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A Lose-Lose-*Lose* Game: Brexit's Impact on Japanese Financial Institutions

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Abstract: This paper explores to present overall assessment of the economic and political damage which the UK's leave from the European Union is expected to bring about on Japanese financial institutions. Given great uncertainty over the Brexit's modality, the analysis is focused on structural changes from medium- and long-term perspectives. It concludes that the direct impact on the Japanese financial institutions will be rather limited, while bigger indirect damages could be attributed to the UK's reduced access to the EU's Single Market.

Key Words: Brexit, EU-Japan relations, financial regulation and supervision, equivalence framework, third country regime, Single Market

1. Background

The UK decided its leave from the EU (Brexit, hereinafter) in line with the outcome of the referendum on 26 June 2016. The UK notified its intent to leave the regional community, and the formal Brexit negotiation between the two jurisdictions started at end March 2017. Based on the article 50 of the treaty of the EU; Lisbon Treaty, Brexit was meant to happen on 29 March 2019 which was two years after the formal notification of the intent to leave the EU. The Negotiators of the EU and the UK government reached a technical agreement on the entirety of the withdrawal terms as "Withdrawal Agreement" and the future relationship between the two jurisdictions as "Outline of the Political Declaration" in November 2018 [European Commission 2018].

Nonetheless, the UK requested the EU to postpone the Brexit date, shortly before the March 2019 deadline, due to lack of agreement among the UK parliament. The EU accepted the request and the deadline was deferred to 12 April and then to 31 October

2019. It was intended just to secure more time for the UK to make a domestic agreement, but not to renegotiate the agreements between the two jurisdictions. In the meantime, the UK had changed the government. The new government had gone for a general election in December 2019 after another extension of the deadline and finally realized Brexit on 30th January 2020. As of this writing, a transition period is being applied until end of 2020 based on the Withdrawal Agreement.

Although the formal negotiation on the future relationship started in early March 2020, it will certainly follow a bumpy path. It is thought that the UK has a leverage of negotiation on fishery in its territorial waters, while the EU has that on financial services. The both sides are waging a "chicken race" against each other, arguing the loss of Brexit will be bigger on the other. Therefore, fundamental uncertainty could continue to remain towards the end of transition period, which leaves possible various scenarios on the modality of Brexit.

The Political Declaration which was revised in October 2019 vaguely stipulates the UK's withdrawal from the EU's Single Market which enables free movement of four elements, namely goods, services, people and capital, inside itself and Custom Union. As the result, financial services transactions between the two jurisdictions will rely on the equivalence regime on regulations and supervisions in a third country which the EU already has and the UK will have in place [European Commission 2019c].

The EU clarifies that the key instrument both parties will use to regulate interactions between their financial systems will be their respective unilateral equivalence frameworks in its negotiating position published in February 2020 [European Commission 2020]. The UK's negotiating position published at the same timing adds that appropriate consultation and structured process for the withdrawal of equivalence findings could be included in line with recent precedents, including the

Table1. Numbers of equivalence decisions

1	US	22
2	Japan	21
3	Canada	20
4	Australia	18
5	Sigapore	16
6	Brasil	15
7	Mexico	14
	Switzerland	14
9	China	13
	Hong Kong	13

Source: European Commission [2019a]
Notes: 1) The data is as of 1. July 2019.
2) US and Japan have reservations for one decision, respectively.

EU and Japan's Economic Partnership Agreement (EPA) [1] which entered into force in February 2019, by establishing regulatory cooperation arrangements [HM Government 2020].

A purpose of an equivalence determined by the European Commission is to provide the third countries with access to the Single Market. But it is implied to be a kind of "gift" which the EU has the discretion to decide unilaterally to give or not give, and to withdraw at any time (see Table 1 for the numbers of equivalence decisions the EU grants to individual third countries).

Although the number of applicable regulations amounts to over 40, the scope of the equivalence regime is rather limited[2]. Commercial banking business (e.g., deposit taking and loan granting), for example, is basically excluded from it. Moreover, the European Commission published a Communication document concerning its revised policy on equivalence regime at the end of July 2019, so that it would be able to yield greater discretion on permitting access to the Single Market, irrespective of regulatory and supervisory equivalence in its third countries [European Commission 2019b]. It is anticipated that the EU's determination on granting access to the Single Market to its third countries will be made from political reasons[3], which dramatically undermines predictability of legal relationship between the two jurisdictions.

