



**Recommendations  
of the  
EU-Japan Business Round Table  
to the Leaders of the European Union and Japan**

Tokyo, 3 & 4 April 2012

**Working Party D  
Financial Services, Accounting and Tax Issues**

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## List of Abbreviations

<b>Abbreviation</b>	<b>Meaning</b>
FSB	Financial Stability Board
EMIR	European Market Infrastructure Regulation
MiFID	Markets in Financial Instruments Directive
OCI	Other comprehensive income
APA	Advanced Pricing Agreement
FATCA	Foreign Account Tax Compliance Act
PPC	Policyholder Protection Corporation
FSA	Financial Services Agency
EIOPA	European Insurance and Occupational Pensions Authority
EU TPD	EU Transfer Pricing Agreement
VAT	Value-Added Tax

## Recommendations from both European and Japanese industries

### WP- D / # 01 / EJ Issues to be mindful of when proceeding with reform

- Regulation on the financial sector should be implemented looking ahead the broader economic implication
- An excessive 'ring-fencing' in each jurisdiction and duplication of regulations have to be avoided with effective supervision and international coordination
- Consider local specificities of each country and region when discussing regulation in a global context

< Background >

#### Overview

There is a need to revitalise global economic growth and restore confidence. Regulation should be designed and implemented looking ahead the broader economic implication; otherwise the financial sector may be safer but not able to fulfil its role to support economic recovery.

Regardless of how superior regulatory architecture is built up, the key to develop a resilient and efficient financial system will eventually rest upon effective supervision and coordination.

In this respect, the BRT is strongly concerned if excessive ring-fencing policies were pursued in each jurisdiction in a different manner. To address the so-called 'too-big-to-fail' issue properly, the BRT appreciates the ongoing, serious efforts by the authorities around the world to develop an effective cross-border resolution regime and prepare recovery and resolution plans. This requires very sensitive and highly intense international coordination and cooperation among the regulators. However, banks are now struggling with the requirement to build up much stronger liquidity buffers than stipulated under Basel III from various host country requirements for local 'ring-fencing'. Without a more carefully coordinated approach, some host countries might opt for ring-fencing policies, increasing demands on banks to build up additional liquidity buffers, resulting in more deleveraging and pose negative effects to the real economy, including in those host countries.

To minimise the risk of these regrettable consequences occurring, more focus should be placed on encouraging consolidated banking supervision by home country regulators, which is one of the most efficient international regulatory frameworks that authorities around the world have developed to date.

Taking into consideration local specificities of each country and region

Regulation needs to fully take into account circumstances that are specific to each country and region, the variety of financial players, and respect their business models and their time horizons. The different economics of financial activities and market mechanisms should be appropriately reflected in the new regulatory regimes.

According to “Basel III”, investments in the capital instruments of banking, financial and insurance entities would be deducted. However, for countries where reciprocal cross holdings in the capital between financial institutions are prevalent, sensitive handling such as giving an adequate transition period would be necessary.

Regulatory capital instruments such as contingent capital or debt instruments with bail-in clauses designed by financial regulatory authorities need to be introduced with sufficient consideration for market capacity.

Current policy discussions for tightening regulation and oversight over shadow banking system, led by the FSB, needs to carefully consider if any unintended consequences or risks to regulatory arbitrage were induced. Apart from wider systemic risk regulatory perspective, the authorities should give due consideration that any additional rules affecting existing market mechanisms or well-established market practices may hinder legitimate role of financial intermediaries and disturb other bona fide business activities.

For completing successful global financial sector reform, the BRT believes that internationally consistent regulations should be built and implemented with level-playing field among players and markets through multilateral discussions on a global basis. Among other things, the impact on the revitalisation of global economy growth and cumulative impacts due to each regulatory reform when they are concurrently being implemented should be taken into account fully.

**WP- D / #02 / EJ to EJ US Regulations**

- The European and Japanese authorities and industries should unite their efforts to ensure an internationally consistent and level-playing field implementation of US regulations while preventing excessive extra-territorial and other prejudicial application thereof

< Background >

To ensure the continuation of smooth cross-border financial service and market activities, it is essential for the regulators both in Europe and in Asia to fully coordinate their initiatives for effectively responding to any extra-territorial effects of US laws and for avoiding any overlaps, prejudicial treatments as well as regulatory

uncertainties as to application of US regulations. For the derivatives market and business, it is particularly important that regulators in both sides of the Atlantic fully coordinate and streamline all requirements for the trading, clearing and reporting of swap transactions as well as associated dealer registration or other licensing requirements, each element of which is currently envisaged under the proposed EMIR (European Market Infrastructure Regulation), the MiFID Review (Markets in Financial Instruments Directive) and the US Dodd-Frank Act. There is a special US-EU task force focusing on implementation of mandatory central clearing of derivatives. Such dialogue should include other areas where extraterritoriality or inconsistent and discriminatory applications could be an issue for non-US parties, such as possible impact anticipated under the proposed US Volcker rule.

