



Financial Services Agency

A photograph of several Japanese coins, including a 1000-yen gold coin and a 500-yen silver coin, resting on a white, smoky surface against a red background. The coins are scattered and partially obscured by the smoke.

**Strategies for Reforming
Japanese Payment Systems**

Final Report

by the Financial System Council



Final Report: Strategies for Reforming Japanese Payment Systems

Presented to the Minister for
Financial Services by the chairman
of the Financial System Council

December 2015

This report is a provisional translation
of original Japanese version.

Contents

Introduction		1
Chapter 1	The basic directions of the reform of payment system	2
Section 1	Transformation of the environment enveloping payment services	2
Section 2	The basic directions of the reform of payment system	3
Chapter 2	Retail payment services innovation corresponding to FinTech	4
Section 1	The directions to be pursued	4
(1)	Recent trends	4
(2)	The directions to be pursued	4
Section 2	New initiatives for FinTech innovation.	6
Section 3	Establishment of a cross-sectional legal system	7
(1)	The current legal system over payments and transaction banking	7
(2)	Fundamental issues to be tackled	7
(3)	The future of the legal system concerning payment services	9
Section 4	Review of the current system factoring in IT innovation.	10
(1)	The legal system concerning prepaid cards	10
(a)	Obligation to indicate information	10
(b)	Calculation of the amounts of security deposits	10
(c)	The method of public notice on refund in case of discontinuation of Business	11
(d)	Procedures for objections by creditors in case of business Assignment	11
(e)	Obligation of issuers of server-based prepaid cards to manage member shops	11
(2)	Procedures for partial discontinuation of fund transfer services	12
(3)	Cash out services utilizing debit cards	13
Chapter 3	Wholesale financial services; the strategic reform of payment services to support growth of corporations	14
Section 1	The directions to be pursued	14
(1)	Recent trends	14
(2)	The directions to be pursued	15
(a)	Innovation on CMS by Japanese banks	15
(b)	Improvement in users' convenience concerning Electronically Recorded Monetary Claims	15
Section 2	Initiatives for providing advanced CMS	16
Section 3	Creating environment for wholesale financial services innovation	16
(1)	Review of application of regulations on money lending business relating to	16

	cash management	
	(a) Cash management utilizing finance subsidiaries	17
	(b) "Bridge financing" associated with business restructuring, etc.	17
	(2) Rationalizing the reporting system on payments regarding foreign remittances	17
	(a) Expanded use of electronic methods for the reporting	18
	(b) Rationalized handling of foreign exchange reports on fund transfer for netting	19
	(3) Responses to issues relating to ERMCS	19
	(a) Improvement of the users' convenience	19
	(b) Utilization of ERMCS in local governments	20
	(c) Overseas expansion of the ERMCS	21
Chapter 4.	Payment infrastructure: five reform items to improve users' convenience and strengthen international competitiveness	22
Section 1	Drastic improvement of payment infrastructure functionalities	23
Section 2	Creating a seamless payment environment across borders, etc.	24
	(1) International standardization of items in remittance formats	24
	(2) Provision of "low-value remittance" services for international remittance	24
	(3) Improved convenience for large-lot remittance	25
	(4) Improving efficiency in yen-denominated remittance to/from non-residents' accounts	25
Section 3	Institutional efforts of the banking industry to continue innovation in payment services	26
Chapter 5.	Institutional framework on virtual currencies	27
Section 1	The current situation surrounding virtual currencies	27
	(1) The current status of transactions	27
	(2) International requests for countermeasures against money laundering and financing of terrorism	27
	(3) Event of a virtual currency exchanger Bankruptcy in Japan	28
Section 2	Regulation of virtual currencies	29
	(1) Scope of the regulation	29
	(2) Measures on anti- money laundering and counter- terrorist financing	29
	(3) Regulations for user protection	30
	(a) The basic framework of the regulations	30
	(b) Segregated management	30
	(c) Capital requirements	31
	(d) Self-imposed regulations	31
Chapter 6	Continuous Efforts for Advancement of Payment System	32
Conclusion		33

The "Working Group on Payments and Transaction Banking" of the Financial System Council List of Members

Members

Tetsuo Morishita (Chairperson)

Professor, Sophia University Law School

Keisuke Takishima

Director & Executive Officer, Sales Division, WELLNET CORPORATION

Takane Horii

Attorney at Law (Partner, Mori Hamada & Matsumoto)

Takashi Okita

Co-founder and Fellow, VeriTrans Inc.

Yuji Tanaka

General Manager, Transaction Banking Coordination Division, Mizuho Financial Group, Inc.

Hideo Makino

Vice President, Accounting & Finance Development, Global, Kao Corporation

Yuri Okina

Vice Chairman of the Institute, The Japan Research Institute, Ltd.

Eiichi Tanabe

Executive Vice President, Mitsubishi Corporation

Hideyuki Matsui

Professor, Faculty of Law, Rikkyo University

Satoru Kado

Chief Economist, Economic Research Department, Mitsubishi UFJ Research and Consulting Co., Ltd.

Takashi Choraku

Executive Director, Japan Payment Service Association

Masashi Miyano

Executive Vice President, Brand Business Department, JCB Co., Ltd.

Akira Kamo

Associate Professor, Faculty of Law and Graduate Schools for Law and Politics, University of Tokyo

Hajime Tomura

Associate Professor, Faculty of Political Science and Economics, Waseda University

Yosuke Yasuda

Associate Professor, Department of Economics, Osaka University

Yasuko Kouno

Secretary General, Consumers Japan

Iwao Toriumi

Senior Manager, International Bankers Association of Japan

Akira Yamagami

Managing Director, Head of Global Financial Business Unit and Singapore Branch, NTT Data Institute of Management Consulting, Inc.

Yuka Koga

Vice President, Producing Division, Financial & Payment Services Company, Yahoo Japan Corporation

Yumiko Nagasawa

Secretary General, Foster Forum

Shinzo Yoguchi

Director & Secretary General, Japan Consumer Credit Association

Satoshi Seki

Executive Officer and Office Manager of Public Policy Office, Rakuten, Inc.

Toshiaki Hama

Director, Global Cash Management, Finance Division, Corporate Finance Unit, Fujitsu Ltd.

Observers

Hideya Takano

Director, Financial System Stabilization Division, Minister's Secretariat, Ministry of Finance

Riwa Sakamoto

Director, Commerce Supervisory Division, Commerce and Information Policy Bureau, Ministry of Economy, Trade and Industry

Toshio Kanazawa

Director, Head of Payment and Settlement Systems Division, Payment and Settlement Systems Department, Bank of Japan

The Working Group invited the following experts in addition to those listed above to exchange opinions.

The 1st meeting(July 23, 2015)

Soushi Fujimoto

Deputy General Manager,
Transaction Banking Coordination
Division,
Mizuho Financial Group, Inc.

The 3rd meeting(November 4, 2015)

Hiroaki Moroe

Representative Executive Officer and
President, densai.net Co., Ltd.

Yasuo Ohta

Deputy General Manager, Structural
Finance Division, Mizuho Bank, Ltd.

The 4th meeting(November 16, 2015)

Yuzo Kano

Co-Founder / CEO, bitFlyer, Inc.

Noriyuki Hirosue

Co-founder CEO, bitbank, Inc.

The 6th meeting(December 2, 2015)

Keiko Tomoyuki

Director, Secretariat of the
Consumer Commission, Cabinet
Office, Government of Japan

Soushi Fujimoto

Deputy General Manager, Transaction
Banking Coordination Division,
Mizuho Financial Group, Inc.

(Honorifics omitted)

INTRODUCTION

In recent years, the rapid development of information technology (IT) has brought evolutionary changes in financial businesses and the globalization of economic activities has progressed remarkably. The combination of this movement and changes in behaviors and modes of transactions of individuals and corporations along with diffusion of IT and globalization has changed the environment surrounding payment services dramatically.

Against this backdrop, on September 26, 2014, the Minister of State for Financial Services referred the following issue to general meeting of the Financial System Council: “the study of payment and other related financial services as well as the development of platforms supporting such services should be made from various perspectives in response to the growing demand to advance payment services”. In response to this, the Study Group on Payments and Transaction Banking of the Financial System Council (the “Study Group”) discussed basic issues on and possible directions of advancement of payment system, and it published the “Interim Note” on April 28, 2015.

In this “Interim Note,” the Study Group identified issues that should be further

studied, including three major challenges of “progress in financial innovation especially in the retail businesses,” “advancement of payment service that supports growth of corporations,” and “renovation of payment infrastructure” as well as cross-sectional issues such as stabilization of payment systems, securing information security, promoting innovation and ensuring user protection.

After publishing the “Interim Note,” the Study Group was reorganized into the “Working Group on Payments and Transaction Banking” (hereafter, the “Working Group”) in July and started to discuss issues pointed out in the “Interim Note.” Issues on virtual currencies were also discussed based on recent international development and other factors.

This report summarizes results of discussions made by the Working Group on specific action plans and directions for a more sophisticated payment and transaction banking in the future.



