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## Institutional Framework for Electronic Payment Intermediate Service Providers and Open API - Report by Working Group on the Financial System -

Koichi Miyamoto / Hajime Taura

The “Report by Working Group on the Financial System of the Financial System Council - regarding development of system for open innovation-”<sup>1</sup> (the “Report”) was released on December 27, 2016. The Report is a summary of the outcome of discussions concerning the “electric payment intermediate service providers (third party providers)” by the Working Group on the Financial System.

### I. Background

The “Report by Working Group on the Financial System of the Financial System Council - regarding development of system for open innovation-”<sup>1</sup> (the “Report”) was released on December 27, 2016. The Report is a summary of the outcome of discussions concerning the “electric payment intermediate service providers (third party providers)” by the Working Group on the Financial System.

In reaction to the development of FinTech on a global scale, it is considered important in Japan to promote open innovation between financial institutions and FinTech companies while securing protection of users. In particular, the possibility of the development of a service by the Electronic Payment Intermediate Service Providers<sup>2 3</sup>, as well as the opening of API connecting financial institutions and

<sup>1</sup> [http://www.fsa.go.jp/singi/singi\\_kinyu/tosin/20161227-1.html](http://www.fsa.go.jp/singi/singi_kinyu/tosin/20161227-1.html)

<sup>2</sup> A person engaged in the communication of payment instructions utilizing IT or the acquisition of account information from financial institutions and the provision of the same to customers under entrustment from customers, acting as an intermediary between financial institutions and customers (the “Electronic Payment Intermediate Service Providers”).

<sup>3</sup> The term, which refers to service providers equivalent to a Payment Initiation Service Provider (PISP) and an Account Information Service Provider (AISP) of PSD2 (Revised Payment Services Directive), entered into force in the EU. (see footnote 5)

Electronic Payment Intermediate Service Providers (Open API) are considered to be important issues, and they were examined in the Report.

According to the Report, many Electronic Payment Intermediate Service Providers are providing services by means of scraping<sup>4</sup> in the present circumstances. The Report also pointed out the following as the issues from the perspective of open innovation: (1) concern regarding the security and protection of users, (2) impact on stability of settlement and the banking system, (3) increase in cost for society as a whole arising from the increase in the cost of Electronic Payment Intermediate Service Providers when scraping was used as compared to the case when API was used.

## II. Development of Institutional Framework for Open Innovation

In light of the above issues, it is said that the following laws and regulations could be developed as an institutional framework, referring to the regulatory framework of the Revised Payment Service Directive (PSD2),<sup>5</sup> which was adopted in November, 2017 in the EU, as an example of environmental improvement for open innovation.

### 1. Institutional framework for Electronic Payment Intermediate Service Providers

#### (1) Registration system

A registration system for Electronic Payment Intermediate Service Providers shall be introduced and the following, for instance, shall be required, keeping in mind that such service providers will not hold customer's funds.

- Proper personnel structure (e.g., Reasons for Disqualification)
- Necessary financial requirements
- Appropriate management of information
- Development of operational control system

#### (2) Execution of contracts with financial institutions

When an Electronic Payment Intermediate Service Provider provides service to customers in connection with a financial institution, it shall request execution of a contract with the financial institution<sup>6</sup>.

<sup>4</sup> In general, scraping refers to the method of collecting necessary data by analyzing HTML data on a web page and extracting or processing the data.

<sup>5</sup> [http://ec.europa.eu/finance/payments/framework/index\\_en.htm](http://ec.europa.eu/finance/payments/framework/index_en.htm)

PSD2 entered into force on January 12, 2016 and member states have to transpose it at a national level before January, 2018 (Article 115(1) of PSD2). In PSD2, operations conducted by the so-called third party providers (TPPs) are divided into PIS (a transmission service of the direction to settle regarding user's account for settlement opened by other payment service providers (banks, e-money operators, payment service operators) at the request of the users) and AIS (an online service in which the users integrate one or more accounts for settlement opened by other payment service providers (banks, e-money operators, payment service operators) and are provided with information of them). Business operators that provide those services are respectively referred to as PISP and AISP, and an institutional framework is set for each. Specifically, it includes: (1) introduction of a licensing system for PISP and a registration system for AISP, (2) imposition of a financial requirement on PISP that the amount of capital must be EUR 50,000 or more, (3) the rules of loss distribution, etc. between PISP/AISP and banks, etc.

<sup>6</sup> With regard to business operators that do not transmit the direction to settle and only acquire account information and provide to customers, for instance, execution of a contract could be suspended for a certain period in consideration of the

### **(3) Provision of services by scraping**

Electronic Payment Intermediate Service Providers may be allowed to provide services by scraping even after expiration of the grace period, as long as it is based on a contract with a financial institution, and the financial institutions can accept service providers with a sufficient information management system.

## **2. Institutional framework for financial institutions**

### **(1) Development of systems in financial institutions**

Financial institutions that participate in such efforts for open innovation shall work to develop systems that correspond with Open API within a certain time.

### **(2) Standards of judgment with regard to execution of contracts**

Financial institutions shall establish and publish standards of judgment on whether a contract can be executed or not, and enter into contracts with service providers that meet such standards in principle.

