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REGULATORY BARRIERS IN JAPAN

Barriers for services companies in doing business in JAPAN

A. General issues

- ESF is in favour of launching deep and comprehensive free trade agreement with Japan.
- Any FTA with Japan should include strong commitments in services.
- There are cross-sectoral barriers in Japan such as in relation to public procurement practices, access to skills, corporate governance and buyer-supplier relations which should be addressed.
- More transparency regarding corporate governance should be encouraged so that foreign investment and functioning of joint ventures become easier.
- Government and legislative consultations should be always available in English. It will considerably help to create a more favourable environment to foreign businesses if information on legislation, regulations, guidelines and policy consultation papers for key sectors with high foreign investment is available in English. The availability of such documents in English is commendable in view of the very high external legal translation costs. Companies need the information to assess the course of doing business in Japan. English translations also will make possible for foreign companies to fully participate in policy dialogues and to provide their useful feedback to regulators and policy makers.
- Existing exchange programmes could be further extended, including those for professionals. They help to overcome cultural and language barriers and will ultimately improve a climate favourable to foreign investors.
- The EU and Japan could further develop bilateral dialogues involving business, parliamentarians and regulators in an effort to promote and advocate competition and regulatory best practices and policies. A mechanism for standards and regulatory dialogue with a fixed timetable would be useful. Experiences may be taken from the Transatlantic Economic Council as well as from the Transatlantic Legislators Dialogue and the Transatlantic Business Dialogue. But dialogues should deliver concrete results in legislative or regulatory measures that effectively address the problems identified by these dialogues.

B. Sector Specific Issues

The list below is only a preliminary exercise of listing the various barriers in doing business in Japan. It does not prevent the European Services Forum and its members to come with additional information at a later stage.

1) Legal Services

- After a very lengthy liberalisation process, lasting 17 years, the Japanese legal market was substantially opened in 2005. As a result EU law firms are allowed not only to establish offices but to enter into partnerships with and employ Japanese Bengoshi.
- A few regulatory issues remain, such as the limitations on the form that law firms can take, which effectively prevents them from opening more than one branch office. There is currently legislation in the Japanese Diet which would remove these regulatory obstacles. This legislation is expected to enter into force in 2012.

- There are no other significant impediments to the conduct of legal business by law firms in Japan.

2) Accounting, Auditing and bookkeeping

- Signing audit report, signing tax returns are only allowed under the laws to Japanese CPAs and foreign CPAs registered with JICPA, and Japanese tax accountants.
- Auditing and tax work are regulated by separate individual laws.

3) Postal and courier services

European Express delivery companies still want a level playing field with (JP) Japan Post's EMS service:

- EMS should be excluded from JP's USO.
- JP should not have advantages with EMS like freedom from parking restrictions for their vans.
- EMS should have transparent pricing and there should be no anti-competitive practices.
- EMS should have the same Customs requirements.

4) Telecommunication and IT services

Japan is Asia Pacific's largest networked IT market - equivalent in size to all other Asia markets. The large size of the market means that despite many entry hurdles it attracts significant foreign investment.

Last year, Copenhagen Economics published a report "Assessment of barriers to trade and investment between the EU and Japan", prepared for DG Trade. It concludes that a decline in the relative importance of bilateral trade between the EU and Japan should not be equated with low economic potential in the bilateral trade relationship. There is considerable unrealised economic potential to revitalise bilateral trade.

In respect to electronic communications services the key areas concern in particular the definition of electronic communications services, the inclusion of virtual private networks, and the independence of the regulator. Those areas are relevant against the background of two aspects raised on page 5 of the new Commission Communication on Trade, Growth and World Affairs

1) "the effective global manufacturing supply chain cannot exist without the vital support of transport, telecom, financial, business and professional services." and

2) "as technological changes create new services and enhance the tradability of cross-border services, our trade agreements should find ways to prevent the erection of new barriers to trade for those services."

Considering those aspects, discussions with Japan should look into the following elements when dealing with market access for electronic communications:

- a) Definition of electronic communications services, non-discrimination and the inclusion of VPNs**

The global economy is increasingly dependent on access to well functioning networks. Ideally, the agreement should therefore use the same generic definition of electronic communications services that is found in EU legislation. In a second-best scenario where commitments are limited to certain services and technologies, specific mention of VPN (Virtual Private Networks) services is nevertheless essential. In both scenarios it needs to be made clear that pro-competitive access rules apply to all services covered by the agreement.

