

# Regulations on payment-services business in Japan

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**On April 1, 2010, the Payment Services Act of Japan (Act No. 59 of 2009, as amended; the “PSA”) came into force to regulate certain payment services in Japan, the most significant of which are fund transfer services and pre-payment services. This article presents some of the fundamental aspects of the PSA, with an emphasis on the provisions relating to fund transfer services, as well as an outline of the provisions relating to pre-payment services.**



## Outline of regulations on fund transfer services

Prior to April 1, 2010, only banks licensed under the Banking Act of Japan (Act No. 59 of 1981, as amended; the “Banking Act”) and certain other financial institutions handling deposits licensed under other applicable laws (collectively, “Banks”) were permitted to engage in fund transfer services in Japan.

Commencing on April 1, 2010, however, the PSA has allowed entities that are not Banks to conduct fund transfer services in Japan provided that (i) they are registered as “fund transfer business operators” with the relevant Local Finance Bureau in Japan; and (ii) the amount of funds to be transferred per customer request does not exceed ¥1m (or the foreign currency equivalent thereof).

Any entity wishing to act as a fund transfer business operator will be subject to a registration requirement, as well as regulations covering matters including the security of its assets and other customer protection measures, regulatory supervision and anti-money laundering measures.

Enacted with the legislative goals of avoiding over-regulation and enhancing convenience for users, the PSA and related laws and regulations set out minimum regulations intended to ensure customer protection and sound development of the fund transfer business. Accordingly, certain regulations that are imposed on Banks are not imposed on fund transfer business operators. For example, although banks generally are not permitted under the Banking Act to engage in other businesses or to own more than 5% of the voting rights in any ordinary company (unless otherwise specified in the Banking Act), such restrictions are not imposed on fund transfer business operators. Further details are set forth below.

## Registration requirements for fund transfer business operators

Under the PSA, any entity wishing to register as a fund

transfer business operator will be required to fulfill certain conditions, the most significant of which are described below.

### Organisation and staff requirements

The applicant must be (i) a stock company (*kabushiki kaisha*), or (ii) a foreign entity which has an equivalent registration in its home country, and has an office(s) and representative in Japan. Accordingly, any foreign entity wishing to register as a fund transfer business operator must establish either a branch or a subsidiary in Japan. Both options require the appointment of at least one representative resident in Japan.

In addition, the PSA requires the applicant to establish (a) a satisfactory organisational structure and appropriate systems for the conduct of fund transfer services and (b) appropriate systems to ensure compliance with applicable laws and regulations, including anti-money laundering regulations and foreign exchange regulations. Under the guidelines issued under the PSA by the Financial Services Agency of Japan (the “FSA”), the systems mentioned in items (a) and (b) above include (i) an internal supervision unit, (ii) a sound internal compliance system, and (iii) stable IT and other operational systems.

### Financial requirements

The applicant must have sufficient financial standing to conduct fund transfer services appropriately and properly; however, there are no express standards as to this requirement (e.g., capital requirements or net assets requirements). As part of this requirement, the above-mentioned guidelines require the applicant to have (i) sufficient financial standing to fulfill a specified asset security obligation (as described below), and (ii) the ability to procure sufficient funds to make payment to its customers.

The PSA also provides that foreign entities are generally prohibited from soliciting any person in Japan to use fund transfer services provided thereby unless registered as described above.

## Regulations applicable to fund transfer business operators

### Asset security obligation

In order for transferred funds to reach the recipient even in the event of the fund transfer business operator's insolvency, the PSA imposes on every fund transfer business operator an obligation to "secure" its assets in an amount not less than the greater of (a) ¥10m or (b) the aggregate of (i) all funds transmitted by such fund transfer business operator during a prescribed calculation period, and (ii) certain other costs which are likely to be incurred by customers in seeking refunds of the amount prescribed in (i).

The PSA provides the following three methods in order to "secure" the assets of a fund transfer business operator:

- deposit of required amount at a governmental deposit office in Japan;
- execution of a guarantee agreement with a prescribed financial institution (e.g., a bank licensed under Japanese law which satisfy certain requirements) and filing of a notification thereof with the FSA; or
- placement of assets in the required amount in a

prescribed trust established under Japanese law (subject to approval of the FSA).