Chapter 1: The basic directions of the reform of payment system

1. Changes in the environment surrounding payment services

Payment services are provided in various forms in the fields of retail and wholesale financial services, and integration between finance and IT has been accelerated in both of these fields, represented by the expansion of so-called Fintech¹. Accordingly, the structural changes in the payment service sector have been progressing as innovation of such services has advanced rapidly and providers of such services have been diversified.

As this movement is spreading all over the world, competition for standardizing such payment services is now getting fierce on a

global scale. At the same time, European countries, the U.S., and major emerging economies have strengthened their strategic efforts for advancing payment infrastructure including interbank networks² and they are now trying to integrate such networks across borders.

¹ "Fintech" is a coined word made of "Finance" and "Technology," largely indicating businesses providing innovative financial services utilizing IT. Particularly in recent years, overseas IT venture companies proactively provide financial services that have not been provided by conventional banks and other financial institutions, utilizing their technologies.

² FRB recognized the necessity of a payment system superior in security, efficiency and versatility in the U.S. and started to study such a system from 2012, and published a strategic document titled "Strategies for Improving the U.S. Payment System" that outlined targets and strategies for advancement of the payment system. This document features "five targets" consisting of speed, security, efficiency, globalization and cooperation, and presented strategies to achieve the targets such as: specifying measures to introduce "faster payment" by 2016; compliance with ISO20022 standards including necessity of end dates; and an increase in the number of connected countries for cross-border payment. In addition, Europe unified items including bank codes and account numbers of ACH and its remittance format banks are using with items (Bank Identifier Code (BIC), International Bank Account Number (IBAN), etc.) used in the international remittance format (SWIFT format in general) to construct a seamless remittance environment inside and outside of the region, in the process of achieving its Single Euro Payment Area (SEPA) concept.

2. The basic directions of the reform of payment system

Innovation as well as structural changes and globalization of payment services in conjunction with technological innovation in IT fields cannot be transient and are likely to continue as a large movement in the financial service industry in the future.

Both public and private sectors in Japan should recognize how influential this movement would be in the field of financial services and should make efforts in a timely manner in the respective field to move toward following directions.

1. Taking in IT innovation and renovating the payment services
2. Securing of payment system stability and information security
3. Promoting innovation and ensuring user protection
4. Demonstrating leadership in international trends concerning payment systems

Recognizing the above fundamental issues, specific directions to be aimed at and actions necessary to pursue such directions as well as the timeline of such actions are as follows.



Chapter 2: Retail Payment Services

- Innovation corresponding to FinTech

1. The directions to be pursued

(1) Recent trends

In recent years, integration between finance and IT has been accelerated, especially in the field of retail payment services. Against this backdrop, varieties of innovative services have appeared in the field of retail payment services.

As providers of such services target international expansion of their businesses, competition for standardizing these payment services has been intensified on a global scale³. Not only banking corporations but also non-bank players are now developing businesses which replace a part of banking operations and provide more comprehensive financial instruments, stemming from provision of payment services.

Non-bank players now provide services by dividing in small parts the services that had been conventionally provided by banks, which leads to changes in the field of retail payment services. Fundamental structural changes that could be described as “unbundling⁴” of banking operations are occurring, especially in payment services.

(2) The directions to be pursued

In light of such changes in the environment, taking necessary steps is considered important in order to promote innovation that could serve to users' convenience in the field of retail payment services along the directions as follows.

- In Japan, banks have been the main provider of payment services, which have been relatively closed and remote from non-bank players and business

³ Some private research entities forecast that the amount of investment to Fintech companies worldwide in 2015 will increase 66% compared to 2014 to reach approximately 20 billion dollars. Investment in Fintech companies is growing rapidly also in the Asia-Pacific region as seven Chinese companies are listed in the top 50 Fintech company ranking and it is reported that the amount of such investment reached 3.5 billion dollars in nine months from January to September in 2015. (Sources: “FINTECH 100 - Leading Global Fintech Innovators Report 2015” (H2 Ventures and KPMG); “Fintech Investment in Asia-Pacific set to at least quadruple in 2015” (Accenture)).

⁴ In general, “unbundling” means decomposition of a product or a service bundling multiple elements and functions into separate elements and functions.

development overseas. However, recent innovation in this field is mainly led by non-bank players including Fintech enterprises. Considering this changing situation, banks are required to continue making efforts to innovate their banking operations through, for example, strategic adoption of cutting-edge IT so as not to be left behind by global trends of innovation.

- Also, in following those directions, a shift from the conventional closed structure of payment systems mainly dominated by banks is important also in Japan, which would help promote innovation of payment services through competition in which various players, not limited to banks, participate. At the same time, it is important, especially for banks, to formulate business structures and business models focusing on open innovation (i.e. innovation through partnership with third parties) and not adhering to in-house resources.
- Furthermore, it is important for banks and other players to secure profitability of providing such advanced services utilizing financial IT through efforts to expand their services quantitatively and qualitatively aiming to standardize such services in Asia and on a global scale and to strengthen strategic aspects of their businesses by linking such advanced services to their loan businesses based on cooperation between financial and sales channels.

Based on the above-mentioned directions, efforts to address specific issues as follows are considered particularly important for the time being in the retail payment service field.

2. New initiatives for FinTech innovation

In order to push forward innovation, banks and other players in the banking industry should innovate their operations and services independently and internally, demonstrating their competitive edges and, at the same time, should utilize or establish common platforms for services outsourceable and transactions that are common for all banks. From this point of view, the following specific initiatives have been announced to be taken in the banking industry⁵. It is hoped that banks will respond with high-level solutions to the requests against the industry such as users' convenience, collaborating and cooperating with experts in the IT industry.

- Study the provision of money transmitting services using cellphone numbers, in which multiple financial institutions can participate⁶.
- Study the possibility of utilizing new financial technologies including Blockchain⁷ technology and challenges on such utilization for the purpose of drastic innovation of financial services including payment networks,

collaborating with competent authority and other concerned parties (a report will be prepared during the fiscal year 2016).

- Open API⁸ movement to disclose specifications for connection to banking systems is now spreading abroad. In Japan, too, establish a task force to study Open API in light of security, etc., with participants from financial institutions, IT companies, and competent authority, for the purpose of improving the quality of payment services, in particular, promoting non-bank players' provision of highly convenient services by utilizing banks' payment platforms (this task force's report will be prepared during the fiscal year 2016).

In addition, business operators other than banks are now playing active roles in innovation in the financial service sector, and such movements are hoped to be further developed.

⁵ As stated below (on Page 22), the officials responsible for practical work proceeded with their studies on payment infrastructure in Japan and reforms deemed to be necessary responding to the "Interim Note." Consequently, the Working Group announced its action plans, representing officials responsible for practical work in the banking industry (please refer to the documents presented by Mr. Tanaka, at the sixth meeting of the Working Group).

⁶ In the U.S., for example, multiple banks collaborate with each other to construct a common platform to provide remittance services using cellphone numbers. Also in the U.K., a remittance service between individuals named PayM, which uses cellphone numbers and is common throughout the banking community, is provided.

⁷ Blockchain is a technology that links a person's transaction records from past to present like a chain in order to maintain an accurate transaction history by creating a mechanism that requires to manipulate all of transaction records newer than the one that is aimed to be manipulated. At present, this technology is used for virtual currencies such as bitcoins, but it has been pointed out that it can be applicable for various purposes beyond virtual currencies and global major banks have jointly initiated researches on its applicability. The National Association of Securities Dealers Automated Quotations: U.S. stock exchange (NASDAQ) also announced introduction of Blockchain technology into transaction of private equities.

⁸ Application programming interface (API) indicates specifications for connection to operating systems (OS) and applications to use their functions, and Open API means API that is made public. By utilizing Open API, everyone can design and provide services incorporating such functions. Her Majesty's Treasury of the U.K. is planning to make public specification of Open API in the banking industry to promote improvement of payment and other services provided by banks and other financial institutions and, in particular, provision of services convenient for non-bank players using the banks' payment and other systems, and it is said that design of the detailed framework is scheduled to be completed before the end of 2015.

3. Establishment of a cross-sectional legal system

As structural changes in payment services are expected to be accelerated and progressed further in future, creating an environment where provision of highly convenient services is further encouraged is critically important, with paying proper attention to the issues including information security and user protection.

In this context, the following issues are identified when considering if the current legal system regulating payment services conforms to changing situations at present and ones assumed in future.

(1) The current legal system over payments and transaction banking

Under the current legal system over payments and transaction banking, banks are strictly regulated under the Banking Act as entities that conduct “exchange transactions” or “acceptance of deposits and loans of funds” as their inherent businesses. On the other hand, when a non-bank entity conducts a part of the banks’ inherent businesses or operations adjacent to such businesses, a framework has been developed for each operation where such operations can be performed under lighter regulations than the relevant provisions of the Banking Act. This means that

- With regard to payments and transaction banking services, fund transfer service providers are now allowed to provide exchange transaction services that only banks had been permitted to be engaged in, only if the amounts of transfer are small. Fund transfer service providers are required to be registered and to preserve the

same amount of assets as funds being transferred, instead of being strictly regulated like banks, given that fund transfer service providers can only perform a part of banks' inherent operations (for example, they cannot accept deposits).

