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Report by the “Working Group on Payment Services System, etc.” of the Financial System Council and Proposed Revisions to the Payment Services Act (Part 1) - Funds Transfer Services

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On January 22, 2025, the “Working Group on Payment Services System, etc.” of the Financial System Council published its report on payment services systems (the “WG” and the report published by the WG, the “WG Report”). This was followed by the publication of a bill for amendment of the Payment Services Act (the “PSA”, and the bill for amending the PSA, the “Amendment Bill”) on March 7, 2025¹. The WG Report mainly addresses and considers issues of (i) remittance/payment services and (ii) crypto assets/electronic payment instruments (stablecoins). Among these issues, this newsletter provides an outline of the issues for (1) diversification of methods to return user funds upon bankruptcy and (2) deregulation of retention of funds by Type I Funds Transfer Services.

● **Funds Transfer Services**

1. Diversification of Methods to Return User Funds upon Bankruptcy

(A) Current Status and Issues

As funds transfer service providers (“FTSPs”) receive funds for funds transfers from users,

¹ <https://www.fsa.go.jp/common/diet/index.html> (Japanese only)

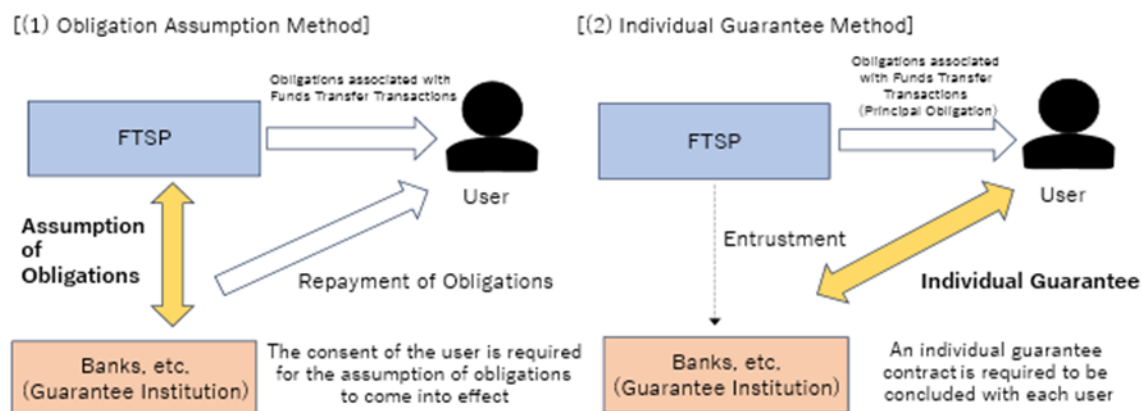
users bear the credit risks associated with bankruptcy, etc., of FTSPs. While FTSPs are required to have a financial basis for the proper and sound performance of the funds transfer services under the PSA (Article 40, Paragraph 1, Item 3 of the PSA), there is no requirement for a minimum amount of stated capital. Instead, as precautionary measures against credit risks borne by users, FTSPs are required to make a security deposit in an amount required for security deposit for providing funds transfer services to the official depository nearest to its head office under the PSA. Such required amount is calculated based on the amount of outstanding obligations in the process of being transferred (Article 43, Paragraph 1 of the PSA). Although FTSPs must preserve assets by way of (i) security deposits as a general rule, FTSPs are also permitted to preserve assets by way of (ii) guarantees by banks, etc. (guarantee contracts for security deposits for providing funds transfer services; Article 44 of the PSA), and (iii) by settling trusts with trust companies, etc. (trust agreements for security deposits for providing funds transfer services; Article 45 of the PSA). Either by way of (ii) or (iii), upon bankruptcy of an FTSP, authorities order the bank or the trust company to deposit all or part of the secured amount or the amount of proceeds from the trust property that has been realized; therefore, FTSPs are subject to official deposit procedures. In addition, **it takes at least 170 days to return the security deposits to users** through the official depository.

(B) Proposals in the WG Report

In this respect, the WG Report states that, in terms of providing options to return funds promptly while ensuring a sound and secure process, there is a need for a method which, upon bankruptcy of an FTSP, enables funds to be returned directly to users without subjecting to the official deposit procedures. While ensuring that FTSPs have the option to choose between the conventional methods described above and the new methods, the WG Report proposes introducing the following two (2) methods.

