

Challenges for EU-Japan Partnership in Financial Services: A Perspective from a Third Country

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- I. Background
- II. Recent regulatory and supervisory developments in EU
- III. Japanese financial institutions in EU
- IV. Towards enhanced partnership between EU and Japan

I. Background

- ✓ UK's decision to leave EU: Brexit
 - new “third country” with significant importance to EU
 - Market's concern over loss of benefit of “single passport” and regulatory equivalence with EU

- ✓ US's Dodd Frank Act
 - Intermediate Holding Company (IHC) requirement
 - CFTC's direct supervision over UK Central Counter Party (CCP)

- ✓ Increase of inward foreign direct investments from China in the areas of EU's strategic interests

- ✓ Growing concern over third countries' regulation and supervision (e.g., **race to the bottom**)
- ⇒ Regulatory and supervisory protectionism against third countries' financial institutions active in EU
- ⇒ **Fragmentation of global financial market and decrease of market liquidity**
- ⇒ Rise of transaction costs in Europe

II. Recent regulatory and supervisory developments in EU

- ✓ New requirement of setting up Intermediate Parent Undertaking (IPU)
 - proposed in November 2016

- ✓ Strengthened regulation over critically important CCPs in third countries which clear euro-denominated transactions, including compulsory relocation to EU and direct extraterritorial supervision
 - proposed in June 2017
 - also review of ESAs (e.g., ESMA) proposed in Sep. 2017

- ✓ Revision of third country regime
 - proposed in September 2017
 - more frequent and stringent equivalence test
 - ⇒ **chilling effect** over business in EU due to decrease of **regulatory predictability**
- ✓ Possible introduction of restriction on investment **outsourcing to UK asset managers**
 - based on ESMA's opinion published in July 2017
- ✓ Screening of direct investment from third country
 - proposed in September 2017

- ✓ ECB and ESMA's position on granting EU's licenses in light of Brexit: No "post box company" admitted as subsidiary!
- Dilemma between a) persistent uncertainty over future relationship between EU and UK and b) the fact that IT development and recruiting local staff takes long although remaining time until Brexit is very limited

- ✓ It is likely that functions of European financial market will be divided in different countries of the world, due to difficulty for any market to replace London completely in a short term

【 Ranking of financial centers 】

Center	EU	Global
London	1	1
Frankfurt	2	11
Luxembourg	3	14
Paris	4	26
Dublin	5	30
Amsterdam	6	33

Source: Z/Yen's GFCI 22

- ✓ Japanese financial institutions have been practically forced to establish/reinforce subsidiaries in Europe immediately to maintain single passport while retaining existing ones in UK to **prepare for worst case scenario**: Hard Brexit with a short/no transitional period (cliff edge)

MUFG	Establish a subsidiary of the securities firm in Amsterdam where the bank already has a subsidiary (and in Paris)
SMFG	Establish subsidiaries of the bank and the securities firm in Frankfurt and a branch of the bank in London
Mizuho FG	Establish a subsidiary of the bank in Frankfurt
Nomura Holdings	Establish a subsidiary in Frankfurt
Daiwa Securities	Establish a subsidiary in Frankfurt
Sompo Holdings	Relocate the existing subsidiary in UK to Luxembourg

