

*New Regulatory Framework for Payment Services Business  
-the Payment Services Act*

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On June 24, 2009, the Payment Services Act of Japan (Act No. 59 of 2009) (the “PSA”) was promulgated. The PSA will come into effect within a year of such promulgation.

Key points of the PSA are as follows:

- ✓ The PSA will allow companies (including business corporations), other than licensed financial institutions handling deposits, to conduct fund transfer services in Japan;
- ✓ The PSA will replace the Act on Regulation on Prepaid Certificates of Japan (Act No. 92 of 1989, as amended, the “PCA”), and the PCA will be abrogated once the PSA comes into effect; and
- ✓ The PSA will introduce new regulations on fund settlement of the Japanese inter-bank payment systems.

## 1. Fund Transfer Services

### 1.1. Current Regulatory Framework

Currently, only banks licensed under the Banking Act of Japan (Act No. 59 of 1981, as amended) and certain other financial institutions handling deposits licensed under other applicable laws (collectively, the “Banks”) are permitted to engage in “Money Remittance Transactions (*Kawase Torihiki*)”. Engaging in “Money Remittance Transactions” means “to undertake the task of transferring funds requested by customers utilizing the systems of fund transfer without transporting cash between distant parties, and/or to carry out such task” according to a Supreme Court precedent<sup>1</sup>. As standard fund transfer services fall under the definition of “Money Remittance Transactions”, other than the Banks, no persons are permitted to conduct fund transfer services in Japan.

### 1.2. New Regulatory Framework

The PSA will allow companies that are not licensed Banks to conduct fund transfer services in Japan provided they are registered as “Fund Transfer Business Operators (*Shikin-Ido Gyosha*)” (the “Operators”).

An entity which intends to be an Operator will be subject to the requirement set out in (1) below and an Operator will be subject to certain regulations including those regulations set out in (2) to (5) below:

- (1) Registration requirements;
- (2) Security of its assets;
- (3) Other regulations for an Operator’s customer protection;
- (4) Supervision; and
- (5) Measures against money laundering.

Further details of such are as follows:

- (1) Registration requirements

In order to be registered as an Operator under the PSA, an applicant for registration will be required to

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<sup>1</sup> Decision of the Third Petty Bench of the Supreme Court of Japan on March 12, 2001.

satisfy certain requirements, including the following:

- (i) The applicant must be one of the following:
  - a stock company (*Kabushiki Kaisha*); or
  - a foreign entity which has equivalent registration in its home country and has an office(s) and representative in Japan;
- (ii) The applicant must have sufficient financial standing to conduct the business appropriately and properly;
- (iii) The applicant must have a satisfactory organizational structure to conduct the business appropriately and properly; and
- (iv) The applicant must have a compliance system to ensure compliance with relevant laws and regulations.

With regard to (ii) to (iv), details of the meanings of “sufficient financial standing”, “satisfactory organizational structure” and “compliance system” are expected to be clarified in the cabinet office ordinances or guidelines which will be published in the future.

Although, generally speaking, banks are not permitted to engage in other business or own more than 5% voting rights in an ordinary company under the Banking Law, such restrictions will not to be placed on Operators.

(2) Security of its assets

The PSA will impose on an Operator an obligation to secure the assets in amounts equal to or more than the total amount of (a) funds which an operator is transmitting; and (b) costs of procedure to refund such funds as set out in (a), so that transferred funds can reach the recipient even in the event of an Operator’s insolvency. Details of the methods for calculating (a) and (b) will be clarified in the cabinet office ordinances, drafts of which have not yet been published.

The PSA provides for the following three (3) methods to secure the assets:

- (i) Deposit at deposit office;
- (ii) Conclusion of guarantee agreement with certain financial institutions such as banks (subject to filing a notification with the relevant authority); and
- (iii) Placing on trust (subject to the approval of the relevant authority).

(3) Other regulations for an Operator’s customer protection

In the PSA, there are certain regulations in relation to an Operator’s customer protection other than the asset security obligation described in (2) above. For example, an Operator will be required to take certain measures for the safe management of its information relating to its fund transfer business (such as measures to prevent the divulgence of such information). Also, it will be required to inform its customer of the details of the fund transfer agreement. Details of those regulations will be provided for in the cabinet office ordinances, drafts of which have not yet been published.

(4) Supervision

The PSA provides certain supervisory functions of the relevant authority in relation to an Operator’s business, including the following:

- ✓ An obligation to book and record keep;
- ✓ An on-site inspection;
- ✓ A business improvement order;
- ✓ Cancellation of registration; and

- ✓ A business suspension order.

In addition, if a self-censorship organization is established under the PSA, the organization shall implement rules which its members shall abide by. An Operator may be required, or expected to, become a member of the organization.

- (5) Measures against money laundering

When an Operator conducts business with a customer, it must verify the identity of the customer pursuant to the Act on Protection of Transfer of Criminal Proceeds (Act No. 22 of 2007, as amended) and the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949, as amended).

- (6) Prohibition of a foreign entity providing fund transfer services

In addition to (1) through (5) above, the PSA clarified that a foreign entity is generally prohibited from soliciting Money Remittance Transactions in Japan without registration as described in (1) above.