#### **WP- D / #03 / EJ to EJ Liquidity in secondary markets**

Maintain liquidity in secondary markets

##### < Background >

One of the most significant risks proven as a factor leading up to the recent financial crisis is an abrupt deterioration or dry-up in market liquidity, particularly in secondary markets. Although current regulatory reforms should move forward in order to prevent the next crisis, due consideration should be given not to weaken the functioning of capital market through affecting availability of liquidity in secondary markets. This is more critical for those countries where capital markets are under developing stage, such as Asian countries. It is well known that Asian countries are expected to continue to be a driver of global economic growth. In these countries, however, the role of capital markets is not as widely spread as western countries and their financial system is primarily based on traditional banking and lending market, even today.

In addition, current design of the Basel III new liquidity standards is becoming another factor to affect market liquidity. For instance, these new liquidity standards incentivise banks to hold more sovereign debts while rejecting to accept other tradable liquidity assets in the markets such as listed equity and gold. The standards also treat sticky deposit funding preferentially as opposed to market-based funding such as securities financing, which is the most efficient tool of funding for market-makers in relevant asset classes. These risk raising costs in various activities in the capital markets, thereby reducing the number of players and the depth of the capital markets, and possibly widening bid and ask spreads, resulting in higher costs for end users. If lower level of liquidity in secondary markets and credit constraints due to the new capital requirements for banks should happen in such countries, credit availability for companies will be severely affected both in the capital market and the banking system. This could limit the ability of companies to invest and hire, and the capacity of households to smooth spending, resulting in a negative impact on wider economic activities and raised concern about future growth.

#### **WP- D / # 04 / EJ to EJ Accounting Issues in EU and Japan**

- Net unrealised gain on available-for-sale securities recognised as other comprehensive income (OCI), dividend recognised as net income but realised gain as OCI, not net income.
- Actuarial gains and losses on employee benefits should be recycled.
- Operating and finance leases should be treated separately.
- The use of direct method in cash flow statement would not add benefit.

#### **WP- D / # 05 / EJ to EJ Tax Issues in the EU and Japan**

- All EU Member States and Japan to modernise tax treaties. Tax treaties should ensure to the greatest possible extent that dividend, royalty and interest payments are exempted from withholdings taxes and provide for corresponding adjustments and arbitration.
- Harmonise and simplify documentary requirements in transfer pricing taxation and promote the conclusion of bilateral and multilateral APAs.
- Introduce participation exemption and exempt dividends and capital gains received from business investment from further corporate taxation.
- Avoid introducing tax regulation focusing on specific industry or category of business, such as a Bank Tax, which could lead to distortion in the allocation of resources and economic activities in the private sector
- Japan and the EU have to work together to convince the United States to prevent the negative aspects of the Foreign Account Tax Compliance Act which is applying to foreign countries as well.

#### **< Background >**

Each country's government has now been considering to reform the domestic tax system and/or to introduce the new one both in the aspects of taxation and execution, to prevent the international tax avoidance and to ensure the power to levy the tax. On the other hand, the feasibility and the social cost and benefit have to be fully considered when the power of capturing the tax evasion is reinforced, as promoting the global investment is more and more important to stimulate the economy.

Non-US countries are concerned that under the Foreign Account Tax Compliance Act (FATCA) in the United States, it would be highly probable that people who are neither American nor residents in the US have to pay the federal tax regardless of where the income source comes from (the concept of path-through payments). They are also concerned that FATCA could cause a lot of trouble in the broad range of business practice as to investment in financial instruments including the deposits and securities.

## Recommendations from both European and Japanese industries to Japan

### **WP- D / # 06 / EJ to J Financial Services Issues in Japan**

Japan Post should not expand its business area and/or raise the cap of Japan Post's insurance policies and postal savings if it is not paving the way for selling its equities which the Japanese government owns.

### **WP- D / #07 / EJ to J Life-Insurance Policyholder Protection Corporation**

Change Life-Insurance Policyholder Protection Corporation to a post-funded scheme and reduce amount required to be funded.

#### < Background >

The current framework for Japan's life insurance Policyholder Protection Corporation (PPC) was extended for three years in April 2009. The system depends on a constant amount of money (400 billion yen) being held in reserve, for use whenever a company needs to be "bailed out". This money is collected and managed by the secretariat of the PPC. A move to a post-funded scheme would be optimal, as it would remove the unnecessary burden of providing early funding to the PPC. A pre-existing PPC fund is a potential moral hazard as it reduces the onus to find a market based solution, and raises costs for well-managed funds.

In addition to the move to a post-funded scheme, the total amount of money in the fund should be reduced to better mirror the market situation as well as the improved regulatory framework introduced by the Japanese authorities.

### **WP- D / #08 / EJ to J Enlarging business scope of financial institutions**

Enhancement of consumer convenience by enlarging business scope of financial institutions (e.g., insurance sales through banks)

< Background >

There are, still some areas of the market that insurance companies cannot access through bank sales – notably the sales of insurance through banks to any companies and the employees of companies of less than 50 employees, where the company is borrowing money from the bank. The FSA undertook to review this rule three years after the first liberalisation took place in 2007. The main reason given for not fully liberalising the bank sales channel in the first place was that the FSA feared the banks would use their superior bargaining powers to force clients to buy unnecessary or inappropriate insurance policies. The concerns that the FSA might raise concerning forced sales or misuse of information are more than adequately addressed in the banks' code of conduct.