- Prepaid payment instruments are issued as paper-based, IC-based, or server-based ones. Refund to the holder of those instruments is prohibited in principle because of the acceptance of deposits or exchange transactions falls upon the inherent businesses of banks. On the other hand, with the notification requirements for the issuers of prepayment instruments for own business and registration requirements for the issuers of prepaid payment instruments for third-party business, regulations on the issuer of prepayment instruments are lighter compared to the ones for banks, where transfer of such instruments is not regulated and the issuer of prepayment instruments are only required to preserve assets equivalent to a half or more of the unused balance of such instruments.
- With regard to loan operations, money lenders are allowed to perform money lending business. However they are required to be registered and are subject to rules of conduct (such as prohibition on excessive lending and obligation to deliver documents) in order to secure proper performance of their business and to protect the interests of persons in need of funds.

(2) Fundamental issues to be tackled

The separate frameworks of regulations on individual operations as seen above are not necessarily consistent with each other. For

example, as IT evolves, similarities are found in the services provided by fund transfer service providers and those provided by large-size issuers of server-based prepaid cards. However, regulations with regard to preservation of assets received from customers on both types of providers are different, as fund transfer service providers are required to make a security deposit in an amount equivalent to the total amount of customers' assets received but issuers of prepaid payment instruments are required to make a security deposit equivalent to a half or more of the unused balance of such instruments issued.

Against the backdrop of integration between finance and IT, payment services are evolving beyond the current regulatory framework and various payment instruments, regulated by relevant regulation respectively, are being provided as integrated services. As payment services are evolving in this direction, the fact that separate regulations exist for each service could disturb users' convenience or distort companies' decision making in businesses.

Also, provision of integrated financial services such as combining payment services with loan operations is emerging as the contents of individual payment services evolves. In addition, provision of such services could be important components of the entire payment network if their size expands, but the current legal framework based on respective regulation corresponding to each payment service does not take those new developments into account sufficiently as seen in the case of prepaid payment instruments.

Furthermore, "intermediate service providers" who provide services that mediate transactions between banks and users have appeared. To cope with these developments of services, actions have been

taken, for example, by establishing regulations that require a person who acts as an agent or intermediary of banks for the conclusion of a contract on acceptance of deposits, loans, or exchange transactions on behalf of banks to acquire permissions under the bank agency service system. On the other hand, provision of ATM services, for example, is regulated only indirectly via banks because providers of these services do not fall under agents or intermediaries for the conclusion of contracts and cannot be regulated directly even if such services are material. In overseas, there is a case where "intermediate service providers", based on contracts with their customers, access customers' bank accounts and provide services without being entrusted by banks. However, regulation on this type of service is indirect via banks and could not ensure sufficient measures for customer protection and other issues. Taking the emergence of these "intermediate service providers" into account, the conventional regulatory system that handles them under the bank agency system or with indirect regulations via banks is deemed not necessarily sufficient.

(Reference) EU Payment Services Directive

- Changes in the situation surrounding payment services have also been seen abroad and actions have been taken in some of these cases. For example, EU has legislated the Payment Services Directive (PSD) to construct a cross-sectional regulatory system that includes capital requirements and obligation to provide information commonly applicable for banks, prepaid card (e-money) service providers, and payment service providers.
- In addition, the recent approval by the

European Parliament to revise the PSD has strengthened efforts to establish a far more cross-sectional regulatory system that can cover the “intermediate service providers” mentioned above (for example, “payment initiation service providers” who provide services to communicate users' payment instructions and their account information between users and payment service providers).

(3) The future of the legal system concerning payment services

Legal systems should be reviewed based on economic situations of the respective countries/areas and other factors. However, in considering recent changes in situations concerning payment services and issues associated with such changes, the following directions are deemed important when we think of the legal system concerning payment services, and considerations should be given keeping such directions in mind.

- As integration between finance and IT advances, various financial services including payment services will be provided comprehensively and users will employ various payment services integrally. In light of these situations, establishment of a cross-sectional regulatory system that could enable flexible development of various services should be studied in order to avoid distorting users' selection of payment services and disturbing users' convenience.
- In addition, to consider construction of such cross-sectional regulatory systems, the fact should be sufficiently considered that “intermediate service providers” are, mainly on relationship

with users, playing significant roles in payment processes.

- Furthermore, international development of payment services is accelerated, and Japanese service providers intend to expand overseas operations while foreign service providers are also providing their services in Japan as well. Bearing those points in mind, establishment of institutional framework with visions is imperative both for international development of financial services and improved convenience and security for users.
- On the other hand, if we aim to establish a legal system as described above, such system should be supportive of the concept of formulating regulations commensurate with risks, not to disturb development of innovation.

4. Review of the current system factoring in IT innovation, etc.

With those directions in mind, it is revealed that the current legal system cannot sufficiently correspond to such movements as an increase in server-based prepaid payment instruments (prepaid cards)^{9, 10} and expansion of payment services on Internet and mobile terminals.

Specifically, the review of the current system is deemed necessary, keeping consistency with the possible future legal system on payment services.

(1) The legal system concerning prepaid cards

(a) Obligation to indicate information

With regard to prepaid cards, the current regulation requires the issuer to indicate information on such cards, including the amount available for payment in their certificates or documents or other materials that are an integral part of such cards if such certificates or documents are issued to users, and if such certificates or documents are not issued, it requires provision of information through the Internet and other relevant media¹¹.

However, prepaid cards that are assumed to be used in conjunction with use of the Internet (e.g., watch-type internet terminals) have appeared recently, and it is difficult for many of them to indicate information on certificates or documents. Therefore, in case prepaid card functions are

embedded in information terminals and other electronic devices, it seems appropriate to allow information provision to users via the Internet.

(b) Calculation of the amounts of security deposits

The current regulation requires issuers of prepaid cards to make security deposits equivalent to a half of the unused balance of such cards at the base date twice a year (at the end of March and September)¹². This obligation to make security deposits is to protect assets received from users and is deemed important from the viewpoint of user protection.

However, if the unused balance decreases rapidly after one of the base dates, issuers of prepaid cards will lack sufficient funds on hand because they need to maintain the same amount of the security deposits calculated as of the previous base date until the next base date to come. Therefore, introduction of some flexible solutions for calculation of the security deposits has been requested.

Considering that a rapid decrease of the unused balance could happen, as noted above, it is deemed appropriate to introduce flexibility in the calculation method, adding two interim base dates at the end of June and December to the current two base dates to set four base dates in case issuers of prepaid cards choose it on the premise that this choice will bind such issuers for the certain period in order to avoid their arbitrary choices.

⁹ Numbers, symbols or other characters tied to records of property values on the servers are issued to users.

¹⁰ In 2014, the server-based prepaid cards accounted for more than 30% of the overall issuance of prepaid payment instruments. (Sources: Japan Payment Service Association, "the 17th Statistics on Issuers of Payment Instruments")

¹¹ Article 13, Paragraph 1 & 2 of the Payment Services Act.

¹² Article 14, Paragraph 1 of the Payment Services Act.

(c) The method of public notice on refund in case of discontinuation of business

The current regulation requires issuers of prepaid cards to make a public notice in daily newspapers as a part of the refund procedure if they discontinue their business relating to prepaid cards¹³. If they discontinue their prepaid card operations, making such information public sufficiently is critical because holders of such cards shall be excluded from the refund procedure unless they state their claims within a certain period specified in the public notice.

On the other hand, in the situation where the use of prepaid cards on the Internet continues to increase, making information widely known in an electronic way is also possible because use of such cards presumes usage on the Internet. However, sufficiently trustful methods to make such information widely known are necessary because users will be excluded from refund procedures unless they state their claims within a certain period. Based upon the above discussion, it is deemed appropriate to allow issuers of prepaid cards which are available on the Internet to choose electronic public notice admitted in the Companies Act instead of public notice in daily newspapers when they discontinue such prepaid card operations.

(d) Procedures for objections by creditors in case of business assignment

The current regulation requires an issuer of prepaid cards to acquire consent of holders of prepaid cards as creditors individually

when the issuer assigns its prepaid card business. Although in practice, the issuer of prepaid cards does not know who the holders are and cannot have their individual consent. Thus, establishment of procedures for creditors to make objections instead of individual consent has been requested¹⁴.

In contrast, there are opinions that in case a prepaid card business is assigned, acquiring consent individually from holders of the prepaid cards as creditors is a principle under private laws, as the assigner of the prepaid card business is exempt from obligations relating to prepaid cards. In addition, it has been pointed out that in case the issuer is a stock company, organizational restructuring is possible already by the procedures for company split under the current Companies Act.

In accordance with the discussion above, we should continue to study this issue, paying attention to how far such procedures are necessary in practice and their consistency with the principle under private laws.