### **(3) Publication of policy regarding introduction of Open API and the rules of loss distribution**

Financial institutions shall set and publish the policy regarding the introduction of Open API and the rules of the distribution of loss accrued by customers in the contracts entered into with Electronic Payment Intermediate Service Providers.

## **3. Other institutional framework and environmental improvement**

### **(1) Appropriate actions in regard to operational aspects**

It is important that appropriate actions are taken in regard to operations including a prompt registration process.

### **(2) Standards related to information security**

It is expected that those involved in industry organizations voluntarily establish risk-based and appropriate standards related to information security led by FISC<sup>7</sup>.

### **(3) Points to note for steady development of open innovation**

It is important that the persons concerned appropriately determine whether or not to require charges and the standard of charges for use of the connection using Open API, depending on the contents of information and other factors.

### **(4) Appropriate handling of customer information**

It is necessary for financial institutions and Electronic Payment Intermediate Service Providers to promote appropriate handling of customer information in connection with the provision of electronic payment intermediate services, in line with related laws and regulations such as the Personal Information Protection Act.

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period necessary for financial institutions to introduce Open API.

<sup>7</sup> "FISC" as used herein refers to the Center for Financial Industry Information Systems.

#### 4. Handling of the regulation of Bank Agency Services

In consideration of the following issues, it is said that what falls under the category of Bank Agency Services should be clarified.

- It is necessary to make a judgment on whether each operation of an Electronic Payment Intermediate Service Provider will be subject to the regulation of Bank Agency Services as an act “for banks” or not<sup>8</sup>, because it is possible for Electronic Payment Intermediate Service Providers to operate “for banks” at the same time as operating “for customers”.
- It is currently understood that receipt of monies “in consideration of determination of terms of contract or involvement in execution of contract” is an action falling under the regulation of Bank Agency Services<sup>9</sup>. However, the application of the regulation is not always clear according to the existing standards since various services using IT, which had not been anticipated when the law was enacted, have emerged.

In addition, with regard to the regulation of Bank Agency Services, it is said that certain notification obligations and system development obligations should be reviewed in consideration of the cost of handling and various needs that have emerged.

### III. Conclusion

In the light of the content of this Report, it is currently expected that a legal framework regarding Electronic Payment Intermediate Service Provider will be legislated by the Diet this year. Generally speaking, introduction of regulations has a risk which could lead to inhibition of innovation. However, as for Electronic Payment Intermediate Service Providers, development of a clear legal framework by legislation would have desirable aspects considering that the absence of a legal framework (including the above issues regarding Bank Agency Services) could have been actually inhibiting innovation due to the ambiguity, making them reluctant to enter the industry as pointed out in this Report. With regard to legislation, it is important to seek sufficient security measures and protection of users while trying not to inhibit open innovation or convenience for users. It is expected that a balanced legal framework will be developed.

In this regard, the review committee on the ideal way of Open API of the Japanese Bankers Association released the intermediate structural plan entitled “Basic concept for security measures and user protection of Open API” on January 20, 2017<sup>10</sup>. The structural plan presents certain principles of security and principles of user protection<sup>11</sup> which will be guidelines for the response of banks and the destinations

<sup>8</sup> Only bank agency services for banks are regulated as Bank Agency Services under the Banking Act of Japan.

<sup>9</sup> This is based on the Financial Service Agency’s opinion on the public comment dated May 17, 2016.

<sup>10</sup> [http://www.zenginkyo.or.jp/fileadmin/res/news/news290120\\_2.pdf](http://www.zenginkyo.or.jp/fileadmin/res/news/news290120_2.pdf)

<sup>11</sup> The following matters were mainly presented as the principles of security.

- Eligibility of destination of API: Preliminary review, monitoring
- Countermeasures against unauthorized access from the outside: Management of access permission (token), authentication regarding each transaction, communication system, robustness of system, illegality detection and monitoring function (on the premise that the system is implemented with OAuth2.0 for granting of access permission, Open ID Connect1.0 for authentication protocol)

of API on the basis of the main risks of Open API (security threat and risk, risks associated with user protection relating to services of destination of API), Progress in future discussions need to be observed closely.

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- Countermeasures against unauthorized access from the inside: Countermeasures against internal illegality in banks, countermeasures against internal illegality in destination of API
  - Response to unauthorized access: System design and specification, information sharing, discussion on countermeasures
  - Continuous improvement and review, and sophistication of security measures
- Also, the following matters were mainly presented as the principles of user protection.
- Eligibility of destination of API: Preliminary review, monitoring, etc.
  - Explanation and display, acquisition of consent: Display of important information, acquisition of consent, display of risks, prevention of misidentification of users, other displays
  - Prevention of unauthorized access
  - Prevention of occurrence and spread of damage: Initial response, report to users
  - Responsibility and compensation to users: Pre-arrangement between the parties, concept on details of compensation and the coverage, points to note when the destination of API is responsible for guarantee and refund

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  - Authors:  
Koichi Miyamoto ([koichi.miyamoto@amt-law.com](mailto:koichi.miyamoto@amt-law.com))  
Hajime Taura ([hajime.taura@amt-law.com](mailto:hajime.taura@amt-law.com))
  
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