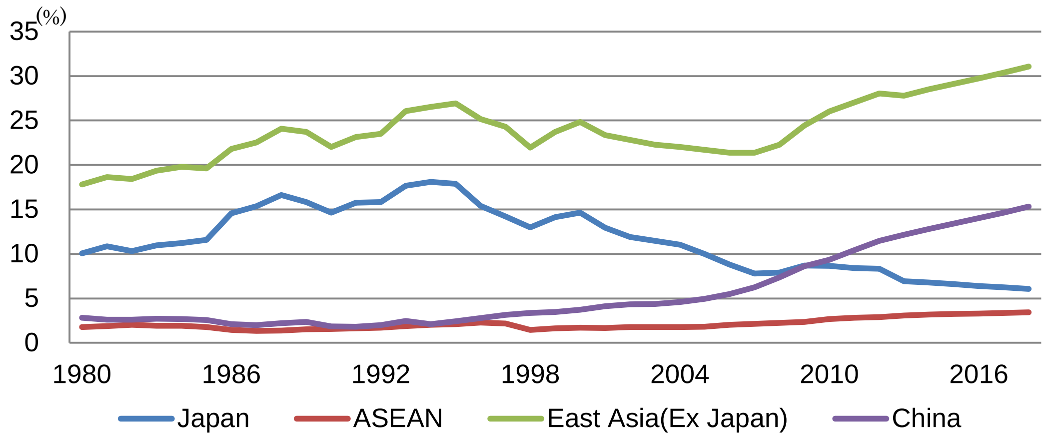
II. The Role of the Japanese Capital Market for Harmonized Growth with Asia

1. Issues Identified by JPX～～～～～～～～～～～～～～～～

Asia’s (ex-Japan) share of the global GDP expanded from 25.4% in 2000 to 28.7% in 2012. Additionally, the IMF estimates that figure to increase to 30% by 2018, making it highly likely that Asia will be the center of global economic growth in the future.

At present, China’s economic growth is overwhelming other countries in Asia. However, the Chinese working population is approaching its peak in 2015, after which it will begin decreasing. In contrast, Malaysia, the Philippines, Indonesia, Vietnam, and other ASEAN countries will see their working populations continue to grow for the next 10 to 30 years and are expected to maintain high economic growth.

<Figure 2-1: Share of Global GDP>



(Source: IMF)

Despite delays in preparations for the establishment of the ASEAN Economic Community (AEC), gradual progress is being made. If productive efficiency in the region can be optimized through economic and regulatory integration, the global economic presence of ASEAN countries will be greatly elevated. Recently, concerns have been growing regarding the slowdown of economic growth in emerging countries overall. Even so, it cannot be denied that Asia will be a major part of global economic growth in the medium-to-long term.

On the other hand, the mature Japanese economy has not surpassed a growth rate of 3% since 1992, with an average of 0.9% which fails to meet the global average figure. Furthermore, given Japan's already shrinking working population, Japan will need to incorporate the economic growth of Asia, its geographic and cultural neighbor, in order to survive.

Looking at recent economic relations between Japan and Asia, many industrial production bases were moved from Japan to regions with lower labor costs like China and ASEAN countries due to the strength of the Japanese yen following the Plaza Accord. As a result, trade and direct investment between Japan and Asia has increased steadily.

Additionally, Japanese banks are beginning to enter Asia in order to support the business activities of Japanese companies expanding in the region. However, there has been no significant change in the scale of securities investment between Japan and each Asian country, making it difficult to claim that financial relationships are developing as closely as the real economy.

In the near future, needs for asset management arising from the rapid expansion of middle-class incomes and fundraising needs of new venture companies are expected to rise rapidly. It is also expected that needs for investment aimed at enjoying returns from Asian economic growth will also expand within Japan. These circumstances are creating an environment ripe for invigorated securities investment flow between Japan and Asia.

Strengthening the cooperative relationship between Japan and Asia in financial areas will also promote the further development of the Japanese capital market. Additionally, the Japanese capital market can achieve harmonized growth with Asia by supporting the growth of real economy within the region, thereby contributing the benefits of such growth to the Japanese economy and forming a foundation for its revitalization.