2. Aim, structure and assumption of this article

Brexit is not substantially effective yet as of the writing of this article. Therefore, it is premature to assess the impact in a quantitative manner. It will need good accumulation of data for a decent observance period. On the other hand, it is already possible, to some extent, to foresee in a qualitative manner what may happen as a result of Brexit. In this regard, this article aims to present a tentative analysis of Brexit's impact over Japanese financial institutions. The analysis is focused on structural changes from medium- and long-term perspectives. Japan is the third largest economy in the world after the US and China. It is an open economy and, therefore, susceptible to relatively large impact from Brexit, compared with the other third countries of the EU. The findings through the analysis on Japan may also provide implications for those countries.

The structure of this article is as follows: The third section explains activities of the Japanese financial institutions in the EU and the UK to show their risk profiles and benefits for the local economy. The fourth section summarizes how Brexit is affecting financial markets in the UK and the EU as an introduction to the following section. The fifth section elaborates both direct and indirect impacts of Brexit on the Japanese financial institutions. Finally, in the sixth section, the author concludes this article.

The analysis of this article is based on the assumption of so-called hard Brexit which is induced from the Political Declaration. The forms of Brexit can be categorized roughly into the following three types; a) soft Brexit where the UK remains in the EU's Custom Union and Single Market as an EEA member state such as Norway, b) hard Brexit where the UK loses full or most of its access to them, and c) no-deal Brexit where the UK leaves the EU without agreement on the future relationship.

For now, hard Brexit seems to be a natural consequence of Brexit, because the UK government doesn't wish to be bound by the EU rules and decisions of the European Court of Justice (ECJ) any longer, while the EU will not allow a "special treatment" for the UK. It is widely believed that the EU intends to prevent the other member states from following the UK by penalizing it. Hard Brexit means that the UK will be a third country from the EU viewpoint. For a third country, access to the Single Market is based on either EU's decision of regulatory and supervisory equivalence or WTO/GATS terms as the backstop[4].

No-deal Brexit is a sub-type of hard Brexit. No-deal Brexit is the most dangerous scenario which will cause serious disruptions, namely "cliff edge" effects, not only to the EU-UK relation but also to global economy through immediate malfunction of the existing transportation systems, including aviation. Nonetheless, this risk is rather high, as it is extremely difficult to conclude agreement/s covering all the important areas before the transition period expires, given the complexity of negotiation on the future relation.

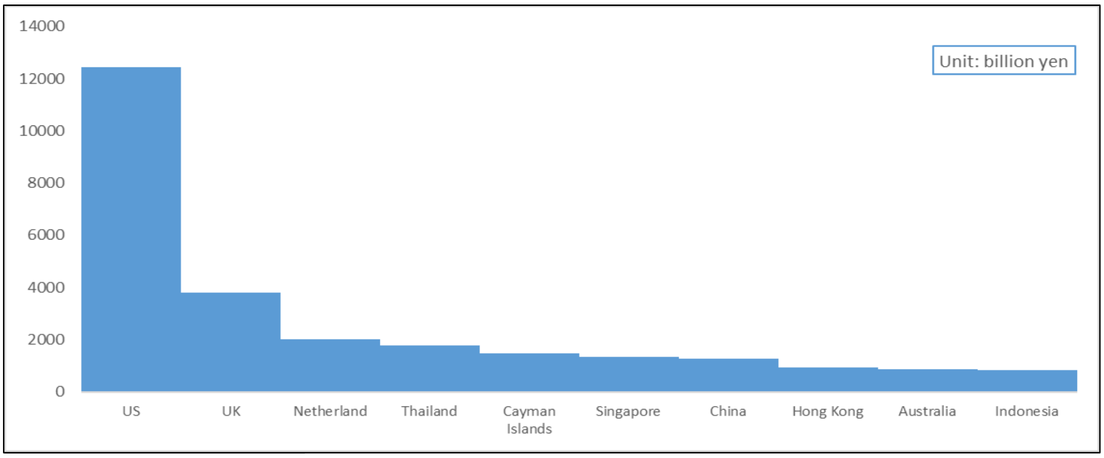
By "medium- and long-term", the author envisages a timespan of around a few years after Brexit, with or without transition period during which regulatory grandfathering will be applied. Based on the Withdrawal Agreement, the transition period would will expire at the end of 2020. The extension of the transition period is technically possible once for maximum two years under the condition that the UK submits the request before 1 July 2020 and all the EU member states accept it. However, it is hardly imaginable from a practical viewpoint, given that the UK would not accept to continue contributing to the EU budget which is known as Multiannual Financial Framework (MFF) beyond 2021 with limited membership unable to participate in decision making process of the EU.

This article has two reservations on terminology. First, as is written above, the UK is still enjoying a de-facto status of a member of the EU in most cases. However, it is legally precise to discriminate it from the EU member states. Therefore, "EU" in this article means the EU without the UK. Second, this article uses the term "Europe" from an Asian viewpoint to combine the EU and the UK.

