Working Party D　Financial Services; Accounting and Tax Issues

D-EJ-1 Concurring with the Financial System Reform

- The Summit on Financial Markets and the World Economy (G20 Summit) identified the root causes of the current crisis: market participants seeking higher yields without an adequate appreciation of the risks and without exercising proper due diligence; weak underwriting standards; unsound risk management practices; increasingly complex and opaque financial products; and consequent excessive leverage, the combination of which created vulnerabilities in the system. The G20 Summit also pointed out that in some advanced countries, policy-makers, regulators and supervisors did not adequately appreciate and address the risks building up in financial markets, nor did they keep pace with financial innovation or take into account the systemic ramifications of domestic regulatory action. We agree with the G20 summit's view on the causes of the financial crisis.

- The G20 Summit upheld the common principles for financial market reform, including (1) strengthening transparency and accountability, (2) enhancing sound regulation, (3) promoting integrity in financial markets, (4) reinforcing international cooperation, and (5) reforming international financial institutions. The G20 countries are now at the stage of establishing action plans and implementing them.

- We agree that these financial reforms will enhance the transparency and accountability of financial institutions, financial markets, and financial products, while ensuring their fairness and integrity.　We note, however, that innovation is also important, and that a careful balance must be struck between innovativeness and regulation.

- The G20 Summit upheld that once the economy recovers, more stringent regulations would be introduced.　We assert that governments should be prudent in determining whether the economy is truly on a recovery track, and make sure the regulations themselves, as well as the timing of their implementation, are considered with flexibility.

- The stability of financial markets and their proper regulation are important for market users, including companies that raise capital. While we currently see government intervention to markets in order to stabilize the financial system and support institutions, such intervention must not distort market and thus be removed as soon as practicable.

D-EJ-2 Prudential Regulation

- To mitigate the pro-cyclicality of bank's capital requirements, the G20 leaders agreed to raise the bank's capital buffer above the required minimum when the economy recovers and allow banks to decrease that buffer during economic downturns to sustain smooth lending. The G20 Summit also asked the Basel Committee of Banking Supervision (BCBS) to review minimum levels of capital and develop recommendations by 2010.

- We need to be fully aware that a policy of raising capital buffers or minimum capital levels in response to the business cycle involves the risk of exacerbating the pro-cyclicality of capital requirements should such policy be implemented at the wrong time. We assert that the determination of when the economy is recovering should be made prudently.

- The strengthening of the capital requirements for trading books is now being discussed at BCBS. A broader range of financial institutions, including financial institutions that do not take deposits, are also complying with Basel II. Financial institutions are subject to various regulations in their respective industries. Solvency II is being introduced to insurance companies. We assert that the governments should keep in mind that the differences between various financial institutions cannot be ignored in regards to the nature of their businesses, the associated risks, and how they are affected by regulatory changes.

- We believe that certain transitional measures should be provided if guidelines for harmonization of the definition of capital are created, because the soundness of financial institutions may be impaired if the new rules are applied in a single step.

- When risk-based capital requirements are supplemented with a simple, transparent, non-risk based measure, it is important that a level playing field be secured, to take into account differences in financial standards across countries.

- We also believe that the level playing field between financial institutions with public money infusion and those without such arrangement should be secured.

D-EJ-3 Risk Management

- One lesson learned from the recent market turmoil is that financial institutions need to strengthen their management of counterparty and liquidity risk as well as meet capital requirements. However, we have been in the situation that governments and the central banks have had to take exceptional measures to support certain financial institutions and supply them with liquidity. Although risk management concepts are moving in the right direction, we believe that such measures should not be taken hastily.

- To manage liquidity risk, the G20 has agreed to build a global framework for promoting stronger liquidity buffers at banks, including cross-border institutions. We note, however, that such a framework could jeopardize the level playing field or lead to freezing of assets if liquidity buffer regulations differ among countries. In building this global framework for promoting stronger liquidity buffers, we ask that governments consider liquidity in a cross-border context and harmonize regulations across countries.

- To enhance the management of counterparty risk, a realistic and feasible level of regulations should be required.

- We believe that the corporate management and compensation structure based on the long term view is important for sound risk management.