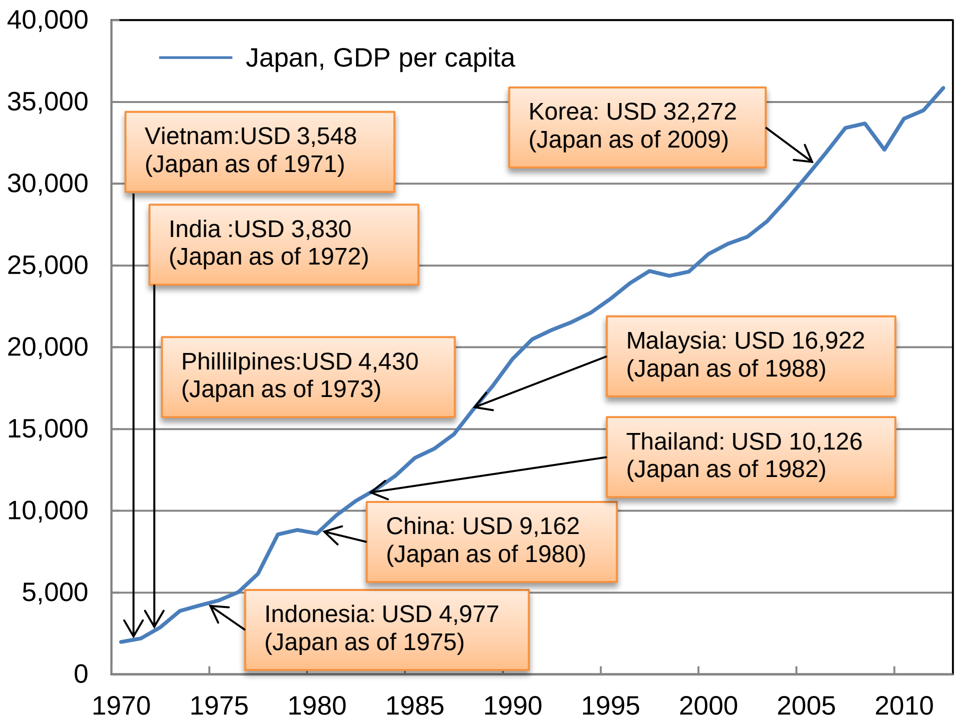
JPX, as a capital market operator, is conscious of the great significance of the role it can and should play in this environment where Japanese capital markets are drawing attentions due to recent favorable market conditions.

In consideration of the above, JPX gathered a group of experts to discuss and analyze these issues in a workshop regarding "JPX's Role within Asia." The following is a summary of the “Proposals from JPX regarding the role of the Japanese Capital Market for Harmonized Growth with Asia” in which the opinions of the workshop have been collected.

2. Current Analysis ～～～～～～～～～～～～～～～～～～～～

By viewing economic growth in Asia using the disparity in GDP per capita within the region, it can be seen that China and more developed ASEAN countries are at a level equivalent to Japan 30 years ago, while developing ASEAN countries stand at a level closer to Japan 40 years ago. It is expected that this 10-year gap will be greatly narrowed in the future.

<Figure 2-2. Asian GDP per capita>



(Note: GDP based on purchasing-power-party per capita)

(Source: Daiwa Research Institute)

Additionally, when viewed from industrial development stages, Asia can be divided into 4 groups. The first group includes Japan, Hong Kong, Singapore, which have progressed to the mature, tertiary stage of industrialization. In the second group, countries like China, India, and the Philippines have begun to enter the tertiary stage of industrialization. The third group consists of core ASEAN countries, like Malaysia, Thailand, Indonesia, and Vietnam. This group is progressing in the secondary stage of industrialization. Finally, the fourth group features Laos, Cambodia, Myanmar, and other less-developed ASEAN countries. These countries are currently rushing to enter into the secondary stage. Due to the large amount of investment needed for second-stage industrial progress, it is clear that ASEAN countries in particular will generate a significant demand for capital. How this demand will be provided for is an issue of great importance to all of Asia.

In the past 5 years, Japan's direct investment in Asia has increased 1.5 times. However, much of this investment has been allocated toward China (securities investment remains flat). More recently, direct investment in South East Asia, including investment by small and medium enterprises, has been on the rise, and support is expected to increase on the capital and software fronts toward local business development. Furthermore, investment in Japanese securities from Asia has risen 2.5 times. With most of the increase originating from China, the majority is investment in short-term government bonds. Separate from this, Chinese sovereign funds are estimated to invest JPY 4.5 trillion in the Japanese stock market.

