

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

Tokyo, April 19 – 20, 2010

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

Working Party Leaders:

Denis Duverne
Member of the Management
Board - Strategy,
Finance and Operations
AXA

Kazutoshi Inano
Chairman of the Board of
Nomura Asset Management,
Co. Ltd.

Recommendations to the EU and Japan

<Financial Services>

D-EJ-1 Progress in the financial market reform since the financial crisis

- In response to the global financial crisis, the G20 countries have agreed to the common principles for financial market reform, which are: (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 taking actions for their implementation.
- Specifically, under the G20 framework the Basel Committee of Banking Supervision (BCBS) has made proposals regarding bank's capital requirements, leverage regulation and liquidity regulation in order to enhance the soundness of the bank's management. And the Financial Stability Board (FSB) has presented the international principles for the compensation practices in the financial institution. Now it seems that a new regulatory order based on the untraditional way of thinking is about to be built, including such measures as imposing additional regulations on the "systemically important financial firms," which are large and complex financial institutions.
- We agree in general that these financial reforms will stabilize the financial system and enhance the transparency and accountability of financial institutions, financial markets, and financial products, while ensuring their fairness and integrity. The stabilization of the financial market and financial system is important for market users including the companies that raise capital.

D-EJ-2 Issues to be mindful of when proceeding with reform

- At the same time, we point out that there are several issues we should bear in mind as we proceed with regulatory reform. Innovation in the financial market is important and a careful balance must be struck between innovativeness and regulation.
- We also have to recognize that maintaining the liquidity in the secondary market is important. One of the most serious problems in the financial crisis was the lack of liquidity in the secondary market. Although the regulatory reform should move forward in order to prevent the next financial crisis, we also have to be mindful of preventing the lack of liquidity in the secondary market. Asian countries are expected to be the driver of economic growth after the financial crisis. In these countries, the role of capital markets is still limited and their financial system is still

based on the traditional banking system. If the low liquidity in the secondary market and the credit restraint due to the bank's capital requirements should happen in such countries, the corporate finance could face constraints from both capital market and banking system, and this could give a negative impact on economic activities and growth.

- Even though the financial industry is one of the most globalized industries, we should still bear in mind that the regulation and practices greatly vary from country to country. For example, in East Asian countries including Japan, banks' financing (debt) is basically through stable small deposits, and their dependence on the short term capital is not so large as financial institutions in the US and Europe. If the uniform regulation on the leverage leads to the restrictions on deposit taking and thus the reductions in lending regardless of the risk to the financial system, this could give a negative impact on economic activities. Also, in economies including Japan the credit risk has been concentrated in the banking sector, and thus the need for risk diversification through securitization is still very high in order to mitigate systemic risk.
- When the regulation is discussed in the global context, the characteristics of each county and region should be fully considered. We believe that we should build harmonized regulations through multilateral discussions on a global basis.

<Accounting>

D-EJ-3 Accounting Issues in EU and Japan

- Working Party D (previously Working Party 2) has recommended enhancement of the governance of the accounting standard setting bodies and the convergence of accounting standards. The Financial Stability Board (FSB) 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 International Organization of Securities Commissions (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. Since its inception, FCAG has announced the wide-ranged report on the activities of Accounting Standard Board. We support these trends and look forward to further developments. We also support the progress towards the IFRS introduction in Japan and look forward to further discussions on the convergence.
- While the purpose of financial accounting is to provide financial information to a company's outside stakeholders such as shareholders and creditors, we strongly 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 with recycling arrangement is useful as accounting information. Companies set the prices for goods and services they sell based on cost. If items not recycled such as the actuarial gains and losses in the pension accounting are expanded and thus profit and loss not reflected in the net income are expanded too, we are concerned that underlying business activities such as cost management and selling price formation could be disrupted.