In the event of a fund transfer business operator's insolvency, customers are granted express rights to recover their assets from the above secured assets in priority over the fund transfer business operator's general creditors, pursuant to procedures prescribed in the PSA.

### Safe management of information

Fund transfer business operators are required to ensure the safe management of information relating to their fund transfer services. As a part of this requirement, fund transfer business operators must take measures to ensure adequate management of IT systems relating to their fund transfer services, as well as measures to prevent the disclosure, loss and/or damage of personal information relating to such services.

### Supervision of outsourcees

If a fund transfer business operator outsources its fund transfer services to a third party, the fund transfer business operator is required to ensure the appropriate and proper implementation of such outsourced services. As part of this requirement, fund transfer



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business operators must carry out necessary and appropriate supervisory actions regarding their outsourcees, such as (a) examining periodically, or as necessary, whether the outsourcees are appropriately and properly implementing the outsourced services and (b) requiring the outsourcees to make improvements when necessary. In addition, fund transfer business operators must take necessary measures, including amendment or termination of agreements with relevant outsourcees, to ensure the appropriate and proper implementation of outsourced services and the protection of customers.

An "outsourcee" includes: (i) any re-outsourcee and any third party which is outsourced by such re-outsourcee to provide the outsourced services; (ii) any third party substantively implementing the relevant fund transfer business operator's business without executing an outsourcing agreement; and (iii) any third party implementing outsourced services in foreign countries.

#### **Other measures for protection of customers**

Fund transfer business operators are required to carry out certain other activities for the protection of their customers, including informing them of the details of the relevant fund transfer agreement and providing them with explanations to prevent them from mistaking fund transfer services conducted by the relevant fund transfer business operator for those conducted by Banks (fund transfer services conducted by Banks are subject to stronger regulations for the protection of customers than those conducted by fund transfer business operators).

#### **Supervision**

The PSA imposes on each fund transfer business operator an obligation to prepare and preserve the books and records relating to its fund transfer services. In addition, each fund transfer business operator is required to prepare and submit to the FSA (i) an annual business report, and (ii) a periodic report on its asset security obligation (as described above), each in a specified form. Fund transfer business operators may also be subject to on-site inspections; business improvement orders; cancellation of registration; and business suspension orders.

#### **Anti-money laundering measures and related measures**

Similarly to Banks, fund transfer business operators are required for anti-money laundering purposes to verify the identity of each customer with which they conduct business, and must also file suspicious activity reports in certain situations, pursuant to the Act on Prevention of Transfer of Criminal Proceeds of Japan (Act No. 22 of 2007, as amended) and/or the Foreign Exchange and Foreign Trade Act of Japan (Act No. 228 of 1949, as amended). If the fund transfer business operator

confirms in a prescribed manner that the identity of the relevant customer has been verified previously and that the relevant records have been properly stored, repeat verification of the identity of such customer generally will not be required.

In addition to these anti-money laundering measures, the Act on Submission of Reports Regarding Fund Transfers Directed Outside Japan to Ensure Appropriate Levy of Internal Tax of Japan (Act No. 110 of 1997, as amended) will generally require any customer that makes a payment directed outside Japan or receives a payment from outside Japan through a fund transfer service to submit a notification to the relevant fund transfer business operator. In such case, the fund transfer business operator will generally be required to confirm in a prescribed manner the customer's name and address set forth in such notification.

#### **Self-regulatory organisation**

On April 1, 2010, the Japan Payment Service Association (the "JPSA") was certified by the FSA as a "certified payment services operators association" under the PSA. The JPSA is a self-regulatory organisation comprised of fund transfer business operators and issuers of prepaid payment instruments (as described below), and implements rules by which its members must abide. Membership in such association by fund transfer business operators is on a voluntary basis. In practice, however, the most fund transfer business operators active in Japan have joined the JPSA.

## **Regulations of prepaid payment instruments**

The PSA also regulates other related fields. One such field is the business of issuing certain prepaid payment instruments.