(e) Obligation of issuers of server-based prepaid cards to manage member shops

In August 2014, the Consumer Commission made a proposal on taking measures to improve effectiveness of member shop management of credit card businesses. Responding to this proposal, review of the Installment Sales Act is currently being studied in related ministries. In this context, the Consumer Commission also pointed out that usage of server-based prepaid cards (e-money) is expanding and consumer

¹³ Article 41, Paragraph 2 of the Cabinet Office Ordinance on Prepaid Payment Instruments.

¹⁴ In the Banking Act, while procedures for creditors to make objections in case of business assignment are prescribed (Article 34), business assignment itself shall be authorized by the Prime Minister (Article 30) and shall be examined if it is fully expected that the business will be conducted appropriately, fairly and efficiently after such business assignment (Article 31).

damages have been made by vicious acts of member shops of e-money, and made proposal to FSA on August 18, 2015 to take measures against issuers of e-money to improve management of their member shops and complaint processing, including possibility of stipulating obligation to do it in the Payment Services Act, for the purposes of preventing consumer damages caused by vicious member shops in the course of e-money transactions and of recovering from such damages.

As for prepaid cards for third-party business¹⁵ including server-based e-money, "not taking necessary measures for ensuring that goods that one can purchase, lease or receive the delivery or services that one can be provided (by using prepaid cards) will not be dangerous to or pose any risk of being dangerous to public order or morals" is one of the requirements for refusal and rescission of registration in the current regulation¹⁶.

The Consumer Commission stated in its proposal that "the requirement on 'breach of public order or morals' is deemed to fall upon highly malicious cases such as usage of prepaid cards for criminal acts. In order to contribute to prevent consumer damages caused by vicious member shops, the responsibility of issuers of e-money to manage member shops needs to be clearly stipulated by law from the standpoint of stressing such obligation more clearly." In contrast, there were opinions, during the discussions of this Working Group, that not only criminal acts but also acts that are broadly deemed malicious to the society in general are included in the "breach of public order or morals."

Furthermore, the above proposal of the Consumer Commission requests issuers of

server-based prepaid cards to respond to complaints more thoroughly, because some of such issuers are uncooperative for settlement of disputes.

Concerning this issue, precise responses should be made toward needs to take measures to prevent or solve the problems of consumer damages keeping the possible review of the Installment Sales Act in mind, and, at the same time, it is appropriate to pay sufficient attention to requests for not unnecessarily disturbing innovation in this field.

(2) Procedures for partial discontinuation of fund transfer services

In the current regulation, procedures for reporting, making public notice and recovering security deposits in case a fund transfer service provider discontinues all of its business are prescribed by law. However, procedures for a fund transfer service provider to discontinue a part of its business have not been prescribed.

After enactment of the current Payment Services Act, providers of multiple types of money order-type services (in which users can withdraw funds deposited in advance from ATMs of business partners of such providers abroad) have emerged targeting, for example, travelers abroad. These service providers issue multiple types of cards and sometimes discontinue one of them. However, the current Payment Services Act does not include provisions pertaining to procedures to discontinue a part of their services and therefore, if there is an unused balance with regard to such card for which service is discontinued, the provider of such service cannot recover the security deposit equivalent to the said balance.

¹⁵ Prepaid cards that can also be used at third-party member shops other than their issuers.

¹⁶ Article 10, Paragraph 1, Item 3 and Article 27, Paragraph 1, Item 1 of the Payment Services Act.

In light of the appearance of various new fund transfer services discussed above, it is deemed appropriate to prescribe procedures for partial discontinuation of fund transfer services and to establish an institutional framework that enables flexible business development while protecting users properly.

(3) Cash out services utilizing debit cards

In Europe and North America, there is a type of services called "cash out" in which users can withdraw cash from their bank accounts at cashiers of retail stores, etc., using debit cards (by inputting security code numbers to withdraw cash). In Japan, this type of services has not been provided and there are requests to clarify that such service is legal in Japan by classifying cash out services as outsourcing of "disbursement of deposits" stipulated by the Banking Act.

In this regard, ATMs and other similar services are classified as outsourcing of "disbursement of deposits" under the Banking Act because such services deal with administrative work necessary for execution of transactions on a regular basis. Cash out services are deemed similar to such services in nature and it is appropriate to classify cash-out services as outsourcing of "disbursement of deposits" under the Banking Act.

As well, if cash out services are provided, it is supposed that banks will be required to develop administrative systems suitable for such services as necessary, considering that cash will be delivered manually.



Chapter 3: Wholesale Financial Services

- the Strategic Reform of Payment Services to Support Growth of Corporations

1. The directions to be pursued

(1) Recent trends

In recent years, along with acceleration of international expansion of corporations and deepening of global supply chains as well as spread of business management at a corporate group level, efficiency in management/transfer of funds (cash management) and efficiency in claim management inside corporate groups and controlling risks in capital and financing are important factors when we think of competitiveness of corporations.

In this context, major banks in Europe and U.S. provides leading global cash management services (CMS) that meet the needs of the company, positioning CMS as one of the pillars of their management strategies. Developing value-added CMS products in these major banks in Europe and U.S. is mainly driven by the trend of strategic IT investment in each banks. Such progress in developing leading CMS has contributed more or less to competitiveness of European and U.S. companies.

At the same time, new services relating to cash management including netting between multiple banks are provided by non-bank players mainly in Europe and U.S. Among such non-bank players, IT companies play important roles and provide advanced services utilizing their system bases with relatively high flexibility and introducing technological innovation of the IT sector. Also, as is the case in the field of retail financial services, such IT companies are collaborating and cooperating with banks actively.

In addition, as electronic and paperless commercial transactions expand, digitalized and paperless management of claims including bank notes are more and more demanded. Furthermore, small and medium enterprises wish to finance more smoothly and safely through claim fluidization as a financing technique not relying on collaterals.

(2) The directions to be pursued

(a) Innovation of CMS by Japanese banks

Innovation of CMS is at progress in the major banks in Europe and U.S. as mentioned above, because cash management has become one of critical factors of company's competitiveness. In contrast, Japanese banks have sufficient physical support in providing CMS, but it is pointed out that major banks in Europe and U.S. are more advanced than Japanese banks in terms of initiatives for sophisticated financial services such as provision of a globally united platform and netting functions across multiple currencies¹⁷.

Considering strong business needs for advanced CMS, innovation of Japanese banks' CMS and improvement of cash management environment are critical challenges.

(b) Improvement in users' convenience concerning Electronically Recorded Monetary Claims

After the introduction of Electronically Recorded Monetary Claims System (ERMCS), four electronic monetary claim recording institutions have been established and the number of users registered to each institution is increasing smoothly. This system is highly convenient for users, because it ensures high liquidity by allowing to divide Electronically Recorded Monetary Claims (ERMC) and also the settlement funds are automatically deposited to obligee's account on the payment due date, eliminating the collection procedures needed in the case of bills/notes.

However, the number of request for accrual record at densai.net (densai.net Co., Ltd.) falls short of its recent target, which means this institution's service has not been fully diffused. Both the number and amount of accrual of ERMC are struggling to grow. In particular these figures saw a decline, even temporary, in the first half of 2015.

In addition, the ERMCS seeks to facilitate small and medium enterprise finance by liquidizing monetary claims for the purpose of facilitating business operator's financing activities. However, it has been pointed out, both by financial institutions and corporations, that ERMC of densai.net has not been fully utilized yet through liquidation of ERMC.

Considering the current situation discussed above, convenience of this system should be improved in accordance with users' needs.

¹⁷ According to Euromoney Cash Management Survey 2014, Japanese banks ranked 15th or lower in the international ranking of banks concerning international CMS.

2. Initiatives for providing advanced CMS

In order for Japanese banks to provide advanced CMS, the following initiatives are hoped to be pushed forward, especially by major banks.

- It is important for the Japanese banks to promote initiatives to develop advanced CMS by fully taking into account the needs of companies by clearly positioning CMS in banks' management strategies and the specific levels and actions to be made.
- In addition, problem of Japanese banks' IT strategies has been pointed out as the reason of difference in the level of CMS between Japanese banks and major banks in Europe and U.S. It is said that the percentage of IT investment of Japanese banks' for "maintenance and administration" is higher. Based on such arguments, banks' strategic IT investments should be diversified to, for example, sophisticate their services through collaboration and cooperation with IT venture companies.

3. Creating environment for wholesale financial services innovation

(1) Review of application of regulations on money lending business relating to cash management

It has been pointed out that application of regulations on money lending business relating to fund transfer between companies in the same group is an impediment when they try to sophisticate or globalize their cash management schemes¹⁸.

The Money Lending Business Act aims to protect the interests of persons in need of funds. However, cash management within a group company is exempt from application of this Act because the lender and borrower are recognized to have economic integrity. This is why, loans between same group companies¹⁹ (loans between same group companies consisting of a parent company and subsidiaries of the parent company which is in substantial control (meaning 40% or more of its voting rights are held by the parent company)), for example, and loans by shareholders of a joint venture to the joint venture²⁰ (loans in case which all shareholders have allowed such loans and the lending company holds 20% or more of voting rights of the joint venture) are exempt from application of this Act by amendment of the cabinet order in 2014.