3. Activities of the Japanese financial institutions in the EU and the UK

Almost all the forms of financial institutions (e.g., banks, broker dealers, insurers) of Japan are active in the EU and the UK. Japan experienced a severe recession after the burst of the bubble economy in the 1990's. It was at that time when the Japanese financial institutions began concentrating their European business in London in order to cut cost through consolidation of their overseas subsidiaries and branches (see Graph

Graph1. Top 10 Destinations of FDIs by Japanese Banks and Insures



Source: Bank of Japan [2019]

1 for outstanding foreign direct investments (FDIs) by Japan's banks and insurers). The City was regarded as a gateway to Europe. Although the business conditions have been improved since then, profitability in the European market remains basically unchanged for many of the Japanese institutions. As the result, they are licensed only in the UK.

London is ranked as the world's best financial market and the current evaluations of the best markets in the EU such as Frankfurt are far below London (see Table 2 for global ranking of financial centers). London has developed its so-called "eco-system" consisted of a wide range of elements including law firms and accountant offices in the last decades. As the result, London is regarded as the most important venue for transactions of derivatives and foreign exchanges in the world. Most notably, London clears almost all the euro-denominated interest rate swaps. Many major Japanese financial institutions are directly participating in a most important UK clearing house operated by the London Stock Exchange.

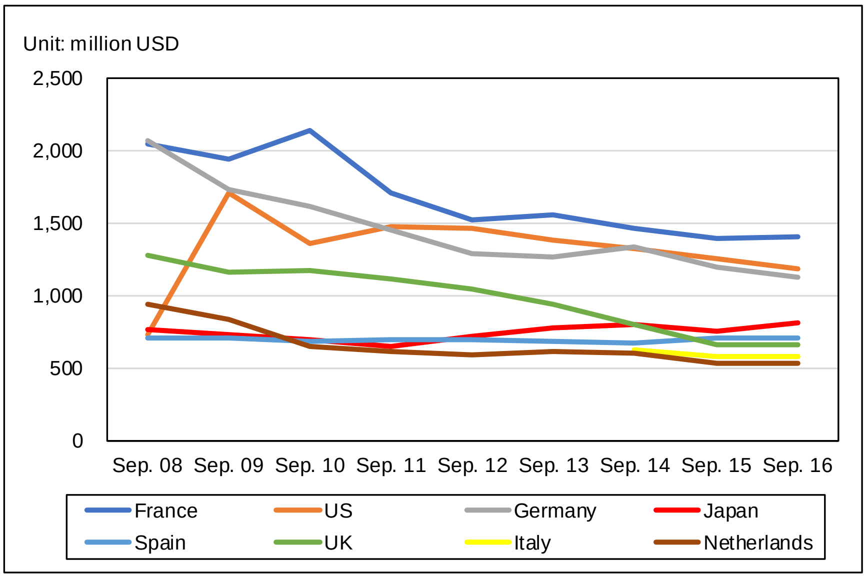
Table2. Ranking of Financial Centers

Center	EU	Global
London	—	1
Frankfurt	1	20
Luxembourg	2	21
Paris	3	24
Dublin	5	31
Amsterdam	9	50

Source: Z/Yen [2018]

On the other hand, activities of the Japanese financial institutions in the EU have been relatively modest. Characteristics of the Japanese banks in the EU can be summarized in the three points; a) small presence in the EU retail market which means that they are not competing with

Graph 2. Banks' Exposures to Europe



Source: Bank for International Settlement [2018] the EU firms in this area, b) doing little risky and complex transactions such as credit derivatives famous for their jump to default risk profile, and c) active involvements in the EU's infrastructure development projects backed by such EU initiatives as Juncker Plan and Invest Europe (see Graph 2 for Japanese banks' exposures to Europe).

4. Brexit's impacts on the UK and the EU

In terms of economy, Brexit is a lose-lose game for both sides of the UK and the EU[5]. However, the damage incurred from it will be greater on the UK side than on the EU side as an entirety. This section analyzes Brexit's impact on the two jurisdictions from viewpoints of both real economy and financial economy, respectively.

4.1. Impacts on the UK

The UK's real economy is heavily dependent on the EU in terms both of trade and investment[6]. UK's trade with the EU occupied 44% (export) and 53% (import) of respective totals in 2017. Of the export, services account for 40%. Most of automobiles produced in the UK are exported to the EU[7]. As for investment, FDIs from the EU account for almost half of the total inward FDIs[8]. The Bank of England [2018] estimates that Brexit in a scenario of "less close relationship" with the EU will decrease the UK's real GDP growth rate by 0.75% annually until 2023[9].