- 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 (OCI). However, it is also proposed that if the net unrealized gain is recognized as OCI, the dividend is recognized as net income but the realized gain is recognized as OCI, not as net income. We cannot agree with this approach.
- The net realized income has been described by some as a kind of income manipulation, but we believe that the sale of the securities is one way of showing the management's decision, and thus recognizing the net realized income as net income gives more useful accounting information. In the insurance context, assets held by insurers are managed consistently with the asset liability management and the risk management of the company in order to back insurance liabilities and to meet insurers' commitments toward policyholders and not in the interest only of the shareholders (and so not for "managing earnings" over time). Furthermore, the removing of the available for sale (AFS) category is inconsistent with the business model approach on which the IFRS 9 is based: the long term business model of insurance should be recognized through the AFS.
- 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 OCI. 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 net income. We support the approach to recognize the actuarial gains and losses as OCI and not as net income. On the other hand, we believe the actuarial gains and losses should be recycled for the above mentioned reason.
- We ask IASB to discuss the revenue recognition criteria with careful consideration of the actual business practices in countries around the world. It is necessary to recognize the possibility that changing the accounting standards affect the business practices. We believe that accounting standard reform is necessary when there are concrete problems that may hinder investor's decision making, but if not, the established accounting practices should not be overruled.

- With regards to the IASB' s financial statement presentation project, in addition to OCI issues and the removing of the two separate statements (income statement and statement of comprehensive income) 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.

<Tax >

D-EJ-4 Tax Issues in the 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 in the source country. While there have been some improvements with respect to the dividend taxation between Japan and some EU member countries, we believe that the removal of double taxation is still an important issue, and we hope that all the EU Member States and Japan will conclude tax treaties. In order to reduce the risk of economic double taxation, furthermore, it is important to ensure an arena for wide-ranging dialogues between the tax authorities. In particular, they should introduce clauses that will enable corresponding adjustments and arbitration in tax treaties. In addition, they should harmonise and simplify documentary requirements in transfer pricing taxation and promote and facilitate the conclusion of bilateral and multilateral APAs.
- 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.
- When companies conduct their businesses on a global basis, transparent and fair taxation in countries are extremely important. If the taxation on some specific industry or sector is introduced, it could distort the resource allocation and damage the sound growth of companies and economies. We hope that transparent and fair tax reform and implementation are continued.

Recommendations only to Japan

<Financial Services>

D-J-1 Financial Service Issues in Japan

- The Japanese Government changed the Postal privatization policy and announced the policy that would allow its entry into new business areas and special regulation while the government share ownership is maintained, and financial institutions in EU and Japan have expressed strong concerns. We believe that new product development and business expansion, as well as the increase or the abolishment of the limit on both postal savings amounts and insurance, should not be implemented until a level playing field is established. In addition, it is necessary to establish transparency procedure and involve constructive discussion through reform process.
- FSA has deregulated insurance sales through banks and consumer convenience is improving. However, there are still some regulations to avoid banks' pressure sales. For example, corporate clients who have a loan cannot purchase insurance products through their lender bank. The regulation will be reviewed by the end of 2010, and the regulatory reform should be discussed for further enhancement of the consumer convenience, while paying attention to the protection of consumer's interest.

<Accounting>

D-J-2 Accounting Issues in Japan

- In IFRS the compensated absences are recognized as liability. However, since the reserve for the compensated absences has never been recorded in Japan and such requirement could have a relatively heavy impact, we believe prudent discussion should be held.

<Tax>

D-J-3 Tax Issues in Japan

- In order for companies to carry out international business expansion smoothly, we ask the tax administration of Japan to implement transfer-price taxation using an

international common model such as the OECD model, and secure further transparency.

- We request the Japanese government to consider reducing corporate tax rates. While many countries are lowering effective corporate tax rates rapidly, Japanese corporate tax rate remains at around 40%, the highest level around the world. In terms of securing Japanese companies' international competitiveness and also furthering foreign investments, Japan should lower its corporate tax rate to the international equivalent of around 30%.
- 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 continue to expand the tax breaks to encourage the development of individual preparation for retirement.

Recommendations only to the EU

<Financial Services>

D-E-1 Solvency margin regulation

- The solvency margin regulation of insurance companies has been discussed on global basis and we support the Japan and EU governments' approach towards regulation, which acknowledges the dialogue between public and private sectors. When the equivalence assessment of its regulations is conducted between the EU and external parties, such process should be conducted in a constructive manner.

<Tax>

D-E-2 Tax Issues in the EU

- Many Japanese companies in the EU are implementing integration and rationalization of their European business organizations. Examples are the centralization of such functions as sales support and accounting. The relation between intra-group transactions and taxation is an important element in decision making in a business. We ask the EU and the Member States to establish a tax system that will enable companies conducting business in the EU to enjoy the benefit of the Single Market to its full extent. In particular, taxation on unrealised gains as a result of a goodwill transfer within a group should be deferred; transactions within a group should be exempted from the application of the arms-length principle; and the off-setting of profits and losses within a group should be allowed.