## 2. Regulation on Pre-payment Services

### 2.1 Current Regulatory Framework

The PCA is currently applicable to pre-payment services (“Certificate Type Services”) where certain values including electronic moneys are recorded on certificates (e.g. papers or cards with IC chips, “Certificate Type Instruments”). The PCA imposes certain obligations on issuers of Certificate Type Instruments, such as the deposit of one-half of the outstanding balance of the issued amount at the competent deposit office. However the PCA is not applicable to services whereby record management is conducted only on a computer server, such as an internet server (“Server Type Services”). In order to purchase the services, users of Certificate Type Services are provided with Certificate Type Instruments; whereas, users of Server Type Services are provided with numbers, codes, etc. (“Server Type Instruments”) which they acquire in exchange for their pre-payment. Both Certificate Type Instruments and Server Type Instruments are prepayment measures, and the only difference is the location where the values are stored. This discrepancy has been said to be problematic in relation to consumer protection and the equal-footing of the issuer of such instruments.

### 2.2 New Regulatory Framework

The PSA is applicable to “prepaid payment instruments”, being Certificate Type Instruments together with Server Type Instruments. Basically, the framework of the regulations under the PSA is similar to that under the PCA; however, some new regulations will be introduced, including the following;

- ✓ Cases will be specified where prepaid payment instruments are refundable;
- ✓ Placing on trust will be introduced as one of the methods to secure the assets of an issuer of prepaid payment instruments<sup>2</sup>;
- ✓ An issuer of prepaid payment instruments will be required to take certain measures for the safe management of its information relating to the issuance of prepaid payment instruments (such as measures to prevent the divulgence of such information); and

<sup>2</sup> The PSA will impose on an issuer of prepaid payment instruments an obligation to secure the assets in amounts equal to or more than one-half of the outstanding balance of the issued amount. The PSA provides three (3) methods to secure the assets as below, while the PCA provides only two (2) methods (i.e. (i) and (ii) below);

- (i) Deposit at deposit office;
- (ii) Conclusion of guarantee agreement with certain financial institutions such as a bank (subject to filing a notification with the relevant authority); and
- (iii) Placing on trust (subject to the approval of the relevant authority).

- ✓ Certain supervision regulations such as the business improvement order and the business suspension order will be applicable to issuers of prepaid payment instruments for their own business (*Jika-gata Hakko-sha*) (the “Own Business Type Issuer”)<sup>3</sup>, which will reinforce the relevant authority’s power of supervision to them.

### 3. Fund Settlement of 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”) is the main retail payment system, which handles domestic fund transfers among individuals and corporations (i.e. customers). The Zengin System is currently operated by the Tokyo Bankers Association and the members of such organization are banks. The organization operating such system serves as a clearing institution and assumes the obligations with respect to payments among multiple banks.

To ensure the function of clearing through the Zengin System, the PSA defines an organization operating such system as a “Fund Clearing Organization” and requires such organization to acquire a license from the relevant authority. Such organization will be subject to the supervisory power of, and inspection by, the relevant authority.

### 4. Deferred Issues

#### 4.1. Regulations on Point Services

In connection with the regulations on the prepaid payment instruments, there has been some discussion that “point services” should be restricted due to consumer protection issues as these point services are used for utilizing assets and services like prepaid payment instruments. However, there is strong opposition that these point services are basically giveaways or free gifts; and for that reason there is no need for any consumer protection.

Also, with regard to the exchange of points, there has been ongoing discussion that if a user exchanges point A for point B, an issuer of point B may be deemed to have issued its point with the price paid by such user. However, there is a contrary 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, therefore, point B can also be considered as a giveaway or a free gift.

The Japanese government took into consideration the strong criticism for the introduction of the regulations on point services and, at the Diet, expressed that the PSA is not intended to be applied to such services, however, points issued with the price paid by users would fall under the definition of “prepaid payment instruments” under the PSA.

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

Fee collection (*Shuno Daiko*) services means services where agents (e.g. convenience stores) collect bills in cash over the counter on behalf of the providers of goods and services (e.g. collection of fees for public utilities). Cash-on-delivery (*Daikin Hikikae*) services mean services where delivery agents (e.g. home-delivery companies) deliver goods or services to customers for payment of the price for such goods

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<sup>3</sup> An Own Business Type Issuer means an issuer of prepaid payment instruments who has filed a notification of such with the relevant authority. Basically, any prepaid payment instruments issued by an Own Business Type Issuer to a customer must be used by such customer only with the relevant Own Business Type Issuer and not with any other goods /services providers. Under the PCA, both the business improvement order and the business suspension order are not applicable to Own Business Type Issuers.

or services. Both fee collection services and cash-on-delivery services have been conducted without any specific regulations.

It has been argued that these services may theoretically fall under the definition of “Money Remittance Transactions” (see 1.1 above). There is also an argument that some measures to protect customers’ funds should be taken to prepare for the insolvency of the providers as well as to prevent fraudulent acts by providers.

The Japanese government took into consideration the strong criticism that there has never been any material issue for these services in terms of consumer protection and that the regulation of these services may harm the convenience of customers. At the Diet, the Japanese government advised that the PSA is not intended to be applied to such services; however, the Japanese government has not expressed a clear view as to whether or not these services fall under the category of “Money Remittance Transaction”.

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