The UK and the EU will aim at concluding a new trade agreement with the EU such as Free Trade Agreement (FTA). Yet, no trade agreement can eliminate custom procedure at the border, however low it can set the custom tax. Therefore, the trading cost between the two jurisdictions will definitely rise in comparison with the current convention under the new relationship.

The UK is also attempting to conclude trade agreements other jurisdictions than the EU. However, the outlook that the UK can make a deal advantageous for itself is becoming unclear, as the UK revealed its weak bargaining power against the EU through the Brexit negotiation. Fall off of the UK's duty to follow the EU's security standards such as Restriction of Hazardous Substances (RoHS) and Registration, Evaluation, Authorization and Restriction of Chemicals (REACH) will reduce consumers' confidence in the UK products, unless the UK appropriately address them.

Brexit will sever supply chain of manufacturing. Automotive industry is especially well known for its complicated and sophisticated supply chains; so-called just-in-time system[10]. The UK embraces assembly factories of foreign car makers, including some Japanese ones. A major motivation for them to have such factories in the UK is an access to the Single Market where they can sell their products to the EU citizens without burdens arising from passing customs. The loss of the UK's access to the Single Market will make various manufacturers rethink their business strategies, which can result in reduction of their new FDIs in the UK and withdrawal of their existing FDIs from the UK.

The UK's financial services sector is a significant driver of the UK economy and heavily dependent on the Single Market[11]. The City of London is the world's leading financial center which trades a large share of foreign exchange transactions and derivatives transactions. The access is based on an EU system named Single Passport which enables a firm, once it obtains a license from a member state; the home state, to operate in all the other member states; the host states. The Brexit will deprive the firms based in the UK of the benefit of Single Passport. It is reasonable to expect that the best outcome of the UK-EU negotiation over the future relations in financial services will be an agreement on regulatory cooperation to inform each other of possible repeal of an equivalence decision well in advance.

As for its well-known "financial eco-system" which is consisted of law firms, accounting firms, consulting firms, etc., the City would face decreased inflow of both skilled experts and blue-collar workers, as well as students[12] from the EU[13]. The relocation of the European Banking Authority (EBA) from London to Paris will impair the value of the City from the viewpoint of communication with the supervisor.

The City is also enjoying huge profits and employments through clearing business of different asset classes. Of all, quite a majority of euro-denominated interest rate swaps is cleared by the UK central counterparties (CCPs). The CCPs provide clearing services with the EU citizens through Single Passport where a license granted by an EU member state is valid throughout the Single Market (see Table 3 for the list of authorized CCPs in the EU).

Table3. Authorized European CCPs

No.	Name of the CCP	Country of establishment	Competent authority
1	LCH Ltd	The UK	Bank of England (BoE)
2	ICE Clear Europe Limited	The UK	BoE
3	LME Clear Ltd	The UK	BoE
4	Eurex Clearing AG	Germany	Bundesanstalt für Finanzdienstleistungs aufsicht (Bafin)
5	European Commodity Clearing	Germany	BaFin
6	LCH SA	France	Autorité de Contrôle Prudentiel et de Résolution (ACPR)
7	ICE Clear Netherlands B.V.	Netherlands	De Nederlandsche Bank (DNB)
8	European Central Counterparty N.V.	Netherlands	DNB
9	Nasdaq OMX Clearing AB	Sweden	Finansinspektionen
10	Cassa di Compensazione e Garanzia S.p.A.	Italy	Banca d'Italia
11	KDPW_CCP	Poland	Komisja Nadzoru Finansowego (KNF)
12	CCP Austria Abwicklungsstelle für Börsengeschäfte GmbH	Austria	Austrian Financial Market Authority (FMA)
13	BME Clearing	Spain	Comisión Nacional del Mercado de Valores (CNMV)
14	OMIClear - C.C., S.A.	Portugal	Comissão do Mercado de Valores Mobiliários (CMVM)
15	Athens Exchange Clearing House	Greece	Hellenic Capital Market Commission
16	Keler CCP	Hungary	Central Bank of Hungary (MNB)

Source: European Securities Market Agency [2019]
Note: The data is as of 9. April 2019.

With Brexit, all of the three UK CCPs (i.e., LCH Ltd, ICE Clear Europe Limited, LME Clear Ltd) will automatically become third country CCPs for the EU standpoint which will be subject to its equivalence regime[14]. Given the EU's new equivalence regime, it is not secured that the UK CCPs will be able to continue providing euro related clearing services, even if the UK regulatory and supervisory rules and practices remain to be regarded substantially to be "equivalent" with those of the EU after expiration of the transition period.