In this way, the Greater China region of China, Taiwan, Hong Kong, and Singapore are demonstrating their incredibly large economic presence. It is thought that most of the direct investment into Asia is by the Chinese. As such, the Asian region has strong connections to China, which must be kept in mind when formulating specific strategies.

<Figure 2-3. Domestic/Foreign Direct Investment >

(JPY 0.1 Bil)	Asian Country Total		China		HongKong		Korea		India	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
2007	150,434	10,622	42,756	141	10,327	2,603	13,691	785	4,771	15
2008	144,060	15,139	44,239	203	10,577	2,892	10,996	1,115	8,523	16
2009	161,822	15,971	50,713	181	12,021	2,447	11,611	1,330	8,275	29
2010	173,379	18,975	54,187	325	12,668	3,297	12,261	1,576	11,051	33
2011	199,941	20,689	64,677	435	13,286	3,556	13,938	1,726	11,958	40
2012	249,399	24,099	80,463	476	15,868	4,976	22,093	2,461	13,040	48

	Singapore		Thailand		Phillipines		Malaysia		Indonesia		Vietnam	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
2007	19,893	5,226	22,371	50	6,538	52	9,258	1	9,405	10	1,936	0
2008	17,615	9,071	18,533	55	7,042	55	6,990	7	7,699	11	2,986	0
2009	21,750	9,796	20,957	73	7,542	55	7,386	199	8,744	11	3,089	0
2010	22,417	11,331	22,651	82	7,081	55	8,128	375	9,738	49	3,668	0
2011	24,592	12,435	27,287	86	7,932	55	8,697	427	12,269	48	4,941	0
2012	31,130	13,278	30,247	112	8,959	57	11,491	439	15,906	47	7,264	0

<Figure 2-4. Domestic/Foreign Securities Investment>

(JPY 0.1 Bil)	Asian Country Total		China		HongKong		Korea		India	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
2007	88,282	147,711	17,671	47694	20,920	29,566	15,690	9,902	7,506	69
2008	46,874	123,958	5,449	47386	9,190	18,078	16,386	6,999	2,568	585
2009	64,254	131,651	12,079	34253	15,148	11,972	11,963	7,612	4,758	253
2010	73,068	264,362	11,382	138360	14,691	24,144	14,674	7,841	5,066	216
2011	64,672	339,818	8,277	215233	11,280	22,911	17,316	7,262	4,010	237
2012	81,694	374,423	9,021	246425	14,699	25,322	20,969	8,799	4,496	250

	Singapore		Thailand		Phillipines		Malaysia		Indonesia		Vietnam	
	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
2007	12,898	45,489	2,019	6,512	2,226	149	3,681	4,235	1,634	326	79	1
2008	5,825	33,622	1,056	7,267	1,410	3,838	2,448	3,053	999	247	24	73
2009	9,249	40,431	1,643	26,118	1,508	3,989	2,848	3,190	2,266	1,732	54	80
2010	10,934	55,223	2,029	26,155	2,613	6,437	3,767	1,558	4,879	1,834	212	50
2011	9,484	59,699	1,865	20,500	2,200	8,436	3,427	997	4,679	1,333	109	150
2012	13,051	56,331	2,667	24,576	2,635	7,358	4,913	916	6,528	731	169	391

(Source: Daiwa Research Institute)

How to proceed with the establishment of infrastructure is another issue for the Asian region. Infrastructure investment is showing large growth across the world. The USD 500-600 trillion in investment funds seen in 2000 has grown to exceed USD 1,800 trillion. However, the level of investment in Asia has long remained around USD 20 billion (approx. JPY 2 trillion). When compared to the amount used in the restoration of the Great East Japan Earthquake (JPY 19 trillion in 2011 and JPY 3-5 trillion annually afterwards), the startlingly low amount of infrastructure investment in Asia becomes clear.

According to estimates, Asia as a whole will need JPY 820 trillion for infrastructure investment over the next 10 years. This means that over JPY 80 trillion will be required annually, which leaves a large gap in demand and supply, given the JPY 2 trillion per year being invested currently. Across Asia, there is an excess of savings in the private sector. The issue of how these assets can be used is an important issue, particularly what support Japan, with its abundant savings, can offer as a source of funds.