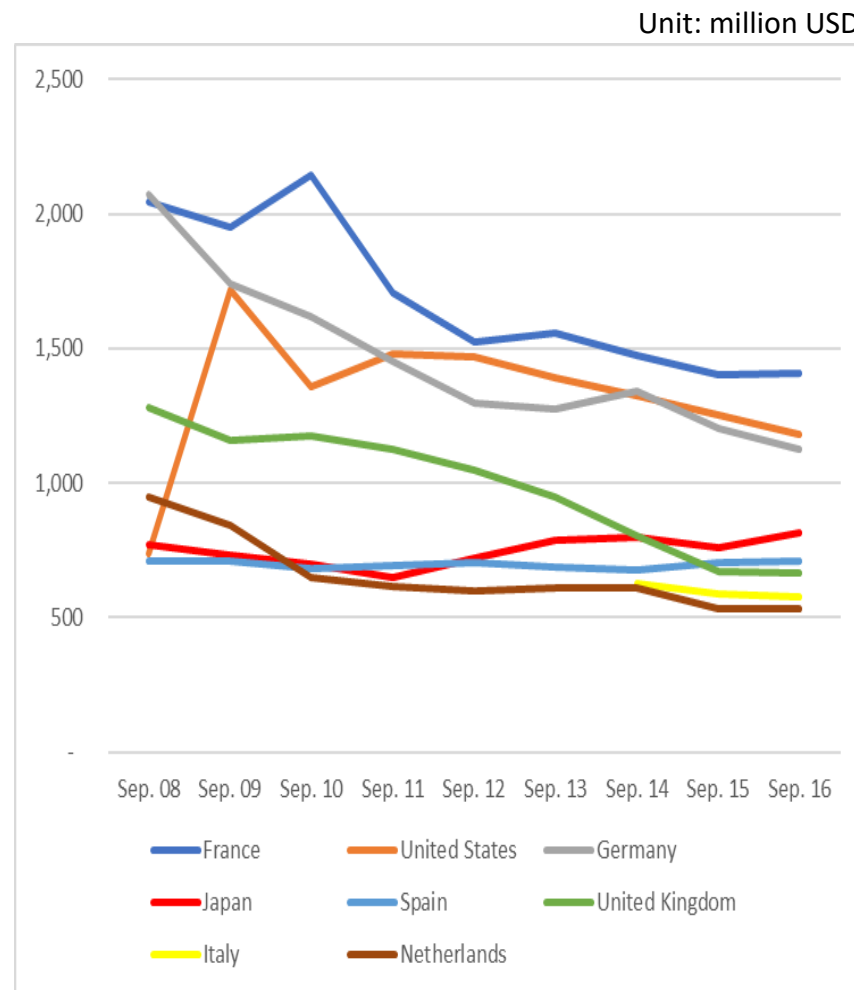
Note: MUFG is short for Mitsubishi UFJ Financial Group; SMFG for Sumitomo Mitsui Financial Group.

Source: Homepages of the individual institutions and media news

III. Japanese financial institutions in EU

- ✓ Japanese financial institutions concentrated their European business in London after the burst of Japan's bubble economy in '90 in order to cut cost, and many institutions are only licensed in the UK

- ✓ Japanese banks have continuously supported EU credit market though a tough time (while US and European ones reduced their lending exposure after global financial crisis)



Source: Bank for International Settlement

Note: Ultimate risk basis which excludes claims to own country

JCIF Japanese banks' involvement in Juncker Plan

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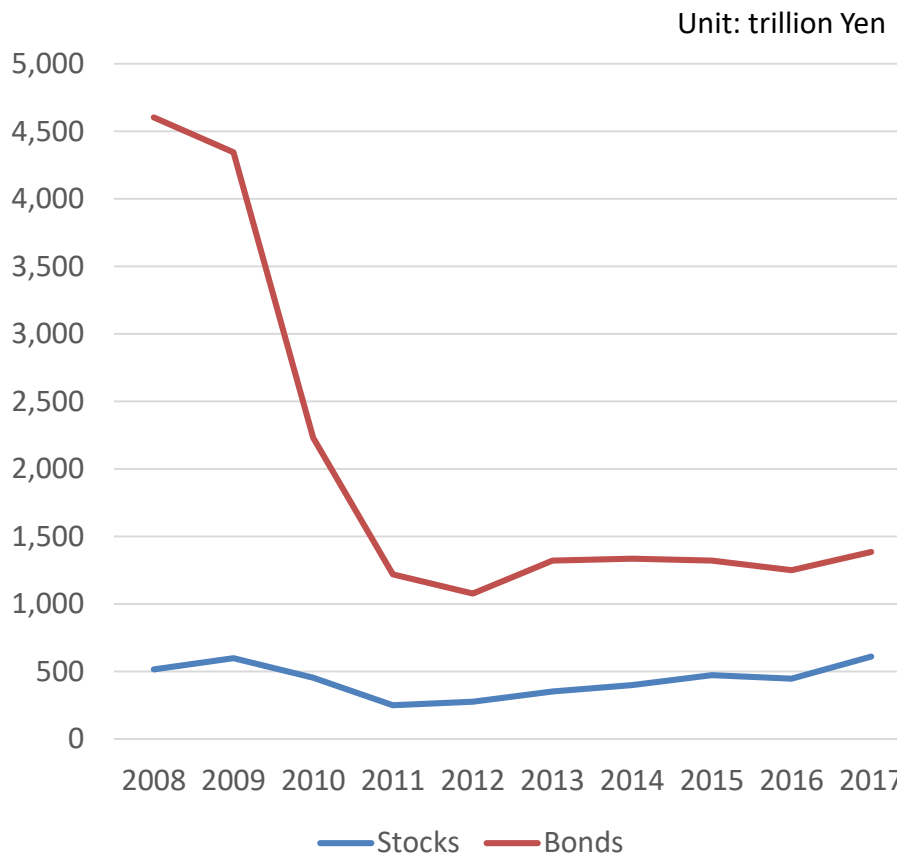
Project	Country	Sector	Signing Date	Facility Amount (MM USD)	Facility Agent	Mandated Arranger
Norther Offshore Wind	Belgium	Energy	Dec-16	454	N/A	ABN AMRO, Belfius Bank, BNP Paribas, BTMU , Rabobank, SG, SMFG , SMTH
D4R7 Slovakia PPP	Slovakia	Transport	Jun-16	593	UniCredit	Credit Agricole, Ceskoslovenska Obchodni Banka (CSOB), Instituto de Credito Oficial (ICO), SMFG , EBRD, UniCredit
A6 Almere Motorway PPP	The Netherlands	Transport	Jun-16	211	BTMU	BTMU , DekaBank, EIB
Primary Care Centres PPP	Ireland	Social infrastructure	May-16	98	BTMU	BTMU
Beatrice Offshore	United Kingdom	Energy	May-16	2,095	MUFG	Commonwealth Bank, Santander, BNP Paribas, CaixaBank, ING Groep, KfW, BTMU , SMFG , NATIXIS, Lloyds Bank, RBS, Siemens Financial Services, SG
Midland Metropolitan Hospital PPP	United Kingdom	Social infrastructure	Dec-15	203	Credit Agricole	Credit Agricole*, KfW Bankengruppe, SMFG
Galloper Offshore Wind	United Kingdom	Energy	Oct-15	1,757	N/A	Santander, ABN AMRO, BNP Paribas, Credit Agricole, ING Groep, SG, NATIXIS, SMFG , BTMU , Lloyds Bank