The EU introduced a new requirement over third country CCPs with significant importance to the EU financial system (Tier 2 CCPs), which makes them subject to direct supervision by the EU authorities and if necessary, forced relocation to the EU. UK's loss of access to the Single Market will significantly harm the profit base of its CCPs[15].

4.2. Impacts on the EU

Brexit does no good both for the real economy and financial economy of the EU. However, the EU's economic and financial dependency on the UK is less significant than that of the UK on the EU[16][17]. In addition, the impacts might be different from country to country. For some member states where financial markets are more developed, the loss of frictionless access to the most sophisticated financial center of the City could be mitigated through inflow of financial transactions and businesses from London. That said, the overall effect will be negative for the region as a whole.

The UK had the second largest economy in the EU, after Germany. The EU enjoyed net surplus of over 78 billion euro in trade balance vis-a-vis the UK in 2017. Brexit will be a game changer also for the EU. Besides reduction of export, the Single Market will face downsizing and decrease of merit through economy of scale. The UK's net contribution to the MFF will fall off[18] and limit its capacity to strengthen the economy through investment and subsidy.

The small and open economies in the region will be more subject to the negative influence of Brexit. Ireland and Malta, for example, will suffer loss of strong trade ties with the UK most significantly. When looking at individual industries, German automobile makers need to reconsider their production process, since their assembly factories are concentrated in the UK. Belgian and Dutch chemical and pharmaceutical industry count on reduction of sales in the UK.

As for financial services, the EU will lose its most sophisticated trade hub of London. For today, no continental European market can provide as much liquidity as the City does for the same low price. The cost to raise fund and manage assets for the EU financial entities will most probably rise. Brexit means notable scale-down of the Capital Market Union (CMU) which aims to facilitate cross border investment across the union[19]. Without the UK, the merit of integration of the European capital markets can be rather marginal. In addition, possible loss of the UK bureaucrats in the EU institutions such as the European Commission and European Supervisory Authorities (ESAs)[20], as well as the UK members of European Parliament could lead to decrease of quality of their policy making, especially in the areas related to CMU[21].

On the other hand, some financial centers will enjoy the increase of transactions and capital moving from London in the light of the Brexit. Frankfurt, Dublin and Paris are among those which are the case. European workers in the City are said to be leaving or considering leaving there for their original countries[22]. Some European centers are improving their assessments in global rankings of financial centers through the inflow of such resources. France has been most aggressive to attract business from London to Paris, expecting to strengthen its financial industry. A German CCP introduced an incentive scheme for large clients to encourage migration of their contracts from UK CCPs to itself[23].

Brexit also means an emergence of a neighboring and influential third country. For the purpose of financial stability, the EU feels the necessity to build a barrier to contagion of financial risks from the UK. In 2019, the EU adopted three legislatures which reviewed existing rules on 1) functions of ESAs[24], 2) over-the-counter (OTC) derivatives and financial market infrastructures (FMIs), including CCPs[25], and 3) investment firms, respectively. In a nutshell, they make access to the Single Market by third countries more stringent.

Behind these legislative developments is growing skepticism of the EU that the UK will go for so-called "race to the bottom" in terms of financial regulation and tax regime, in order to attract and to retain financial activities in the City[26]. It might be justified given the fact that one of the UK's fundamental motivations to withdraw from the EU is to get out of the scope of application of the EU rules and the jurisdiction of ECJ. Therefore, the possibility that the EU will not recognize the UK's regulatory and supervisory regimes in different areas of financial services as equivalent to those of itself in certain time after Brexit is high[27]. There also exists wide-spread belief on the EU side that its equivalence regime based on the idea of mutual recognition has not been reciprocal enough in many cases.

Despite the negative influence of Brexit over the EU economy and financial market, there exits a policy intention on the EU side to make use of it for strengthening unity of the community. Loss of the UK well explains the absolute necessity of the projects for deepening integration of the region such as completion of Banking Union and development of CMU. By penalizing the UK, it is believed that the EU can disincentivize the other member states where Euro-skeptic political parties are dominant from following the country and induce them to abide by the fundamental principles of the community (e.g., rule of law, democracy, human rights).

5. Brexit's impacts on Japan

Brexit brings about negative effects on the Japanese financial institutions through two channels which are direct causalities and indirect causalities. In both ways, the damage will arise from change of the EU regulations based on skepticism against third countries, most notably the UK. In this regard, Japanese firms are suffering collateral damages from the EU-UK war of Brexit[28][29]. Already before the UK referendum in 2016, Japan expressed its view to prefer the UK to remain within the EU [HM Government 2016], while it kept its neutral stance not to take side with either party. Since the referendum, the Japanese government has sent messages both to the UK and the EU, urging them to agree to avoid a hard Brexit[30].