Prior to April 1, 2010, pre-payment services in which certain values are recorded on certificates (e.g., documents, IC chip-equipped cards or mobile electronic devices) were regulated; whereas services in which record management was conducted only on a computer server were not expressly subject to regulation. Since both services constitute pre-payment mechanisms, this discrepancy was viewed as problematic from the perspective of consumer protection. Accordingly, effective as of April 1, 2010, both mechanisms became subject to the coverage of the PSA as prepaid payment instruments.

So-called "electronic money" is generally likely to fall within the meaning of prepaid payment instruments under the PSA. By contrast, certain other instruments (e.g., membership cards) as a matter of interpretation of law do not fall within the meaning of prepaid payment instruments under the PSA, and accordingly are not regulated thereunder. In addition, the PSA provides

express exceptions for certain types of instruments (e.g., railway tickets and admission tickets), and instruments falling within such exceptions are not regulated under the PSA. Accordingly, whether a specific instrument will constitute a prepaid payment instrument regulated by the PSA will depend on its nature and structure.

#### **Notification requirement**

Under the PSA, entities or persons which engage in issuance of “prepaid payment instruments for their own business” (but not in issuance of “prepaid payment instruments for the business of third parties” as described below) must file a post-facto notification with the relevant Local Finance Bureau if the aggregate outstanding balance of the issued prepaid payment instruments as of any prescribed record date exceeds ¥10m. For the purpose of the PSA, “prepaid payment instruments for their own business” means prepaid payment instruments which can be used by holders thereof only with the issuer thereof or with certain entities/persons closely related to such issuer; but not with other providers of goods or services.

#### **Registration requirement**

Under the PSA, any entity wishing to engage in the business of issuing “prepaid payment instruments for the business of third parties” must first register with the relevant Local Finance Bureau. For the purpose of the PSA, “prepaid payment instruments for the business of third parties” means any prepaid payment instruments which do not fall within the meaning of prepaid payment instruments for their own business. An example would be, e.g., prepaid payment instruments which can be used with designated providers of goods or services other than or in addition to the issuer and certain entities/persons closely related to the issuer.

In order to so register, the applicant must be (i) a judicial person incorporated under Japanese law, or (ii) a judicial person incorporated under foreign law which has an office in Japan. In addition, the PSA requires the applicant to (a) take measures to ensure that the goods or services which can be provided by member shops in exchange for prepaid payment instruments issued by the applicant do not and are not likely to impair public order or morals; and (b) establish appropriate systems for proper payment to member shops. The PSA also requires the applicant to establish appropriate systems to ensure compliance with relevant laws and regulations. Furthermore, the applicant must have net assets equal to or exceeding a prescribed amount (such amount may range from zero to ¥100m, depending on the scope of usability of

the relevant prepaid payment instruments and other related matters); provided that the above restriction will not apply to certain non-profit organisations approved under Japanese law.

#### **Regulations applicable to issuers of prepaid payment instruments**

The PSA sets forth detailed provisions applicable to issuers of prepaid payment instruments that have filed notifications or completed registrations as described above. Such provisions include: an obligation to provide certain information to customers; an asset security obligation; prohibition of repayment of prepaid payment instruments; an obligation to ensure the safe management of information; book and record keeping obligations; ongoing reporting requirements; on-site inspection provisions; and a grant of power to the regulatory authorities to issue business improvement orders, to cancel registrations and to issue business suspension orders.

The PSA also clarifies that foreign entities are generally prohibited from soliciting any person in Japan to purchase prepaid payment instruments issued thereby in a foreign country without notification or registration (as applicable) as described above.

#### **Conclusion**

The regulatory framework for the payment-services business in Japan was drastically altered by the PSA when it came into force on April 1, 2010. These regulatory changes in turn have impacted many aspects of the business of those working in this area. Particularly affected are fund transfer services, which were previously the exclusive preserve of Banks in Japan.

For payment-services providers generally, the new framework provided under the PSA offers both a variety of business possibilities and reasons for appropriate caution.

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