**WP- D / # 09 / EJ to J Accounting Issues in Japan**

Maintain conventional treatment for recycling even after the convergence of Japanese standard to IFRS

< Background >

Under IFRS, income is classified into “net income” and “other comprehensive income.” The BRT requests organising the concept of a profit and the range of recycling in the early stage. In particular, “net income” is regarded as the basis of performance indicators in Japan and compatibility between the Companies Act and the Tax Code is secured. Therefore, the conventional treatment for recycling should be maintained even after the convergence of Japanese standards to IFRS advances.

**WP- D / # 10 / EJ to J Tax issues in Japan**

- Review 2012 tax reform limiting deductible interest to 50% of taxable income to:
  - exclude interest income subject to Japanese withholding tax
  - increase threshold to 300 million yen
  - introduce unlimited carry-forward of non-deductible interest and of unused amounts
  - limit pick-up of interest exceeding average world-wide group interest burden
- Transfer pricing :
  - Review transfer-price taxation based on international common models such as OECD model



- All cross-border transactions should be dealt with under transfer pricing legislation and not under domestic corporate tax rules relating to donations
- Consistency between transfer pricing methodology for audit assessment and methodology used in Advanced Pricing Agreement
- Tax authorities to accept and process applications for tax rulings and tax law to provide for right to request and obtain tax ruling

< Background >

The new rule limiting interest deduction to 50% of taxable income (after adjustments for interest and depreciation) under the proposed Tax Reform 2012 will curb foreign investment into Japan as it will cause double taxation of interest income in both the foreign investor's home country as well as in Japan. It will also create a burdensome need for local refinance in Japan in turbulent financial markets.

## Recommendations from both European and Japanese industries to the EU

### **WP- D / # 11 / EJ to E Issues to be mindful of when proceeding with reform**

Amongst the prevailing credit crisis in Europe the trend to tighten the regulations on financial institutions and to decrease the fiscal debt might be useful to avoid the foreseeable future's possible financial crisis. However, in the perspectives of coping with today's crisis, it might not only be least effective, but worsen the current situation. The European governments should cautiously make a decision when and how to introduce tighter regulations in order to minimize potential economic slowdown.

### **WP- D / # 12 / EJ to E Solvency margin regulation**

- With respect to “Reinsurance” among three areas to be assessed, Japan received equivalence determination from the European Insurance and Occupational Pensions Authority (EIOPA).
- In the meantime, concerning the remaining areas, “Group supervision” and “Group solvency”, assessment procedures expected to continue until 2015 should be conducted constructively

Some progress has been seen for this recommendation.

< Background >

The EIOPA's advice published in October 2011 was that Japan meets the criteria for equivalence with certain caveats.

### **WP- D / # 13 / EJ to E Tax issues in the EU**

Establish a tax system which will enable companies conducting business in the EU to enjoy fully the benefits of the Single Market. In particular,

- Introduce a common consolidated corporate tax base as soon as possible.
- Amend the Merger Directive (Directive 90/434/EEC) to cover the transfer of real estate and other intangible assets in reorganisation and to abolish the requirements in certain Member States to maintain the holding of shares received in exchange of contributed assets for a specified number of years
- Exemption from penalties related to non-compliance with documentation requirements and transfer pricing adjustments, and from interest related to

- adjustments if a company submits an EU TPD in good faith and in a timely manner
- Simplify and harmonise the VAT system to enable centralised VAT accounting in a cost-efficient manner.

#### **WP- D / #14 / EJ to E Tax on Financial Transaction**

The BRT insists that EU should not introduce tax on financial transactions. If EU might introduce the tax on financial transactions, it would not only harm the potential growth rate of GDP, investors may execute its transactions on bonds/equities/derivatives in the non-EU countries, instead of EU member countries.

EU governments should also bear in mind that the tax on financial transaction may cause a lot of burden in the transaction through IT system, which could give a similar bad effect in the markets. As this could reduce the market liquidity, it is likely that market volatility would rather become bigger.

< Background >

The European Commission announced proposals on 28 September 2011 to impose a Financial Transaction Tax on financial instruments between financial institutions when at least one party to the transaction is located in the EU

- **Chargeability:** Moment when the financial transaction occurs. Cancellation will not be considered as a reason to not charge the tax, except in cases of errors
- **Rates:** Shares and bonds taxed at 0.1 percent, derivatives taxed at 0.01 percent
- **Exemptions:** The European Financial Stability Facility, central counterparties (CCPs), and central securities depositories (CSDs) are exempt, although their counterparties would not enjoy an exemption. The ECB, European agencies and national central banks would be out of scope completely
- **Implementation:** If approved by the EU institutions, the tax would be effective from 1 January 2014