5.1. Direct causalities for Japan

In order to maintain their licenses based on Single Passport, the Japanese financial institutions have been practically forced to establish subsidiaries or strengthen resources of the existing subsidiaries inside the EU. It is because, in most of the cases, they have accessed the Single Market with the Single Passport based on the licenses granted by the UK authorities to their subsidiaries in London. Many of the major Japanese financial institutions already announced their plans to establish new subsidiaries in the EU[31]. Most of them have already been granted with licenses from competent European authorities.

EU authorities including European Central Bank which directly supervises significantly important institutions (SIIs) for the stability of the EU financial system and

ESAs (i.e., European Banking Authority, European Securities and Market Authority, European Insurance and Occupational Pensions Authority) are, in the light of Brexit, repeatedly emphasizing that they are not going to grant licenses to subsidiaries without sufficient capital, capacity and staff. The so-called “no letterbox/shell company policy”. In general, processes for development of IT systems and recruitment of local staff take long time. Therefore, third countries’ financial institutions could not afford the luxury to wait and see the outcome of the Brexit negotiation despite the persistent uncertainty.

What makes the situation worse is that no EU financial center can substitute all the functions which the City provides at the same price and of the same quality in a short term, even though some member states are keen to do so. Thus, Japanese firms need to retain their existing subsidiaries in the UK, while opening up new subsidiaries in the continental Europe. It substantially means duplication of their doing business cost in Europe as an entirety, including the EU and the UK, at least until they can concentrate their presences on either side, if possible at all.

It is worth mentioning that one exception of the above may be a new EU’s ringfencing rule. According to it, third countries’ financial institutions with asset over 40 billion euro in the EU will be subject to requirement to establish inter-parental units (IPUs) inside the community. This is a part of tit-for-tat against the US similar requirement of intermediate holding company (IHC) for foreign banking organizations (FBOs) stipulated in Dodd-Frank Act. Depending on the amount of their assets in the UK, some Japanese banks could enjoy exemption of the EU requirement through Brexit which excludes their UK assets from the calculation and reduce the total assets below the threshold.

As is shown in the Table 1, Japan is one of the third countries with the most equivalence decisions made by the EU. The new third country regime will potentially bring greater possibility that Japan loses a/some equivalence decision/s in the future, even if it doesn’t happen suddenly. The growing legal unpredictability could have a significant chilling effect over long-term investment from Japan to the EU (e.g., Japan’s FDIs in financial sectors and involvement in infrastructure development projects in the EU).

5.2. Indirect causalities for Japan

Contrary to the UK, EU's policy changes to make its third country regime more stringent will have limited direct impact on Japan. The EPA between the EU and Japan includes an appendix to stipulate cooperation in financial regulation which is titled Annex 8-A. On this basis, information sharing between the European Commission and the Japan's Financial Services Agency is expected to be enhanced, so that they mutually let the other know about changes in regulatory and supervisory policy well in advance.

As for EMIR 2.2., the possibility that a Japanese CCP is designated as Tier 2 is scarce, given the volume of Euro denominated asset classes cleared by them. However, the future inability to continue using clearing services by UK CCPs for their Euro denominated OTC derivative contracts will have a significant implication. Given the limited liquidity at the continental CCPs at present, the cost to use the service of them will be inevitably higher for most of the Japanese institutions which can not enjoy special treatment due to their limited transaction volumes. The fundamental migration of existing contracts from one CCP to another CCP is unprecedented and will entail unignorable operational risk[32]. Given the relatively long maturities of OTC derivatives, to hold all the existing contracts until their due dates is not a practical alternative.

One of the main reasons for the Japanese financial institutions to have presence in Europe is to provide their Japanese clients in Europe with financial services necessary for them. Especially for small-sized Japanese enterprises, the financial services provided by local European firms are less interesting than those by the Japanese firms, due to better knowledge on their business model and language of Japanese. If a number of manufacturers such as automotive makers and their medium and small-seized subcontractors decide to leave Europe[33] because of the broken supply chain or value chain, the associated financial institutions will perhaps lose the rationale enough to stay in Europe[34].

6. Conclusion

Despite different political propagandas on both sides of the UK and the EU, Brexit is a lose-lose game for both the UK and the EU. Moreover, it is harmful also for most of the third countries, notably including Japan[35]. If anything, the hidden winner will be financial centers in north America and Asia which can enjoy windfalls from the turf war. However, it is fair to call the current situation a lose-lose-LOSE game basically for all the stakeholder groups [Kaneko 2018].

Most probably, important functions of European financial markets will be fragmented in different countries of the world, due to the difficulty for any of the continental European markets to replace London completely in a short term. At the end of the day, the factors which forms the City's eco-system, including English and common law as global standards, will remain unaffected by the Brexit.