In the past, Japan has offered support for the development of the Asian financial and capital market in a number of ways. For example, in order to utilize Asian savings toward investment in the region following the Asian Currency Crisis, Japan promoted the Asian Bond Markets Initiative. Currently, issuance in the Asian bond market has expanded from USD 1 trillion in 2002 to USD 6 trillion in 2012. Additionally, Japan has contributed to the Asian financial and capital market through the provision of financial systems, knowledge of market supervision, and other measures.

In the long-term, there is no doubt that financial/securities trading will greatly increase as corporate development and the rise of middle-class incomes continues alongside expected economic growth in ASEAN countries. Just as it was with Japan, these countries will require the establishment of a financial and capital market which matches their stage of economic development. Japan must reexamine how it can contribute to promoting use of the financial capital market, as countries all over the world plan for expansion into Asia.

<Figure 2-5. Change in Market Capitalization and No. of Listed Companies in Asian Stock Markets>

USD 0.1Bil	Market Cap		Listed Companies	
	2003	2012	2003	2012
China	5,130	36,974	1,285	2,494
HongKong	7,146	28,319	1,037	1,547
India	5,320	24,978	6,535	6,856
Indonesia	547	4,282	333	459
Korea	2,982	11,794	684	1,784
Malaysia	1,608	4,666	901	920
Phillipines	232	2,293	236	254
Singapore	1,485	7,651	551	776
Taiwan	3,790	7,353	674	840
Thailand	1,190	3,898	419	558

In the future, the growth of financial markets of Asian countries will provide an opportunity for the Japanese market. At present, assets held in pensions and other savings in Asian countries are managed using domestic financial products, leading to a strong home country bias. However, the need for internationally diversified investment is expected to increase with the expanding scale of assets under management, and it is thought that international diversification will become an increasingly prominent option for asset management. Though gradual, the balance of securities investment in the region is actually increasing, and, possibly resulting from experience with the Asian Financial Crisis, diversified investment is on the rise. Additionally, there have been some signs of transitions from bond investment to stock investment as stock exchanges develop.

Based on these circumstances, it is vital that we think of means to pro-actively encourage Asian pension and sovereign wealth funds to choose Japan as a venue for their asset management and hold Japanese stocks and other financial instruments. Stimulating long-term and stable investment in Japanese stocks by Asian countries will both increase the liquidity of the Japanese stock market and generate stable returns for those Asian countries. We believe this will contribute to a mutually beneficial relationship between Japan and Asia.

As stated above, finance is expected to serve the following roles in Asia:

① Provide funds for investment in the second stage of industrialization, which is expected to act as an economic growth engine in lesser developed ASEAN countries (investment in large-scale production facilities and technology/personnel investment to improve productivity)
② Provide funds for the establishment and improvement of infrastructure needed for industry and daily life (stable electricity, plumbing)

The most realistic sources of these funds are the rich private sector funds in over-saving nations such as Japan and China. Deliberation is required regarding how best to distribute such funds, as well as the following points:

③ How can Japan support less developed ASEAN countries in order to establish a framework for indirect/direct financing to facilitate fundraising in their local markets?
④ How can Japanese financial instruments be positioned as a destination for investment for effective management of growing pension, etc. assets in Asia?

3. Proposals ～～～～～～～～～～～～～～～～～～

① Provision of funds for investment for the second stage of industrialization

In the process of Asian economy development, the large role of conglomerates or family-owned companies, in addition to that of the state/government, is a trait shared by many companies in the region. It is also a fact that many among them have been dependent on indirect financing from other group companies. While changing this basic framework will be difficult, recent advances have reduced the time and costs associated with cross-border financial transactions and communications, meaning that funding from overseas financial institutions is also an option.

Of course, many countries still have restrictions on foreign investment and fund transfers. These issues can be minimized via the pro-active local expansion of

Japanese financial institutions and their support for local Japanese companies. As the next step, such financial institutions can enhance their abilities to lend funds to local corporations, thereby facilitating the use of Japanese individual assets within the Asian region.

In particular, during crises like the Lehman Shock, Japanese financial institutions have received international praise for their stability despite the lack of liquidity in global markets. We believe this strength can be used as a selling point to differentiate Japanese institutions from local ones. While financial institutions have been entering Asia recently, we believe this trend should be recognized as an important national strategy, and government efforts should be formulated to support it. This includes seeking to open up local financial services markets to support the entry of securities companies and asset management companies, which have lagged behind banks.

