

Proposed Regulations on Settlement and Payment Systems

On January 14, 2009, the Financial Services Agency (“FSA”) announced the Report by the Second Subcommittee of the Sectional Committee on Financial System of the Financial System Council subtitled “System concerning Cash Settlement-Promotion of Innovation and Protection of Users”¹ ²(“FSA Report”).

FSA Report advocates ① the introduction of regulations against so-called Server Type electronic money, and ② permitting non-banks to conduct and provide fund transfer services (currently only banks may conduct and provide such services).

According to an article on Page 4 of the morning edition of Nikkei Newspaper on January 16, 2009, the Cabinet will submit “Bill concerning Payment and Settlement” (provisional title) to the current ordinary diet session (i.e. the 171st ordinary session of the Diet).

The notable points described in the FSA Report are as follows:

1. Proposed Regulations on Server-Type E-Money

The Act on Regulation on Prepaid Certificates (Law No. 92 of 1988, as amended, “Prepaid Certificate Act”) is currently applicable to the pre-payment services in which electronic moneys (E-Money) are recorded on the certificates (e.g. papers or cards with IT chips, “Certificate Type”), and imposes certain obligations on the issuer of prepaid certificates, such as deposit of one-half of outstanding balance of the issued amount at the competent Legal Affairs Bureau. However the Act is not applicable to services for which record management is conducted only on a server on the internet (“Server Type”). Both Certificate Type and Server Type E-moneys are prepayment measures, and the only difference is how E-Moneys are stored. This discrepancy is said to be problematic from the viewpoint of consumer protection and equal-footing among E-Money service companies. The FSA Report suggests the introduction of the new regulations on Server Type E-Moneys which are similar to the regulations imposed on Certificate Type E-Money.

With regard to cashable and/or refundable E-Moneys, the FSA Report points out that such service may fall within the definition of “deposit” (*azukari-kin*) under the Investment Deposit and Interest Rate Law (Law No. 195 of 1954, as amended), which only banks and certain financial institutions may legally accept. Considering this issue, the FSA Report suggests prohibiting cash-out and refund of prepaid money in principle.

¹ http://www.fsa.go.jp/singi/singi_kinyu/tosin/20090114-1.html (Japanese version only)

² Please also refer to “Interim Summary of Points of Discussion on Payment and Settlement (Chairman’s Notes)”.

<http://www.fsa.go.jp/frtc/kenkyu/20071218.html> (Japanese)

<http://www.fsa.go.jp/frtc/english/seika/sgr/20080611.html> (English translation)

2. Fund Transfer Services

Currently, only banks licensed under the Banking Law (Law No. 59 of 1981, as amended) and certain other deposit taking financial institutions are permitted to engage in “Exchange Transaction (*kawase torihiki*)” (Article 2, Paragraph 2, Item 2 and Article 4, Paragraph 1 of the Banking Law, etc.).

“Exchange Transaction” under the Banking Law is defined in the case law to mean “to undertake the task of transferring funds requested by customers utilizing the systems of fund transfer without transporting cash between distant traders, or to carry out such a task” (Decision of the Third Petty Bench of the Supreme Court of Japan on March 12, 2001).

As typical fund remittance services fall under the definition of “Exchange Transaction”, companies other than banks may not conduct fund remittance services in Japan.

Although fund remittance services currently conducted by banks are safe and secure, consumers (especially foreigners residing in Japan) frequently complain about banks’ expensive remittance charges and limited business hours of banks. When we turn our eyes to the US and EU countries, fund remittance services are open to non-banks with licenses or authorizations from regulators (“remittance business” in US³ and “settlement business” in EU countries). From the viewpoint of improvement of consumers’ convenience and strengthening international competitiveness for settlement services, the FSA Report suggests permitting non-banks to conduct and provide fund remittance services. The FSA Report also suggests such new service providers shall take measures to secure retained funds from the insolvency of the service providers. It is also recommended that the new service providers shall owe the obligation of identity verification of customers pursuant to the Law on Protection of Transfer of Criminal Proceeds (Law No. 22 of 2007, as amended).

According to the said article in Nikkei Newspaper, the Bill concerning Payment and Settlement will allow a company other than a licensed bank to conduct fund transfer services if the company is registered as a “Fund Transfer Business Operator.” A Fund Transfer Business Operator will be obliged to secure assets in amounts equal to the funds which the operator is transmitting as safeguards to ensure that transferred funds reach the recipient even in the event of a service Fund Transfer Business Operator’s bankruptcy. Although banks are not permitted to engage in other businesses or own more than 5% voting rights of an ordinary company, such restrictions will not be placed on Fund Transfer Business Operators. If such Fund Transfer Business Operators establish a self-regulatory organization, the FSA will grant an authorization to the organization. The organization is expected to draw up self regulations.

3. Inter-Bank Payment Systems

Inter-bank payment is made through payment systems operated by the private sector. The Zengin (Japanese Bankers Association) Data Telecommunication System (“Zengin System”)

³ Please note that regulations are different state by state.

is the main retail payment system, which handles domestic funds transfers among individuals and corporations (i.e. customers). Zengin System is currently operated by Tokyo Bankers Association, a public-interest corporation, the members of which are banks. Operator of Zengin System serves as a clearing institution conducting assumption of obligations regarding payments among multiple banks. To ensure the functions of clearing at Zengin System, it is desirable to strengthen its legal stability.

The FSA Report suggests introductions of measures to supervise Zengin System with reference to regulations in foreign countries and securities settlements systems.

According to the said article in Nikkei Newspaper, the Bill concerning Payment and Settlement will regulate an organization operating inter-bank payment and settlement system (i.e. Zengin System) by licensing as a “Clearing Organization of Funds” (provisional name).

4. Deferred Issues

4.1. Regulations on Point Services

There has been a discussion that “point services” relating to E-Money should be restricted for the consumer protection as points are used for utilizing assets and services like prepayment measures. However, there is strong opposition that points are basically giveaway or free gifts and there is no need for consumer protections.

Also, with regard to the exchange of points, there is a discussion that if the user exchanges point (a) for point (b), the issuer of point (b) can be deemed to have issued its point with the price paid by the users. However, there is a countervailing view, namely that, even if point (a) can be converted into point (b), this does not change the nature of point (a) as a giveaway or a free gift, and point (b) can also be considered as a giveaway or a free gift.

As there has been strong criticism for introduction of regulations on point services, the FSA Report has merely compiled pros and cons of the introduction of new regulations, and has deferred the conclusion.

4.2. Fee Collection Services and Cash-on-Delivery Services

Fee collection (*shuno daiko*) services mean services where agents (e.g. convenience stores) collect bills in cash over the counters of the agents or its affiliates on behalf of providers of goods and services (e.g. collection of fees for public services). Cash-on-delivery (*daikin hikikae*) services mean services where delivery agents (e.g. home-delivery companies) deliver goods or services to customers in return for the payment of the goods or services. Both fee collection services and cash-on-delivery services are currently conducted without any regulations.

It has been argued that these services may theoretically fall within the definition of “Exchange Transaction” (see 2 above). There is also an argument that some measures to

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protect customers' funds should be taken to prepare for the insolvency of the providers as well as to prevent the fraudulent acts of the providers.

However, as there are strong criticisms that there has never been any material issue for these services in terms of consumer protections, and that the regulations on these services may harm the convenience of customers, the FSA Report has merely compiled pros and cons of the introduction of new regulations, and has deferred the conclusion.

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