Source: EIB, Dealogic

Note: BTMU is short for Bank of Tokyo-Mitsubishi UFJ; SMTH for Sumitomo Mitsui Trust Holdings.

- ✓ Characteristics of their activities:
 - Having small presence in retail market
 - Doing little risky transactions
 - Active involvements in “The Investment Plan for Europe/Juncker Plan”

- ✓ Japanese investment in stocks in euro area is steadily increasing
- ✓ The current level is higher than that before global financial crisis



Source: The Investment Trusts Association, Japan

Note: Data covers Austria, Belgium, Germany, Spain, Finland, France, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Slovenia.

Daiwa Capital Markets Europe Limited	LCH Ltd
Mizuho Capital Markets LLC	
Mizuho International plc	
Mizuho Securities Co Ltd	
Mizuho Securities USA LLC	
MUFG Securities EMEA plc	
Nomura Financial Products & Services Inc	
Nomura Global Financial Products Inc	
Nomura International plc	
SMBC Capital Markets Inc	
Sumitomo Mitsui Banking Corporation Europe Ltd	
The Norinchukin Bank	



Source: LCH's website (accessed on 15 Feb. 2018)

- ✓ Japan shares with EU fundamental values (e.g., freedom, rule of law, democracy) and is contributing to EU's economy
 - EU and Japan can further deepen partnership based on mutual trust, resisting surge of egoisms in global environment

【 Numbers of granted regulatory euivalence 】		
1	Japan	17
2	US	16
2	Canada	16
4	Australia	13
5	Brasil	12
6	Sigapore	11

Source: European Commission

- ✓ Unfortunately, Japanese financial institutions' net profit will probably shrink towards break-even point due to increase of costs (e.g., cost related to **holding more physical presences** in Europe and to **migrating clearing contracts** from UK CCP to EU CCP)
- ✓ This may result in **shift of their existing resources in Europe to outside Europe** (, which is an unintended consequence for EU?)

*“.....It's sad, so sad (so sad)
It's a sad, sad situation..... ”*

by Elton John

Sorry Seems to Be the Hardest Word

IV. Towards enhanced partnership between EU and Japan

- ✓ Brexit is a **lose-lose-LOSE game** not only for UK and EU but also for third countries!
- ✓ Against the backdrop of EU's growing skepticism on third countries, Japan is suffering **collateral damages**
 - Damage may be inevitable but needs to be controlled and minimized

- ✓ The **EU-Japan Economic Partnership Agreement (EPA)** will hopefully address this issue
 - EPAs EU and Japan have concluded respectively are principally nothing more than WTO rules (GATS) in terms of financial service

- ✓ Differentiation of third countries in accordance with individual risks to EU financial system is desirable: A clear and foreseeable **risk-based approach**

- ✓ Agreement between EU and UK on enhanced regulatory and supervisory cooperation to mitigate market fragmentation will be also welcome (e.g., allowance for EU subsidiaries to rely on capital and system on risk management of UK subsidiaries)

Thank you for your attention!

Disclaimer: The views expressed in this presentation are those of the author, and do not represent those of the organizations he belongs to or belonged to.