Additionally, as the fundraising amounts grow, the merits of the bond market become more apparent in comparison to bank loans. While OTC transactions are the norm for bonds (off-board bilateral trading), Asia lacks the large intermediaries which exist in the US and Japan, leaving it as a secondary business for banks. The Asian Bond Market Initiative has had success in cultivating a bond market up to now. However, we believe furthering this initiative will diversify and vitalize fundraising methods for local corporations.

Alternatively, because TSE's TOKYO PRO-BOND Market has no restrictions on the denomination of fundraising, it can provide Asian companies with access to the funds of Japanese professional investors. As such, we believe that it is vital to promote awareness of this convenient market within Asia.

② Provision of funds for the establishment of infrastructure

In relation to raising large amounts of funds for the establishment of infrastructure within Asia, TSE is proceeding with preparations to open a listed infrastructure market in 2015. Of course, since listed products will be expected to provide returns on investment, the market will be limited to infrastructure projects that can produce cash flows to generate stable returns. However, we believe there is a wealth of Asian infrastructure projects capable of meeting this requirement. We view the listed infrastructure market as a great opportunity for the Japanese financial market to act as a large fundraising venue.

③ Support of Developing Asian Capital Market Functions

At present, Asian corporations rely on banks for most of their fundraising needs. Continuing this reliance on indirect financing has the potential of stunting improvement of quality and efficiency of financial services overall. As such, the prompt establishment of a framework for direct financing is vital.

At the very least, opening a path to fundraising via direct financing in the securities market would alleviate the unease that accompanies periodic bank instability and credit crunches, which have plagued Asia in the past.

Most countries in the region have already established stock markets, with the exception of Myanmar and a few others, and we believe they share a common awareness regarding this matter. However, given that rules and operations remain less developed than those of Japan, we feel that discussions should be conducted regarding support for improving this area.

However, due to the significant costs associated with the export of core systems and the need for customization according to local needs, it is extremely important that negotiations be conducted in close coordination with the Japanese government to present a unified "All-Japan" front. In this field in particular, Korea has had success leveraging its strengths with the solid backing of its government. The promotion of technical support for financial infrastructure was mentioned in the "Japan Revitalization Strategy" announced in June 2013. Implementing this will require a strong support framework involving both the public and private sectors.

Additionally, countries with still developing stock markets have established a variety of restrictions for capital transactions in order to cultivate their own markets. In light of this, it will be necessary to advance talks with those governments on revising regulations which are a barrier to fundraising and smooth transactions within the region, while taking into account stages of market development.

④ Facilitating Use of Japanese Financial Instruments for Asian Asset Management

Pensions and sovereign wealth funds of Asia are expected to increasingly engage in internationally diversified investment when managing their assets. In order for Japanese stocks and other financial instruments to be positioned as potential destinations for these funds, we must see an increase in the profitability of Japanese corporations alongside activities aimed to promote Japanese stocks to pensions and other institutional investors at an early stage.

Additionally, we believe that the timing is right to promote the Tokyo market's evolution as an international financial center in order to ease the entry of Asian financial institutions into the Japanese market. For example, government measures that identify Tokyo as an international strategic zone which offers special treatment to Asian financial institutions would incentivize expansion into Tokyo and demonstrate a dedication to becoming an international financial center, thereby attracting global interest.

At present, there are many difficulties facing Japan-China relations. In this environment, China has already taken action toward a national strategy involving the Asian financial market through Hong Kong Exchange's acquisition of the London Metal Exchange and the start of RMB-clearing arrangements.

Against the backdrop of China’s growing global presence, not only Hong Kong, a gateway to China, but also Taiwan and Singapore are pursing collaboration and alliance with China as a national strategy.
If Japan just waits and does not act now, the Japanese market's influence in Asia will gradually decline. In order to prevent this from happening, Japan needs to work on a government level, while observing the actions of China, to devise a market strategy which will improve its presence.

Viewing the amount of trade between Japan and China, it is clear that China is a vital partner. Also, with the growing amount of RMB-based clearing, we believe it would be prudent to strengthen cooperative efforts with China once again. While further developing the direct RMB-JPY clearing, which began in June 2012, is a matter of course, we also need to consider promoting the issuance of RMB-denominated bonds and establishing Tokyo as a venue for RMB, JPY, and USD-based international currency clearing.