On the other hand, as cash management is more and more sophisticated and diversified in recent years, it is supposed that the current system should be reviewed with regard to the following points.

¹⁸ If a company is subject to the regulations on money lending business, its conduct is controlled by requirements such as appointment of the chief of money lending operations and delivery of documents.

¹⁹ Article 1-2, (vi), (a) of the Order for Enforcement of the Money Lending Act.

²⁰ Article 1-2, (vi), (b) of the Order for Enforcement of the Money Lending Act.

(a) Cash management utilizing finance subsidiaries

As mentioned above, loans by a shareholder of a joint venture to the joint venture (loans in case which all shareholders have allowed such loans and the lending company holds 20% or more of voting rights of the joint venture) are exempt from application of the Money Lending Business Act.

In the growing tendency of positioning financial subsidiaries as treasury centers of group companies to strengthen specialty and integrity of cash management within same group companies, it has been indicated that there are needs for subsidiaries (financial subsidiaries) wholly owned by shareholders of joint ventures to make loans to joint ventures. Such loans by wholly owned subsidiaries are deemed appropriate to be exempted from application of the Money Lending Business Act because such subsidiaries are recognized as economically integrated with their respective parent companies.

(b) "Bridge financing" associated with business restructuring, etc.

In recent years, when companies collaborate and cooperate with each other, they tend to utilize financial measures, such as making loans, as one type of cooperation more than ever. For example, when one of the group companies is sold for the purpose of

business restructuring, the seller of such group company is conditioned to arrange financing of this sold group company for the time being. Therefore, there are requests to exclude bridge financing in this case from application of the Money Lending Business Act²¹. In reality, group companies selling their subsidiaries need to manage funds of the sold companies with "bridge financing" because financial plans of the purchasing group companies have not taken the finance plan of companies into account at first²². Therefore, while paying attention to prevention of regulatory arbitrage²³, "bridge financing" associated with this type of business restructuring is deemed appropriate to be exempt from application of the Money Lending Business Act only for a certain period.

(2) Rationalizing the reporting system on payments regarding foreign remittances

With the progress of globalization of business activities, more efficient global treasury management including that is related to cross-border funds transfers is required. Especially in corporate finance, it has become important to process transactions with the STP (straight through processing)²⁴, and companies and banks have been making their constant efforts for this.

A person who conducts cross-border

²¹ In the current system, if the group company (seller) makes loans to the sold company that does not belong to the group company any longer, the seller will be subject to regulations on money lending business.

²² In addition to the above requests from financial point of view, it has been pointed out that in some cases provision of "bridge finance" by the seller is an important factor of consensus building on the business restructuring, for the purpose of demonstrating the seller's commitment to sound management, etc. of the sold company to the corporate group purchasing it.

²³ For example, if there is no restriction on the period which the sold company had belonged to the original group company, the original group company (seller) could try to escape from regulations on money lending business by controlling the sold company for an extremely short period. Therefore, we consider that the period which the sold company had belonged to the seller's group company needs to be included in the requirements to be exempt from regulation.

²⁴ STP (straight through processing) means a seamless operation of a series of processes from agreement of trade to settlement by linking information systems using standardized telegram formats.

payments over a certain threshold amount is required to submit a written report (“foreign exchange report”) to the Minister of Finance in accordance with the Foreign Exchange and Foreign Trade Act (Foreign Exchange Act). It has been pointed out (i) whether it is feasible to combine the foreign exchange report with practical work flows of cross-border remittance via banks; and (ii) the reporting obligation under the Foreign Exchange Act is a burdensome for companies because they are required to follow a designated reporting format and method and on a gross basis.

The Foreign Exchange Act requires the Minister of Finance to compile statistics on international balance of payments and other related figures based on international standards as a measure to secure sound development of cross-border transactions, equilibrium in balance of payments, and stability of currencies. In reviewing the foreign exchange reporting system, it needs to take into account that the foreign exchange reports are essential to compile such statistics and to monitor the cross-border transactions. In addition, business practices and burden of the Bank of Japan that handle administrative work and financial institutions involved in submission of such reports should also be taken into consideration.

It is strongly hoped to see the following efforts to be made, in light of the points above and the movement toward sophisticating companies’ cash management and other trends.

(a) Expanded use of electronic methods for the reporting

Under the current laws and regulations on foreign exchange and foreign trades, companies are required to submit foreign exchange report only by paper if companies choose to report via banks. Should companies choose to report electronically, reports shall be submitted directly to the Bank of Japan via its electronic data processing system (BOJ Online²⁵)²⁶. However, there are strong requests from companies, in light of realities discussed above, that in cases of remittance via banks using EB/FB²⁷, their transmission of remittance data to banks should be treated as performance of reporting duty required by the laws, by deeming such data transmissions from EB/FB to banks as the procedures stipulated by law.

Even now, banks are allowed to prepare and submit foreign exchange reports utilizing remittance data of EB/FB provided by companies in case where banks file it as a proxy of the companies, and banks may submit the reports through BOJ Online on behalf of companies. However, companies indicate that the current system is not sufficient because companies need to take responsibility when banks should fail their reporting obligation.

Based on the discussion above, it is appropriate for the government (competent authority) to explore alternative methods such as accepting data transmission through EB/FB to banks as a legitimate reporting procedure.

²⁵ A system to prepare and transmit reports online using the Internet.

²⁶ Article 3, Paragraph 1 of the Ministerial Ordinance concerning Reports on Foreign Exchange Transactions, etc. stipulates that with regard to reporting of payments, etc. via banks or fund transfer service providers, if a resident make the payments, etc. concerned, the resident shall prepare a report and submit it to the bank or fund transfer service provider that conducted the exchange transaction relating to such payment, provided, however, that if such a procedure is performed using the electronic data processing system (BOJ Online), the resident shall perform the same procedure against the BOJ.

²⁷ EB denotes Electronic Banking; and FB denotes Firm Banking.

In addition, when companies submit foreign exchange reports directly to the BOJ through BOJ Online, they can input data, in an electronic manner, using XML²⁸ formats as well as Excel templates²⁹ and they can also input data at a web page exclusively for this purpose³⁰. However, it has been pointed out that a large number of companies do not recognize the electronic reporting as acceptable in the first place, and it is important to make this electronic reporting system, including a scheme utilizing banks as agents of companies, more widely notified.

(b) Rationalized handling of foreign exchange reports on fund transfer for netting

Group companies manage funds by transferring money back and forth within the group companies as a way of cash management, several times a day in some cases, but each one of such transactions should be reported in a foreign exchange report at present. Although these fund transfer transactions are allowed to be compiled and reported monthly, companies request for softening the reporting duty after netting if such fund transfer, for example, is aiming at fund management within the same group companies during a limited period.

Based on the above discussion, considering the necessity of rationalizing the handling of foreign exchange report with respect to fund transfer for the netting purpose is

important in light of the level of needs for reporting on a gross basis in adherence with the purpose of the foreign exchange reporting system and burdens of companies.

In addition, it has been pointed out that many companies do not recognize in the first place that they can report fund transfer monthly in a lump, not in each transaction, so that this point should be further publicized.

(3) Responses to issues relating to ERMC

(a) Improvement of the users' convenience

In principle, ERMC accrued at electronic monetary claim recording institutions established by one of the major banks can be assigned to limited persons specified in agreements between the bank and companies and made into cash through factoring services³¹ of the said bank. In addition, some people point out that factoring services are now common in corporate strategies, addressing actual financing needs of obligee companies based on creditworthiness of the obligors.

However, in terms of improvement of users' convenience through further smoothing of financing with claim liquidation and dissemination of ERMC, an environment should be created where such ERMC can be discounted at main banks of user companies regardless of which electronic monetary claim recording institutions it was accrued of. Thus, we suppose the following actions need

²⁸ XML (eXtensible Markup Language) is a data description language that can indicate content of the data by placing specific codes called tags on the both sides of a string of numbers and characters and inputting names (element names), and can express logical structures between multiple data by arranging data sandwiched with tags in a multilayered way.

²⁹ Users can input figures to be reported into the electronic Excel template created by the BOJ to prepare an electronic report and transmit it using the "Transmission Setting" screen on the BOJ Online system.

³⁰ Users input and transmit data using the exclusive screen on BOJ Online (only for reporting formats with relatively small number of reporting items and fixed fields for figures to be reported).

³¹ Services in which financial institutions purchase accounts receivable and other claims that companies hold based on creditworthiness of obligors to enable such companies to make cash before payment due dates.

to be taken.

(i) Development of systems to enable transfer of ERMC between recording institutions

Transfer of ERMC between multiple electronic monetary claim recording institutions is not assumed in the current system. This point is indicated to disturb liquidation of ERMC and, in particular, to make it difficult to discount such ERMC when financial institutions of an assigner and an assignee of such claims are different and, for small businesses, to raise funds by assigning such ERMC.