(i) Method for returning funds directly by a guarantee institution

There are two possible methods for returning funds directly by a guarantee institution: (1) an obligation assumption method, and (2) an individual guarantee method. (1) The obligation assumption method is a method where an agreement for assuming obligations is concluded between a FTSP and a guarantee institution in advance, and upon bankruptcy of the FTSP, the guarantee institution will assume the obligations of the FTSP to the users and repay the same directly to the users. (2) The individual guarantee method is a method where a guarantee contract is concluded between users of the FTSP and a guarantee institution in advance, and upon bankruptcy of the FTSP the guarantee institution will repay the guaranteed obligations directly to the users. As for (1), the consent of the users is required for the assumption of obligations to come into effect, and as for (2), guarantee contracts are required to be concluded between the guarantee institution and each user. In both cases, it is reasonable to obtain the consent of the users or concluding guarantee contracts through the FTSP.



Source: Excerpt from p.14 of Material 1 of the "Bureau Explanation Material" of the 2nd meeting of the Working Group on Payment Services System, etc., for the Financial System Council (October 17, 2024) ²

(ii) Method for returning funds directly by trustee

This is a method where a trust agreement in which users are the beneficiaries is concluded between the FTSP and the trustee in advance, and upon the bankruptcy of the FTSP, the trustee will repay the agent of the beneficiaries using the trust property as the source of repayment, and the agent of the beneficiaries will then repay the users directly.

So as not to damage the users' interests, as for the (i) method for returning funds directly by guarantee institution, it is expected that banks, etc. that meet the criteria for sound management will serve as the guarantee institution to ensure that the guarantee institution will not go bankrupt, and as for the (ii) method for returning funds directly by trustee, it is expected that trust companies, etc. will serve as the trustee, and that attorneys or certified public accountants will serve as the agents of the beneficiaries to properly manage the trust property. In addition, it is also expected that the prime minister will be given the power to order FTSPs which have installed the new method for returning funds based on the proposed regulations, to make security deposits, if necessary for the protection of users.

(C) The Amendment Bill

According to the Amendment Bill, which was drafted by the JFSA based on the WG Report and was submitted to the Diet on March 7, 2025, it is proposed that the FTSP may replace an obligation to make a security deposit with one of the following measures:

1. Performance Obligation Assumption Agreement (Article 45-3 of the bill)

Entering into a performance obligation assumption agreement with a financial institution that meets certain requirements ("Qualified Performance Guarantor"). Under this agreement, the Qualified Performance Guarantor agrees to assume all or part of the obligations relating to funds transfer services that the FTSP owes to all or part of its users, in the event that a petition for the commencement of bankruptcy proceedings or similar

² https://www.fsa.go.jp/singi/kessaiseido_wg/siryoku/20241017/1.pdf (Japanese only)

event occurs in relation to the FTSP.

2. Performance Guarantee Agreement (Article 45-4 of the bill)

Entrusting the conclusion of a performance guarantee agreement to a Qualified Performance Guarantor, under which the Qualified Performance Guarantor agrees to guarantee all or part of the obligations relating to funds transfer services that the FTSP owes to its users, in the event that a petition for the commencement of bankruptcy proceedings or similar event occurs in relation to the FTSP.

3. Performance Guarantee Trust Agreement (Article 45-5 of the bill)

Entering into a performance guarantee trust agreement with a trust company. Under this agreement, the trust assets shall be managed with the purpose of being used, in the event of a petition for the commencement of bankruptcy proceedings or similar event involving the FTSP, to repay all or part of the obligations relating to funds transfer transactions that the FTSP owes to all or some of its users. The trust agreement must also provide for necessary acts to manage the trust property to fulfill this purpose, and the competent authority must be notified of the conclusion of such an agreement.