D-EJ-4 Enhancing the Risk Management of Securitization

- It is obvious that securitized products were among the major causes of financial crisis contagion. The structure of securitized products became increasingly complex, and self discipline at the financial institutions in the securitization business, credit rating agencies and other entities, including their due diligence measures, failed to function properly. However, we do not believe that this diminishes in any way the importance of securitization per se, which is to enable the transfer of credit risk. In economies like Japan where credit risk has been concentrated in the banking sector, risk diversification through securitization is still an important means of mitigating systemic risk.

- The G20 leaders agreed that the BCBS and authorities should take forward work on improving incentives for risk management of securitization, including considering due diligence and quantitative retention requirements. The aim of quantitative retention requirements, which would require originators and other service providers to hold a certain portion of the securitized products, is to align their incentives with those of investors. We believe that such measures risk diminishing the incentives for the securitization itself, and that setting the right level of required retention will be difficult.

D-EJ-5 Accounting Issues

- In 2008 the Working Party 2 (the previous title for the Working Party D) recommended enhancement of the governance of the accounting standard setting bodies and the convergence of accounting standards. The Financial Stability Board is going to undertake a strategic review of the policy development work of international standard setting bodies, and the IASB has established an external Monitoring Board, members of which include the IOSCO, the European Commission, the US Securities and Exchange Commission, and Japan's Financial Services Agency. In addition, IASB and FASB have established the Financial Crisis Advisory Group (FCAG), which is comprised of senior leaders with broad international experience in financial markets. FCAG will advise the IASB and FASB on the standard-setting implications of the global financial crisis and on potential changes to the global regulatory environment. We support these trends and look forward to further developments.

- To address pro-cyclicality, the Financial Stability Forum has recommended that the IASB and other international standard setting bodies look at loan loss provisions and fair value accounting as well as bank capital requirements. We note that such prudential regulations could result in certain conflicts with investor protections, and thus must be carefully considered.

- While the purpose of financial accounting is to provide financial information to a company's outside stakeholders such as shareholders and creditors, we wish to point out that the view of a company's management is also important when setting standards. Changes in accounting standards have impact on corporate activities and thus on the economy. We believe that net income is useful as accounting information for corporate performance.

- IASB is in the process of revising its financial instrument accounting standard, and we support the approach to recognize the net unrealized gain on available-for-sale securities as other comprehensive income. We wish to point out that when securities are sold, gains or losses realized by the sale should be recognized in net income.

- As part of the process to strengthen the immediate recognition in the accounting standards for employee benefits, the actuarial gains and losses may be recognized immediately upon accrual as income or expense. The immediate recognition of the actuarial gains or losses coming from short term financial market fluctuations could cause the pension plans, which are long term promises between employers and participants, to give excessive fluctuation to the profit and loss statement. We believe such standard should not be adopted.

- With regards to the IASB's financial statement presentation project, we are concerned about the requirement for the use of direct method in cash flow statement. The users of financial statements are able to acquire sufficient useful information from disclosures with indirect method. Based on the fact that companies will incur large amount of cost, we do not see any overriding benefit coming from the requirement of direct method.

D-EJ-6 Tax Issue Proposal for EU and Japan

- The Governments of Japan and Europe should ensure that dividend payments from subsidiaries to parent companies and royalty and interest payments between related parties are, to the greatest possible extent, exempted from withholding taxes. We hope that EU Member States and Japan will enter into common agreements on tax issues in order to fully enjoy the benefits of the single market. We ask the public authorities to ensure a continuation of wide-ranging dialogue aimed at achieving such agreements.

- With the progress of convergence of Accounting Standards, new deviations arise between corporate accounting and tax practice. We ask that the Governments of Japan and Europe respond flexibly to the deviations.

D-J-7 Tax Issue Proposal for Japan

- We ask the tax administration of Japan to secure transparency in executing transfer-price taxation in order for companies to carry out international business expansion smoothly. From a viewpoint of international common understanding, we request that the tax administration of Japan revert to on international common model such as the OECD model.

- We repeatedly ask the Government of Japan to reform the consolidated tax system as quickly as possible to allow carrying forward tax losses in subsidiaries which incurred before the system came into effect, to exempt revaluation of subsidiaries at fair value at the initiation, and to allow including donation between consolidated corporations in expenses.

- We request the tax administration of Japan to consider reducing corporate tax rates.

- As Japanese society ages, Japanese individuals in the workforce will need to invest and accumulate more assets for retirement. The role of private sector insurance will be more important in such fields as medical (hospital), long term care and pension insurance. We ask the Japanese tax authority to expand the tax breaks to encourage the development of individual preparation for retirement.