Against the backdrop, there seems to be growing concern among the EU legislators over regulatory and supervisory regimes in the third countries as a whole. The concern over "race to the bottom" led by third countries which wish to attract financial transactions and institutions to themselves, can be pointed out as such. EU's counter-reactions will only accelerate market fragmentation, decrease market liquidity and lead to increase of cost for doing business in Europe in the end[36]. Downsizing and fragmentation of the Single Market reduces attractiveness of the European financial market as an entirety.

From a Japanese viewpoint, Europe will remain important as one of the most influential players at international standard setting bodies (e.g. FSB, BCBS, IOSCO, CPMI), rather than as a trading venue after Brexit, as long as the European members, including the European Commission and Bank of England (PRA) are active at such fora. Closer exchange of information and views on financial and economic policies based on the EPA is an impending challenge for both the EU and Japan.

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1 Together with the EPA, Strategic Partnership Agreement (SPA) was also concluded. Prior to the agreements, there were EU-Japan Mutual Recognition Agreement (2001), Agreement on Cooperation on Anticompetitive Activities (2003), The Science and Technology Agreement (2009) and The Agreement on Cooperation and Mutual Administrative Assistance (2008) in place.

2 Rules on capital markets (MiFID), OTC derivatives and financial market infrastructures (EMIR), asset managers (AIFMD) and reinsurance (Solvency II) are the case.

3 One example of politicization of the EU's equivalence decision is withdrawal of its equivalence on Swiss stock exchanges at the beginning of July 2019. Despite lack of reasonable regulatory or supervisory change in Switzerland, the EU decided to do so out of the intention to put pressure to induce it to ratify the technical-level agreement on "Institutional Framework" which is meant to replace current relationship between the two jurisdictions in a comprehensive manner.

4 Trade on GATS terms is seen as one of the worst possibilities of a hard Brexit [Thomas 2018: 46].

5 Heuser [2019] argues that Brexit is not desirable for the both sides mainly from political viewpoints, including security and protection of human rights and democracy in Europe as a whole.

6 Tetlow and Stojanovic [2018] comprehensively analyzes Brexit's impact on the UK real economy, in terms of trade, FDI, labor force, regulations, productivity, value of GBP and other policy responses.

7 For instance, 80-90% of the output of three big Japanese automotive producers active in the UK is exported to the EU. Of these, Nissan has a plant in Sunderland, north-eastern England, which is the largest car manufacturing facility in the UK.

8 Considering that about half of the FDI stock in the UK comes from the EU, it is justified to state that the UK leaving the EU will have a significant impact on inward FDI in the UK and therefore its economy [Napiórkowski 2018: 193].

9 According to an IMF projection and estimate as of end 2018, the nominal GDP of the UK measured in dollar terms at market exchange rates will fall to the world's seventh position after India and France in 2019 from the fifth position in 2018.

10 It is originally known as “Kanban” system in Japanese which enables reduction of cost associated with storage of materials for production.

11 Oliver Wyman [2016] calculates that the UK-based financial services sector annually earns approximately 190-205 billion GBP in revenues, contributes 120-125 billion GBP in Gross Value Added (GVA), and, together with the 1.1 million people working in financial services up and down the country, generates an estimated 60-67 billion GBP of taxes each year. In a scenario that sees the UK move to a third country status with the EU without any regulatory equivalence, 40-50% of EU-related activity (approximately 18-20 billion GDP in revenue) and up to an estimated 31,000-35,000 jobs could be at risk, along with approximately 3-5 billion GBP of tax revenues per annum.

12 The quality of tertiary education is one of the keys to creating the high-quality workforce that the financial sector needs. The UK’s university system contains a number of institutions that rank with the best in Europe, and has recently been expanded to encompass almost as large a proportion of the student-age cohort as in the US [Laslett 2000: 66].

13 According to Office for National Statistics [2019], EU immigration to the UK has continued to fall since 2016 and is at its lowest level since 2013. This is mainly because of a fall in immigration for work, which is now less than half the level it was at its peak in the year ending June 2016.

14 If a third country CCP fails to be recognized as a qualified CCP (QCCP) by the European Commission, participants of the CCP will be subject to a punitive capital charge of 1,250% in accordance with a relevant international standard: Basel rule.

15 In addition, Whitman [2017] maintains that Brexit will have significant political and institutional implications for the external affairs of the devolved administrations of Scotland, Wales and Northern Ireland as a consequence of the devolution of power that has taken place within the UK since it joined the EU.

16 According to a calculation by European Parliament [2017], average losses caused by Brexit will be limited to 0.052 % of GDP annually up to 2030 even in “pessimistic scenarios”.