Thus, it is deemed appropriate to improve the existing system in order to enable transfer of ERMC between electronic monetary claim recording institutions by, for example, introducing procedures to transfer data of ERMC upon requests of obligees.

After that, it seems necessary for related parties including electronic monetary claim recording institutions to discuss realization of effective measures as soon as possible on what kind of methods should be taken to enable discount of ERMC when financial institutions of an assigner and an assignee of such ERMC are different and to cope with other issues.

(ii) Introduction of *densai* factoring

As most of all financial institutions have

participated in *densai.net*, expectation for factoring services using ERMC accrued at *densai.net* ("*densai*") is very high. However, there is a problem that, if financial institutions of obligees and obligors are different, financial institutions of obligees cannot provide factoring services, because such financial institutions do not have credit information of obligors and there are constraints on sharing credit information of obligors among financial institutions.

In light of this, we hope countermeasures for the above issue to be investigated by *densai.net* and financial institutions respectively as soon as possible and factoring service schemes utilizing *densai* to be introduced quickly³².

(b) Utilization of ERMC in local governments

ERMC have not been actively used for payments by public entities. If such entities recognize ERMC on private corporations accepting orders for their projects, it would be effective for such companies' smooth fund management and could also contribute to regional vitalization. Also from the viewpoint of accelerating use of ERMC, utilization of ERMC by local governments has become a challenge.

For example, needs for making payment earlier through introduction of ERMC are assumed to be high in the fields where measures for making payment for public

³² It is desirable that at least a part of financial institutions will introduce factoring services utilizing *densai* during the fiscal year 2016 at latest.

³³ Pre-payment is made for 40% of the contract fee or less in a lump sum as advanced payment. Interim pre-payment is made in case of a construction work at the contract fee of 10 million yen or more and the construction period of more than 150 days. If the advanced payment is requested after 50% of the work and the period are both completed, the interim pre-payment is made for 20% or less of the contract fee.

³⁴ Payment for work completed is made in case of a construction period of more than 180 days. The advanced payment is made for 40% or less of the contract fee in two installments. In addition, if the partial payment is requested at a suitable timing, it is made based of the work completed. The request can be accepted once in about 90 days, and the number of the requests is agreed in the contract. However, in case of a construction work in which the inspection method through the construction process is introduced, the request can be made once in about two months (about 60 days).

works earlier, such as pre-payment and interim pre-payment of a part of the contract fee³³, and payment for work completed³⁴, have not been implemented yet. densai.net and the FSA are expected to work more proactively on this challenge especially in the fields specified above, in order to push forward early utilization of ERMC in local governments, deepening dialogues with local governments highly motivated for vitalizing their regions.

(c) Overseas expansion of the ERMCs

The ERMCs in Japan enables accrual and assignment of claims with electronic procedures. There is not such a system worldwide, and it is likely to be a pioneering initiative even in the current movement of integration between finance and IT. In particular, Asian countries are interested in introduction of this ERMCs. In order to secure Japan's innovativeness in the current movement for integration between finance and IT, initiatives such as introduction of ERMCs as specific business projects should be developed in major Asian emerging markets where a lot of Japanese companies operate their businesses.



Chapter 4: Payment Infrastructure

- Five Reform Items to Improve Users' Convenience and Strengthen International Competitiveness

Payment infrastructure including interbank networks is a core foundation for financial functions that has a significant influence on economic development. In light of this, European and North American countries and major emerging economies strengthen their strategic initiatives to sophisticate payment infrastructure. It seems necessary, also in Japan, to implement strategic reforms on its payment infrastructure from the perspective of improving users' convenience and enhancing international competitiveness, given the changes in the environment surrounding payment services such as advancement of integration between finance and IT.

Responding to the "Interim Note," concerned parties at working level conducted examination on how payment infrastructure in Japan centering on *Zengin* System should be and on matters necessary to be reformed, and the action plans were announced at this Working Group³⁵ by a WG member from the banking industry representing concerned parties at working level.

Based on discussions to date and in light of improving users' convenience and enhancing international competitiveness, it is considered important to carry out reforms ("five reforms") steadily and constantly according to the clear timeframe of actions set as specific as possible³⁶ so as to strengthen functionalities of payment infrastructure, to create a seamless payment environment across borders and to further advance innovation.

³⁵ Please refer to the documents presented by Mr. Tanaka, at the sixth meeting of the Working Group.

³⁶ If changes in the environment that are unforeseeable at present occur, persons responsible for practical work should have discussions to make amendment on these reforms as necessary.

1. Drastic improvement of payment infrastructure functionalities

XML³⁷ format, which is superior in terms of the information volume and compatibility, is adopted as the international standard (ISO20022)³⁸ for telegrams used for financial transactions including payment services, and transition to this format is proceeding systematically in Europe and North America. Drastic improvement of payment infrastructure, including full-scale transition to XML telegrams for remittance between companies, is considered necessary also in Japan, and steady implementation of the following action plans is hoped³⁹.

- By 2018 or so, establish a new system (“Finance/ IT Network System (tentative)”) ⁴⁰ in which financial institutions that are members of *Zengin* System participate and commence service; and by 2020 or so, abolish the current fixed length telegrams and shift

to XML telegrams completely ⁴¹ for domestic payment instructions between companies;

- This new system above would be equipped with functions to accept domestic payment instructions from companies and would employ the latest international standard in advance (attachment of EDI information with large-volume tags) ⁴², by which companies would be enabled to carry out administrative work regarding payment more efficient and sophisticated, to conduct quantitative analysis of their businesses using EDI information, and to discover new business opportunities by linking payment information to information on commercial distribution; and
- Study the possibility of adding new functions such as analysis and utilization of big data, applying artificial intelligence (AI) to the new system.

³⁷ See Note 28.

³⁸ ISO20022 is the international standard on telegrams used in various financial operations and stipulated by the International Organization for Standardization (ISO) in 2004. Content of items and XML formats necessary for transactions and administrations of each operation subject to the standard are registered to ISO by SWIFT.

³⁹ With regard to specific occasion of its use and its handling amount, concepts on standardization of the format and sharing of expenses and the timeline, the financial and non-financial industries, system-related business operators and the FSA will sort out issues to be discussed during the fiscal year 2015 (and will scrutinize and review them as necessary).

⁴⁰ This is a system to accept domestic remittance instructions from companies with XML format telegrams. This system will classify information received from paying companies into information on payment and commercial distribution. This information on commercial distribution will be saved in the system temporarily and numbered for identification, and these numbers are transmitted to the sending financial institutions together with the payment information. After the payments are settled at the sending financial institutions, *Zengin* system and the receiving financial institutions, this system will accept payment information (including the numbers to identify information on commercial distribution) from the receiving financial institutions and integrate the payment information with the information on commercial distribution again and transmit them to the receiving company. It is said that this system will contribute to make payment operations more efficient because, even in case paying companies pay for multiple accounts payable at one time, receiving companies can identify which payment is for which account receivable because the paying company attached information on commercial distribution to information on the multiple payments and such accounts receivable can be erased automatically.

⁴¹ The timing of complete transition to this new system and the scope of transition to XML telegrams (assuming BtoB domestic remittance instructions between corporations and not including remittance between individuals and of salaries at present) are supposed to be determined concerning the general intent of non-financial industries as users.

⁴² The latest international standard (ISO20022) adopts specifications that enable setting tags and creating multi-layer structure for EDI information fields. This is said to contribute to efficient erasure of accounts receivable by dividing and presenting information on commercial distribution into EDI information fields on multiple slips, and there are requests for introduction from non-financial industries.

2. Creating a seamless payment environment across borders, etc.

(1) International standardization of items in remittance formats

Currently in Japan, items required to be filled in the formats of domestic remittance and international remittance⁴³ are different. Companies expanding their businesses globally are requesting consolidation of items between those formats to centralize their cash management operation inside and outside of the country.

A seamless payment environment across borders should be developed given the above mentioned user needs, and steady implementation of the following action plans is hoped in this regard:

- Employ the international remittance format to provide domestic payment services via banks⁴⁴;
- During the fiscal year 2016, identify issues with regard to permitting account holders' names in the alphabet and adoption of BIC (Bank Identifier Code)⁴⁵ and IBAN (International Bank Account Number)⁴⁶ in domestic payment infrastructure, assuming users to make

every payment instruction with a single procedure or system irrespective of the domain or the amount of remittance.

(2) Provision of “low-value remittance” services for international remittance

In Europe and North America, initiatives for internationally connecting a small-lot settlement system, such as Automated Clearing House (ACH)⁴⁷, and standardization of remittance procedures have been progressing. Through these initiatives, the ACH in the U.S. has connected with the ones in 35 countries including 22 European countries so far.

In Asian countries, the idea of Asian Payment Network (APN)⁴⁸ has been promoted to establish a common payment infrastructure in the region by connecting domestic small-lot settlement networks mainly in ASEAN +3 countries across borders.