2. Deregulation of Retention of Funds by Type I Funds Transfer Services

(A) Current Status and Issues

While Type I FTSPs are able to process large amount funds transfer transactions that exceed JPY one (1) million per transfer, the failure to ensure the performance of such transactions will have a significant social and economic impact, such as causing the beneficiaries of the transferred funds to face cash-flow issues. Under the current rules, the so-called strict retention regulations apply, whereby (i) from the point where outstanding obligations in the process of being transferred are accrued, FTSPs are required to ensure that the funds transfer transactions are completed within the period necessary for processing administrative affairs relating to the transfer of funds, and (ii) FTSPs may not accept funds for which specific instructions of funds transfer transactions are not given. With respect to (i), funds transfer transactions are generally expected to be completed within several days to a week, although this may vary depending on the processing structure of each FTSP. With respect to (ii), specific instructions of funds transfer transactions clarifying (a) the amount of funds to be transferred, (b) the day on which the funds are to be transferred, and (c) the beneficiary to which the funds are to be transferred are required (Article 51-2, Paragraph 1 of the PSA; Article 32-2, Paragraph 1 of the Cabinet Office Ordinance on Funds Transfer Service Providers; III-1-1-1(1)(i) of the “14 Guideline for Supervision of Funds Transfer Service Providers”). If any of the aforementioned is not clarified, it is deemed that sufficient specific instructions of the funds transfer transactions have not been given.

In addition, (iii) in terms of preventing regulations from being circumvented with respect to funds received from users by FTSP engaging in both Type I and Type II funds transfer services, if the FTSP is engaged in both Type I and Type II funds transfer services, the FTSP is prohibited from diverting the funds received from users through Type II funds transfer

services to Type I funds transfer services. Therefore, in order to use the funds received through Type II funds transfer services for the Type I funds transfer services, the FTSP is required to take such measures as refunding the funds to the user's bank account, etc. from the Type II funds transfer services account, and then the user transfers the funds to the Type I funds transfer services account.

(B) Proposals in the WG Report

The WG Report proposed the following three (3) amendments.

(i) Allowing an extension of the period of retention of funds

For the purpose of improving users' convenience and maintaining the balance with regulations on banks, etc., and based on the fact that it is a regular business practice in Japan to make payments by the end of the following month, and in light of the business model of each operator, the WG Report proposed that FTSPs be allowed to retain funds for up to two (2) months. However, since a time lag of two (2) business days are permitted between the receipt of user funds and the preservation of assets by making a security deposit, FTSPs will be required to explain the risks of FTSPs going bankrupt, etc. to the users in advance. The WG Report also suggested that each FTSP establish the following systems (a) and (b) in order to minimize the effects on users of a bankruptcy, etc. of the FTSP.

(a) System for returning user funds promptly

The establishment of this system is based on the assumption that the method for returning funds directly by the guarantee institution or the trustee stated in (1) above has been adopted, making it possible to return user funds promptly. In addition, FTSPs will be required to manage the users' creditor information and be aware of users' contact and account information.

(b) System for returning user funds with great certainty

For example, FTSPs will take one of the following measures after informing the authorities.

- (In the case of trust) that the time lag will be reduced from two (2) days to one (1) day or less;
- That an amount equal to or greater than the amount of the funds expected to be received from users will be preserved in advance by guarantee or trust;
- If the received funds exceed the amount preserved at that time, that the amount in excess will be managed separately by bank deposits until the amount in excess is preserved.

(ii) Easing the specificity level of acceptable transfer requests

The WG Report proposed an amendment to the effect that if "the day on which the funds are to be transferred" cannot be specified upon the user's request, FTSPs will be allowed to specify "the deadline for transferring the funds" instead. Nevertheless, specific instructions of the amount of funds to be transferred, and concerning the beneficiary to which the funds are to be transferred, will still be required.

(iii) Allowing FTSPs engaging in both Type I funds transfer services and Type II funds

transfer services to transfer funds

The WG Report proposed allowing FTSPs to transfer the funds received as Type II funds transfer services to Type I funds transfer services. However, with a view to preventing the regulations governing Type I FTSPs from being circumvented, FTSPs will not be allowed to design a system under which funds scheduled to be used for funds transfer transactions related to Type I funds transfer services will be received under Type II funds transfer services from the beginning and then pooled, and funds scheduled to be used for funds transfer transactions related to Type II funds transfer services may be transferred only in such cases where it later becomes necessary to transfer more than JPY one (1) million.

(C) Expected Amendments on the Regulations

It is expected that the revised Cabinet Office Ordinance on Funds Transfer Service Providers will prescribe the deregulation of the requirements relating to the retention of Funds by Type I Funds Transfer Services, but the revised Cabinet Office Ordinance has not yet been made public.

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