This will help to avoid *price discrimination*. A VPN provider cannot normally achieve the economies of scale needed to justify investment in its own transport infrastructure at the local access level. In most cases local access links must therefore be considered as an “essential facility”, which are subject to regulated wholesale access. In countries where regulation does not ensure this, imports of VPN services will be blocked in scenarios where (a) the local market is characterised by the presence of vertically-integrated incumbent operators which are themselves suppliers of global VPN services and (b) a draft contract specification with a potential multi-site customer requires connection of a number of sites of which the majority are located in the country in question.

But also *non-price discrimination needs to be avoided*. The “Unique Selling Point” of VPN services to business customers is their reliability. Since wholesale local access is a critical input for such services and the overall reliability of any system cannot exceed the reliability of its weakest link, it may be impossible to offer a retail service which is in line with customer expectations in those countries where standard Service Level Agreements (SLAs) for such links are absent, inadequate or un-enforced. And the same countries’ imports of VPN services can be blocked if a vertically-integrated incumbent operator offers premium SLAs to its own customer-facing, retail business units, which are not matched in its wholesale offer.

To sum up, it is vital to ensure that the principle of non-discrimination is applied not only to the pricing and technical configuration of wholesale local links, but also to such mundane matters as delivery and repair times.

b) Independent regulator

The role of an independent electronic communications regulator should be strengthened by a bilateral agreement with Japan. It should support measures that are effective, transparent and non-discriminatory, which guarantee transparent costs, ensure that charges to competitors are cost-based, and anti-competitive behaviour in relation to the price and non-price terms of supply is monitored.

On the other hand, Japan has still one of the most regulated electronic communications markets creating a very restrictive business environment, which has been a major factor in the decisions of many European carriers to withdraw from Japan. Regulatory supervision and control extends to almost every aspect of business. In most cases, operators can do very little without first consulting and obtaining the formal or informal approval of the regulator.

c) Guidelines on universal services funding

Universal service obligations should not be regarded as anti-competitive *per se*, provided they are administered in a transparent, objective and non-discriminatory way. The administration of such obligations shall also be neutral with respect to competition and not be more burdensome than necessary for the kind of universal service defined by each Party.

5) Distribution services

The process for developing and opening new retail outlets remains fraught with restrictions, inefficiencies, and delays. Opportunities to streamline the Large-scale Retail Location Law - intended to improve efficiency by decentralising control and decreasing administration - with the

Building Permit and Environmental Impact Assessment procedures have not been taken. Instead the law, implemented in 2000, led to individual local governments imposing their own procedures and - in some cases - new licence conditions, thus increasing costs and delays. The effect of this situation, combined with restrictions on opening retail stores over 10,000 m² introduced in 2006 has been to discourage foreign retailers by making the costs to enter and establish operations in Japan even higher.

Arguably even more important than restrictions on large-scale retailing per se is the local interpretation of construction, safety and environmental regulations. It adds to investment costs and increases uncertainty and risk, effectively undermining any learning curve benefits for retailers attempting to expand their operations in Japan. Moreover, predefined usage of most land through zoning and rigid zoning regimes in many cities make it extremely difficult to find new land for large-scale retailing.

6) Financial Services

a) Insurance services

- **Japan Post Inc (JPI)**

The European Insurance industry has long expressed concern at the preferential treatment afforded to Japan Post Inc (JPI). JPI is not only a post office but the world's biggest bank ("postal savings scheme"), with assets of more than 300 trillion yen (2.6 trillion €). It also has a life insurance unit, which controls 40% of the market. It was privatised in 2007 although the government still remains a majority shareholder retaining a stake of more than one-third. Advantages afforded to JPI already place Japan in breach of its World Trade Organisation commitments under the General Agreement on Trade in Services and recent government proposals in Japan have only sought to increase JPI's privileges further. Under the proposed legislation, endorsed by the Japanese Cabinet on Oct 2010, JPI is to be provided with special legal and regulatory exemptions, including from provisions in the banking and insurance law; permitted to enter into new business areas by changing the current approval process already unique to JPI to one that requires only 'notification'; permitted to raise the per person deposit and coverage limit substantially to 20m and 25m yen for Japan Post Bank and Japan Post Insurance respectively and give JPI special tax exemptions.