These international remittance schemes realized through international connection of ACHs or others are recognized as “low-value remittance⁴⁹” which is cheaper and less rapid remittance in comparison with international remittance schemes that are

⁴³ In general, SWIFT format, which is regarded as the international standard, is used for international remittance.

⁴⁴ Some major banks (three mega-banks) have already started to provide this service to specified customers, and these banks are assumed to provide this service to general companies that have need to use this service in future.

⁴⁵ Bank Identifier Codes (BIC) are 11-digit codes used in ISO9362, the international standard to identify banks in case of international remittance and registered to SWIFT.

⁴⁶ International Bank Account Numbers (IBAN) are 34-digit code at maximum used in ISO13616, the international standard to identify banks in case of international remittance and also registered to SWIFT. In addition, IBAN should be registered to SWIFT by entities for standardization or central banks of each country and 66 countries have registered IBAN as of March 2015 (but Japan has not registered IBAN).

⁴⁷ An Automated Clearing House (ACH) generally means a small-lot settlement system and Japanese Banks' Payment Clearing Network (*Zengin* Net) falls on this category in Japan.

⁴⁸ Asian Payment Network (APN) is an organization established by ATM network operators in major ASEAN countries in 2006. Afterwards, China, Korea, Australia, New Zealand participated in this network in 2010 and 2011, and private business operators from Japan also participated in January 2014.

⁴⁹ In cross-border remittance through correspondent banking, fees for multiple banks and fund settlement for each remittance are incurred because intermediate banks and cover banks are involved. In contrast, “low-value international remittance” is to reduce remittance costs by, for example, aggregating payment by country and paying in bulk (once a day).

currently provided by Japanese banks under correspondent agreements between banks⁵⁰.

As international activities of corporations and individuals are expanding, “low-value remittance” provided by banks should become available also in Japan from the viewpoint of improving users’ convenience⁵¹, and, from this standpoint, steady implementation of the following action plan is hoped:

- By 2018 or so, provide “low-value remittance” services by connecting with network service providers participating in APN on a premise that agreements will be reached with countries to be connected to, in order to provide cheap international remittance services via banks⁵². In doing so, the banking industry is assumed to conduct examination on the specific connection methods, transaction procedures and settlement methods, etc., and to present the result of such examination to other deposit-taking institutions including other business categories.

(3) Improved convenience for large-lot remittance

In Japan, a single remittance transaction through *Zengin* System should be less than 10 billion yen⁵³ and systems of individual

banks are constructed based on this upper limit of *Zengin* System⁵⁴. Large business corporations opine that this is an obstacle of cash management because they cannot introduce straight through processing (STP)⁵⁵ as, in case of remittance of 10 billion yen or more, they should divide the large-lot remittance or should use another scheme, i.e. transfer funds on the BOJ-NET.

From the viewpoint of efficient cash management by corporations, it is important that payment infrastructure provides seamless payment environment regardless of the amounts of remittance. Such environment can be created by increasing the number of digits of the amounts to be remitted on *Zengin* System or utilizing fund transfer on the BOJ-NET. The banking industry and the Bank of Japan are expected to lead examination of these solutions and obtain a conclusion as soon as possible with due consideration on the aspects of users' convenience, economic rationality and settlement risks.

(4) Improving efficiency in yen-denominated remittance to/from non-residents' accounts

As businesses of major Japanese companies have become borderless in general, it is essential to provide a seamless environment where financial settlements can be smoothly made regardless of the residency

⁵⁰ In international remittance between banks currently performed in Japan and many other countries, the sending bank makes a payment instruction to the receiving bank for every payment and such payment is settled using saving deposit accounts opened at both banks in accordance with the correspondent agreement between them.

⁵¹ As the movements to provide new instruments for international remittance, interconnection between payment systems such as APN and collaboration and cooperation with Fintech companies for individual banks are anticipated. These initiatives should also

⁵² Handling of financial services is judged by each financial institution, but preliminary connecting schemes are supposed to be reviewed by the banking industry as a whole.

⁵³ The field of the remittance amount on *Zengin* format has been set as 10 digits (less than 10 billion yen) since 1973 when the figure was initially defined.

⁵⁴ In Europe, for example, companies can remit fund not using other schemes such as multiple-time remittance even in the case of large-scale fund transfers.

⁵⁵ See Note 24.

of the parties involved. In this regard, a steady implementation of the following action plan is hoped.

- Domestic financial institutions are to conduct practical feasibility study to ensure their compliance with the obligations provided by the Foreign Exchange Act in regard to verification at yen-denominated payments to/from non-residents. This includes: (i) a measure under the new system to ensure financial institutions to identify and reject transactions prohibited by the Foreign Exchange Act, such as those with designated persons subject to sanction programs; and (ii) a system that enables financial institutions to conduct prompt and accurate matching with account holders and the designated persons whenever the list of designated persons is updated.
- The Japanese banking industry is to start handling yen-dominated remittance to/from non-residents at the *Zengin* System in the fiscal year 2016 at the earliest.

3. Institutional efforts of the banking industry to continue innovation in payment services

Improvement of the setup of Japanese Banks' Payment Clearing Network (*Zengin-net*) should be considered in order to continue delivering strategic initiatives responding to diversified needs for payment infrastructure services, necessity of international coordination and requests for quick actions, etc. Steady implementation of the following action plans regarding payment infrastructure is hoped to encourage banks to continue their proactive efforts.

- Reorganize the current Expert Panel on *Zengin-Net* that is established to directly collect opinions from users and set up a round table at the Federation of Bankers' Association where representatives of private and public sectors as well as related industries discuss issues.
- Make additional efforts to strengthen the structure when necessary.



Chapter 5: Institutional Framework on Virtual Currencies

1. The current situation surrounding virtual currencies

(1) The current status of transactions

So-called virtual currencies (VC) traded electronically on the Internet have emerged as a result of advancement of IT and other factors. There are various types of VC⁵⁶, and it is pointed out that “Bitcoin⁵⁷,” the typical VC, is handled by approximately 100,000 dealers⁵⁸ and traded approximately 170,000 times a day⁵⁹ and its aggregate market value has reached approximately 5.2 billion dollars in the whole world at the end of November of this year⁶⁰. Also in Japan, VC are traded in hundreds of millions of yen per day, and there are several tens of shops where payment by VC is possible⁶¹.

(2) International requests for countermeasures against money laundering and financing of terrorism

It is argued internationally that VC have a risk to be abused for money laundering and other crimes because the transfer of VC is made quickly and easily and they can be used anonymously⁶².

On June 8, 2015, at G7 Summit at Schloss Elmau in Germany, leaders declared that “We will take further actions to ensure greater transparency of all financial flows, including through an appropriate regulation of virtual currencies and other new payment methods.”

Furthermore, the Financial Action Task

⁵⁶ According to a private information website, there are more than 600 virtual currencies (Source: coinmarketcap (<http://coinmarketcap.com/>)).

⁵⁷ A virtual currency developed by volunteer developers on the Internet, based on the thesis published by a person named “Satoshi Nakamoto” in 2008. This currency is transferred electronically between network users and all transaction histories are recorded on the public register shared by the users. There is no issuer of Bitcoin and coins are issued automatically on the system as a reward for registering transactions recognized by users.

⁵⁸ Source: CoinDesk (<http://www.coindesk.com/research/state-of-bitcoin-q3-2015/>)

⁵⁹ Source: BLOCKCHAIN.info (<https://blockchain.info/ja/charts/n-transactions>)

⁶⁰ Source: coinmarketcap (<http://coinmarketcap.com/>)

⁶¹ Source: the material prepared and presented by an expert at the fifth meeting of the Working Group.

⁶² For example, FATF pointed out in its report published in June 2014 and titled “Virtual Currencies Key Definitions and Potential AML/CFT Risks” that convertible virtual currencies that can be exchanged for real money and other virtual currencies have a risk to be used for money laundering and terrorist financing and virtual currencies have been actually used for money laundering in multiple cases such as Liberty Reserve case (in which a Costa Rica-based money transmitter offered highly anonymous means of money laundering using virtual currencies).

Force (FATF)⁶³ published a guidance⁶⁴ on June 26, 2015, which directs countries to register or license natural or legal persons that provide convertible VC exchange services between VC and fiat currencies and to ensure their compliance with the relevant anti-money laundering and counter-terrorist financing (AML/CFT) measures such as customer identification/verification, suspicious transaction reporting and recordkeeping requirements.

Fighting against money laundering and financing of terrorism using VC has become one of the top priorities in the international community including Japan.

(3) Event of a virtual currency exchanger Bankruptcy in Japan

In 2014, a bankruptcy event occurred in Japan where a company providing convertible VC exchange services between VC and fiat currencies failed. The company was one of the world's largest in terms of the transaction volume at that time. The bankruptcy proceedings of this company revealed that it was in the state of insolvency and the amount of funds and Bitcoins received from customers was far less than the amount of funds and Bitcoins actually held by the exchanger at the time of commencement of bankruptcy proceedings. In addition, the company's representative is suspected of embezzlement of escrowed funds in relation to its bankruptcy.