17 PwC [2018] estimates that the EU’s annual GVA impact will be -0.3% (or 33.0 billion euro in 2016 values) by 2030 in case of hard Brexit, while that of the UK will be -1.3% (or 27.2 billion euro in 2016 values).

18 The UK’s contribution has been refunded partially based on the unique system named “The UK rebate”. Darvas [2019] estimates the total Brexit hole in the EU budget for March 30th 2019, the initial deadline of Brexit which was delayed to October 31st 2019 – December 31st 2020 could amount to about 16.5 billion euro, or 0.066% of EU gross national income (GNI) in case of zero UK contribution after Brexit.

19 The UK accounts for nearly a third of all EU capital market activity, more than France and Germany combined [Asimakopoulos 2019: 5].

20 This is a collective name for EBA, European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA).

21 The then European Commissioner responsible for financial services and the then associated Director-General of the European Commission were both the UK nationals. They left their respective positions immediately after the UK referendum in June 2016.

22 Sapir, et al. [2017] estimates that London could lose up to 30,000 jobs and at least 8 billion euro in revenue each year due to Brexit.

23 In October 2017, Eurex under Deutsche Börse Group in Frankfurt launched an incentive system named “Partnership Program” to share its revenue with the participants of which clearing volumes are relatively large.

24 Based on findings by the EBA of which ex-post monitoring capacity was strengthened with the legislature, the European Commission repealed for the first time existing equivalence decisions in the field of Credit Rating Agencies for Argentina, Australia, Brazil, Canada, and Singapore in July 2017.

25 This legislative work is known as EMIR 2.2.

26 It is not easy to lower regulatory requirement for conventional financial transactions beyond

internationally accepted allowances. On the other hand, there may exist bigger room for it in some new areas (e.g., fintech) where international standards are underdeveloped or not in place yet.

27 According to Ferran [2018: 6], the UK does not want to be shackled to EU norms going forward, and in the search for an alternative model that would provide scope to diverge attention has focused on the use of financial standards and supporting assessment processes as the basis for an alternative 'super-equivalence' model.

28 According to Angelescu [2018a: 3], given the fact that, since the 1980s, the UK government has pro-actively courted Japanese investments, there is an implicit understanding from the Japanese side that the UK government "owes" special attention to Japanese interests, and should keep those interests in mind when negotiating Brexit. The former UK Ambassador to Japan, David Warren, indicated that some of his Japanese counterparts share a sense of "betrayal," and feel that the UK does not share the same understanding of the situation.

29 More evident example of the collateral damage of Brexit than Japan may be Switzerland which suffers growing pressure from the EU to practically integrate it into the Single Market through conclusion of Framework Agreement between the two jurisdictions.

30 For example, MOFA Japan [2016] is a 15-page letter to the UK and the EU which states its hope that the both sides will maintain the current business environment or alleviate impacts of any radical changes, so as to remain an attractive destination for doing business. As regards this publication, Dzienis [2018: 277] points out that what the government in Tokyo seems most troubled about is the future of Japanese business in the UK.

31 For example, SMBC and Norinchukin Bank opened up a new subsidiary in Frankfurt and Amsterdam, respectively and obtained full banking licenses, while MUFG and Mizuho FG reinforced their existing subsidiaries in Amsterdam. Daiwa Securities established a new subsidiary in Frankfurt and obtained a securities trading license. Sompo International established a new subsidiary in Luxembourg and obtained an insurance license.

32 Jeffery et al. [2019] point out the failure of Germany and France to amend rules related to the treatment of OTC derivatives contracts as a risk, quoting a statement by Mark Carney: Governor of Bank of England. "Lifecycle events" such as amendment of the terms of trads and compression are mentioned as such.

33 In February 2019, Nissan announced to switch its production site from the UK to Japan from around 2020 as for new models in the light of rising possibility of hard Brexit.

34 According to Dzienis [2018: 288], the UK has become the second largest safe harbor for Japanese business in Europe, after Germany. This gives Japan a strong position in relation with EU partners and Japan's voice in the Brexit discussion cannot be left unheard.

35 In addition to the economic impacts this article deals with, Angelescu [2018b] asserts that Tokyo seeks reliable like-minded partners to help it advance its goals, concerned about the rise of China and the future of the global liberal international order, and that the prospect of Brexit weakening the international standing of either the UK or the EU, or making them more inward-looking and internationally disengaged, is of equal concern for Japan.

36 According to Carney [2017: 12], industry estimates suggest that a single basis point increase in the cost resulting from splitting clearing of interest rate swaps could cost EU firms 22 billion euro per year across all of their business.

A Lose-Lose-*Lose* Game:
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