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Japanese Fintech Regulation Update: New Law & Regulations on Electronic Banking Settlement Agency Service

The Financial Service Agency of Japan (JFSA) submitted a bill (Bill) to the National Diet to amend the Banking Act (Act No. 59 of 1981, as amended, the Banking Act) on March 3, 2017, to employ a new regulation on the electronic banking settlement agency service (Electronic Settlement Agency Service or Service), which provides agent services for bank account holders, such as giving a remittance instruction to banks or receiving bank account information from a bank on behalf of such account holders.

Background

Payment services provided by financial technology (fintech) companies have been developed on a global scale and international financial institutions are proactively working out their strategies for upcoming financial technologies. Under the circumstances, the Financial System Council established by the JFSA discussed the "Open Innovation," which means more collaboration between banks and fintech companies to provide better solutions for addressing customers' settlement needs. A report was published regarding the establishment of a system for Open Innovation on Dec. 27, 2016 (Report).

The Report warned that an increasing number of fintech companies, which are unregulated, have accessed their customers' bank accounts on their behalf by retaining and using customers' IDs and passwords, and have received an unlimited amount of information related to customers' bank accounts. In addition, the Report claimed that the situation might expose such customers to great risk of information leakage and unauthorized access, and that such unauthorized access or fraudulent instructions may cause adverse effects on the stability of banking systems. In response to the Report, JFSA drafted the Bill to employ a new regulation on an Electronic Settlement Agency Service to protect both consumers' information and the stability of banking systems, while enhancing the collaboration between banks and fintech companies to enhance convenience and productivity in settlement services in Japan.

The three pillars of the Bill are as follows:

- > Registration requirements on Electronic Settlement Agency Service in Japan;
- > Regulations on conduct of Electronic Settlement Agency Service providers (Electronic Settlement Agency Service Provider or Provider); and
- > Obligation to execute agreements between banks and Electronic Settlement Agency Providers.

This Bill is being discussed during this Diet session, and after passing the Diet and enacting the amended Banking Act, JFSA will publish a draft of detailed regulations for Electronic Settlement Agency Services.

Key Features of the New Regulation

Definition of Electronic Settlement Agency Service

The **Electronic Settlement Agency Service** is defined in the Bill as follows:

- > At the direct or indirect request of a person who holds a deposit account at a bank (Account Holder), instructing or intermediating the request to transfer funds via an electronic data processing system; or
- > At the direct or indirect request of an Account Holder (including those who hold an installment saving account), acquiring information related to the account from the bank and providing the information to the Account Holder (including providing the information via third parties or providing modified information) via an electronic data processing system.

So-called “eWallet service,” which is generally a service to purchase goods/services or to keep/transfer real money on behalf of its customers, is currently handled by money transfer business providers in Japan to the extent permissible under the Act on Settlement of Funds (Act No. 59 of 2009, as amended, the Settlement Act) and other applicable laws and regulations. One restriction of the Settlement Act is the limitation of transferring a maximum of JPY 1 million (approx. USD 9,000) per transaction. However, Electronic Settlement Agency Service Providers may provide payment solutions without being subject to such restriction on transfer amounts because they do not have to rely on the money transfer business registration under the Settlement Act. The key for the success of such a solution, which relies on the banking system, may be to allow banks to become more flexible in setting the remittance fees. This is because the high cost of remitting money through the banking system may cause retail consumers to choose the money transfer business providers.

If an Electronic Settlement Agency Service Provider enters into relevant agreements with multiple banks for its underlying customers/Account Holders, the Provider may control the entire money flow to/from such customers’ bank accounts.

Registration Requirements

Electronic Settlement Agency Service Providers are required to register to conduct Electronic Settlement Agency Service in Japan. Although both an individual (including foreign nationals) and a legal entity (including entities established in a foreign country) can be registered as an Electronic Settlement Agency Service Provider, non-resident foreign individuals/entities cannot be registered as an Electronic Settlement Agency Service Provider without placing an agent or representative in Japan.

An applicant is required to submit an application form with certain documents attached. The information included in the application form is to be registered and subject to public disclosure. Such information includes, but is not limited to, trade name, address, and name of each director, executive officer, and representative in Japan.

The following are some of the documents that are required to be attached to the application (not exhaustive):

- > A company oath to declare that a company does not fall under any disqualification items specified in the amended Banking Act;
- > The Articles of Incorporation and a certificate of registered matters; and
- > A document describing business contents and methods.

Detailed requirements will be provided in the Amended Regulations after the enactment of this Bill.

Regulations on Operation; Protection of Investors

A registered Electronic Settlement Agency Service Provider is required to take necessary measures for: (i) providing a disclaimer to its customers to prevent any misunderstanding that the service is carried out by a bank; (ii) proper treatment and safe management of customers' information obtained for the Electronic Settlement Agency Service; (iii) ensuring proper provision of the Service, even if the Provider delegates a part of the Service to a third party; and (iv) other matters related to ensuring sound and proper management of the Service.

An Electronic Settlement Agency Service Provider must provide certain information (*e.g.*, trade name, address, its authority, damage compensation, a contact point for addressing claims or consulting with customers, etc.) to its customers before conducting Electronic Settlement Agency Service.

An Electronic Settlement Agency Service Provider must prepare and keep books and records on its business and submit a business report to the regulators for each fiscal year as required under the amended Banking Act.

An Electronic Settlement Agency Service Provider shall execute an agreement pertaining to Electronic Settlement Agency Service with each bank, which specifies the following items:

- > Allocation of damage compensation liability between the bank and the Provider when a customer suffers damage from the Service;
- > Measures taken by the Provider for proper treatment and safe management of customer information obtained for the Service, and measures which can be taken by the bank if the Provider does not take such measures; and
- > Other matters necessary for ensuring proper provision of the Service, which will be specified in the Amended Regulations.

These items shall be disclosed on the Internet or in some other way without delay when a bank and an Electronic Settlement Agency Service Provider execute the agreement.

Furthermore, a bank is required to prepare and disclose the criteria of matters to be satisfied by an Electronic Settlement Agency Service Provider prior to executing such an agreement (including, but not limited to, measures for proper treatment and safe management of customer information obtained for the Service). The bank may not treat any Electronic Settlement Agency Service Provider, which satisfies the criteria above, in an unjust or discriminatory way in executing the agreement on the Service.

AML/CFT

Electronic Settlement Service Agencies will not be subject to the Act on Prevention of Transfer of Criminal Proceeds (Act No. 22 of 2007, as amended, the AML Act), because they merely receive and deliver instruction of funds retained at bank accounts and will not retain any customers' funds. An AML check shall be conducted by the contracted bank side.

End Note

The purpose of this memorandum is to provide a general overview of the Bill on the Banking Act regarding Electronic Settlement Agency Service in Japan. It is not intended as a comprehensive and detailed analysis of all of the provisions of the regulations that may apply to Electronic Settlement Agency Service. Also, it is important to keep in mind that the detailed regulations will be prepared after the Bill passes the Diet and is enacted. Therefore, if you would like additional information on the Electronic Settlement Agency Service in Japan that may affect your potential business or transactions with Japanese residents, please feel free to contact us.

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