In light of these points, construction of an

institutional framework from the viewpoint of user protection is desired in addition to AML/CFT measures⁶⁵.

⁶³ Established in 1989 as an inter-governmental body to formulate the international standards to tackle money laundering and terrorist financing (FATF Recommendations). The FATF Recommendations are adopted by 190 countries and regions or more, and implementation of such recommendations are mutually evaluated by members and rectification of deficiencies identified in such evaluations is followed up.

⁶⁴ <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf>

⁶⁵ Major countries are roughly classified into: (i) ones banning use of virtual currencies (Russia), (ii) ones that have introduced or are considering regulations on money laundering and funding for terrorism (the U.S. (Federal), the U.K., Canada and Singapore), and (iii) ones that have introduced regulations for user protection as well as regulations against money laundering and funding for terrorism (State of New York (the U.S.), Germany, France and Switzerland).

2. Regulation of virtual currencies

(1) Scope of the regulation

Under the FATF guidance, convertible VC exchangers are required to be subject to regulation, because they act as a gateway to the existing financial system by exchanging VC with fiat currencies⁶⁶. At the same time, actual VC use condition reveals that VC are acquired mainly through VC exchangers and VC are accepted on the condition that they can be exchanged with fiat currencies at VC exchangers. On the other hand, transactions (including purchase and sales, intermediary, brokerage, agency, as well as acceptance of escrowed funds or VC relating to purchase and sales) between VC and fiat currencies have risks of failure of service providers or missing customers' escrowed assets in the process of purchase and sales and risks of non-provision of accurate and sufficient information to customers.

In this regard, in introducing regulations on VC from the viewpoint of AML/CFT as well as user protection, VC exchangers that purchase and sell VC and fiat currencies⁶⁷ should be subject to regulation where VC exchangers are asked for registration.

Future direction of VC-related services developments is yet to be known at this moment. New types of service providers might appear in the future if VC are to be used in various fields, and agile response to any changes in circumstances, if any, is considered necessary with possibilities of wide acceptance of VC use in mind and

paying attention to the actual conditions of VC-related service provision.

(2) Measures on anti- money laundering and counter- terrorist financing

In accordance with the FATF guidance above, it is necessary in Japan to introduce AML/CFT measures prescribed in the Act on Prevention of Transfer of Criminal Proceeds against VC exchangers trading VC and fiat currencies. Specifically, it is considered necessary to include VC exchangers trading VC and fiat currencies in specified business operators⁶⁸ under the Act on Prevention of Transfer of Criminal Proceeds and to impose on them the following obligations⁶⁹ as stipulated in the Act⁷⁰:

- Customer identification/verification (in opening accounts, etc.);
- creating customer verification and transaction records, and maintaining these records;
- Reporting suspicious transactions to the competent authorities; and
- Establishing systems (including development of internal rules, training sessions and appointment of compliance officers in charge⁷¹).

⁶⁶ Paragraph 14 of "Guidance for a Risk-Based Approach to Virtual Currencies" by FATF, published on June 26, 2015.

⁶⁷ Service providers who provide places of trade or who are counterparties of buying and selling of virtual currencies.

⁶⁸ Article 2, Paragraph 2 of the Act on Prevention of Transfer of Criminal Proceeds.

⁶⁹ Article 4, Article 6, Article 7, Article 8, Article 10 of the Act on Prevention of Transfer of Criminal Proceeds.

⁷⁰ Under the Act on Prevention of Transfer of Criminal Proceed, persons who assign deposit books, etc. shall be punished (Article 27 and 28 of the Act). Customers who assign IDs, etc. to log on to accounts at convertible VC exchangers should be punished as well.

⁷¹ The obligations of development of internal rules and appointment of compliance officers in charge are added after partial revision of the Act on Prevention of Transfer of Criminal Proceeds (proclaimed on November 27, 2014 and enforced on October 1, 2016).

(3) Regulations for user protection

(a) The basic framework of the regulations

Considering the case of the bankrupted VC exchanger above and in light of risks assumed in the course of transactions of VC (users' damages caused by the lack of information, loss of users' escrowed assets, leakage of user information, etc.), taking measures to impose the following obligations is deemed appropriate,

- Implementation of measures for user protection and other purposes;
 - Explanation to prevent misunderstanding (e.g., no guarantee for exchange of VC with fiat currencies),
 - Provision of information to users (e.g., details of transactions, fees and contact points for complaints),
 - Delivery of written documents when money is accepted (electromagnetic documents are also possible),
 - Internal controls (e.g., formulation of internal rules and training sessions for employees);
- Prohibition of name lending;
- Segregated management of funds and VC escrowed by customers;
- Securing information safety (security measures for systems and safety control of privacy);
- Capital requirements (on minimum capital, minimum net assets, etc.);
- Preparation and preservation of books and documents and submission of business reports to the competent

authorities; and

- Requests for reporting, inspection, orders to improve or suspend business operations and rescission of registration by the competent authorities.

(b) Segregated management

In relation to the segregated management of funds and VC escrowed to VC exchangers by customers, under current Japanese financial legislation concerning separate management of funds, the methods of such segregation in general are classified roughly to: (i) preserving as deposits; (ii) preserving as trusts; and (iii) administering assets in the condition where assets of its own and customers are managed separately as they can be immediately distinguished from each other.

There is a restriction that VC are not eligible for being deposited or entrusted because their nature in the private law has not been clear yet. In such a situation, some people doubt the effectiveness of deposit and entrust of funds, instead of VC, in order to protect customers, and others point out if VC exchangers can entrust funds in practice.

In light of these discussions, it is deemed appropriate, at least currently, to impose, as the basic scheme, VC exchanger to manage customers' assets separately from its own assets and to require VC exchangers to have external audits by chartered public accountants or audit corporations concerning conditions of such separation in the management of customers assets because, in the above case, customers' assets were actually lost at the domestic VC exchanger⁷².

⁷² Under the current legislation, some of Financial Instruments Business Operators who are engaged in Type I Financial Instruments Business specified in the Financial Instruments and Exchange Act are required to have external audits by chartered public accountants or audit corporations on a regular basis concerning segregated management.

(c) Capital requirements

Some requests not to make VC exchangers' capital requirements too excessive from the viewpoint of promoting innovation, as small and medium-sized companies are also providing VC exchange services in Japan.

In contrast, it is pointed out that VC exchangers trading VC and fiat currencies should have a certain amount of capital for user protection in order to make initial investments on construction of systems with security measures taken and others necessary at minimum. In light of these opinions, introduction of a proper level of capital requirements on VC exchangers is deemed necessary, striking a balance between protecting users and promoting innovation.

In addition, capital requirements are effective only if VC exchangers' financial statements are appropriate. Therefore, it is desirable to require them to have external audits of their financial statements by chartered public accountants or audit corporations⁷³.

(d) Self-imposed regulations

Foreseeing rapid progress in innovation, the forms of services provided by VC exchangers are also supposed to evolve quickly. In introducing regulations from the viewpoint of user protection, it is considered fundamentally important to act flexibly by combining statutory regulations, if introduced, with self-imposed regulations by the industry. In light of this, it is

appropriate to allow the establishment of an organization for self-imposed regulations on VC exchangers, which are admitted by the laws and to set up an alternative dispute resolution (ADR) system for VC exchangers like other financial industries⁷⁴.

⁷³ Some countries that have introduced regulations on VC exchangers for the purpose of user protection (State of New York (the U.S.), Germany, France and Switzerland) require exchangers to have external audits of their financial statements.

⁷⁴ As for self-imposed regulations, financial industries under registration system normally have systems of certified associations, etc. based on laws and regulations. In addition, major financial industries normally have ADR systems for financial services regardless of whether service providers should be registered or licensed. The same system is established for fund transfer service providers also under the Payment Services Act.



Chapter 6: Continuous Efforts for Advancement of Payment System

Actions for advancement of payments and transaction banking have to be taken steadily along with the directions discussed above. Also considering possibilities of changes and developments in the environment surrounding payment and payment services, it is important to implement strategic efforts continuously based on the fundamental directions presented in this report.

For this purpose, it is necessary to follow up progress in the efforts to advance payment systems and to specify issues and actions to be taken continuously based on the overseas trends and innovation relating to advancement of payment systems. The public and private sectors should act together to implement such actions and the FSA is expected to make efforts to establish a framework for it. In addition, it is important at the same time to see if appropriate measures are taken to stabilize payment systems and secure information security.

CONCLUSION

The above-mentioned are the findings from the deliberation at the Working Group. In light of the approach presented in this report, it is hoped that concerned parties will push forward appropriate measures.

IT development and integration between finance and IT are expected to accelerate in a global scale from now on. Unless we respond quickly to the global trends in innovation or take such trends in advance, demonstrate our leadership in the international trends surrounding payment and settlement, or review constantly how payment services and related systems should be, we will be left behind in the global trends in innovation and users' convenience might not be improved sufficiently. The competent authorities and service providers involved in payment and settlement business are expected to adequately consider the above content and make responses continuously and proactively.