In their dialogue with the Japanese government the European Commission should ensure that Japan Post is included in the agenda. The European Commission should call Japan to honour its WTO commitments under the GATS, and in doing so raise the insurance industries concerns regarding provisions in the draft postal reform legislation that gives JPI additional competitive advantages, including less rigorous regulation of Japan Post operations.

- **Mutual Aid Cooperatives providing Insurance Products (Kyosai)**

There needs to be a level regulatory playing field between licensed insurance companies regulated by the FSA and kyosai (mutual aid cooperatives that provide insurance products). All kyosai that compete with FSA-regulated insurance companies should therefore be brought under identical FSA supervision under the Insurance Business Law (IBL). Doing so would help ensure equivalent conditions of competition between kyosai and FSA-regulated insurance companies and would enhance the welfare of Japanese consumers by requiring kyosai to, for example: (1) contribute to a safety net system to protect policyholders from potential failures; (2) follow the same rules and regulations as FSA-regulated insurance companies, including the same reserve and market conduct rules; (3) submit to FSA supervision consistent with globally accepted standards in accordance with the International Association of Insurance Supervisors' "Insurance Core Principles and Methodology"; and (4) be subject to the same taxes as their FSA-regulated competitors.

- **Branch Domestication**

Japan needs to revise the Insurance Business Law (IBL) in order to facilitate the efficient domestication of a branch in Japan of a foreign-incorporated insurance company (such a branch is defined in the IBL as a “foreign insurance company”).

Under the IBL, corporate transactions by domestic insurance companies are treated differently from those by foreign insurance companies. Japan-incorporated insurance companies have procedures such as mergers (shinsetsu gappei), spin-offs (kaisha bunkatsu), policy portfolio transfers (houkatsu iten), and non-portfolio transfers of the company’s business (jigyuu no jouto) available to them. However, the procedures available to foreign insurance companies are limited to only policy portfolio transfers and non-portfolio transfers of the company’s business. These procedures are also more complicated and costly compared to procedures available to Japan-incorporated insurance companies.

- **Policyholders Protection Corporation**

The work of the Policyholders Protection Corporation (PPC) needs to be reviewed and made more transparent, in the interests of equal treatment for foreign and Japanese-owned insurance providers, as follows:

- There needs to be continuous re-evaluation and improvement of the PPC’s mechanisms for promptly treating the causes of life insurance company failure through ensuring accurate and timely disclosure and early intervention procedures by the Japan FSA;
- As regards life assurance, the PPC needs to be changed from a pre-funded to a post-funded system to ensure that the PPC is used as a last resort, which would benefit consumers through lower costs and increased efficiency.

- **SASTI (Small Amount Short Term Insurers)**

Small Amount Short Term Insurers are by regulation only permitted to purchase reinsurance from Japanese reinsurers. This situation is supposed to change soon though.

b) Banking services

- Many restrictions that prevented foreign banks from competing with their domestic rivals disappeared as a result of years of deregulation and liberalisation. In June 2008, wide-ranging changes to the Financial Instruments and Exchange Law (FIEL) addressing better regulation and firewalls concerns were passed, constituting a first legislative step in implementing the Government of Japan’s Better Market Initiative.
- However, implementing guidelines by the Financial Services Agency (FSA) so far continue to uphold restrictions on the sharing of customer information. Thus, it remains very difficult for European financial institutions to integrate operations in Japan into their global financial group.
- Many practical difficulties for European banks operating in Japan stem from onerous regulatory requirements. In this light European banks have expressed interest in agreements of mutual recognition of home-country core standards between the EU and Japan. This should in particular concern capital and governance structures, while the host regulator would maintain responsibility for licenses and local business activities. This is as opposed to the current situation where, in the case of applications for new licenses, capital adequacy is calculated on the basis of the Japanese entity of a European bank in isolation. This can be a substantial barrier for newcomers. It would be a substantial alleviation that financial institutions holding a universal banking license in one jurisdiction be allowed the same scope of business for their branches in the other jurisdiction (i.e., banking, securities,

trust banking, asset management, insurance), without having to establish separate structures.

- Branches of foreign banks are not allowed to engage in trust banking. Since 2002, however, Japanese city banks can engage in trust and banking business concurrently. Foreign banks should be allowed in the scope of the definition of authorised banks that can engage in trust banking.
- The disclosure requirements for secondary offerings (i.e. European banks selling European bonds in Japan) appear far too burdensome, because such transactions are treated like an IPO by the Japanese authorities. This issue seems to have been taken up in the EU-Japan regulatory dialogue.
