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Publication of Cabinet Order and Cabinet Office Ordinance on the Revision of the Payment Services Act 2020

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I. Introduction

The Act for Amendment of the Act on Sales, etc. of Financial Instruments, etc. for the Convenience and Protection of Users of Financial Services (the "**Amendment Act**") was passed and enacted by the Diet on June 5, 2020, and promulgated on June 12, 2020, as first highlighted by us in the July 2020 issue of the FINANCIAL REGULATION BULLETIN.[1] In response to the Amendment Act, on December 25, 2020, the Financial Services Agency (the "**FSA**") announced the draft Cabinet Order and Cabinet Office Ordinance concerning the revision of the Payment Services Act (the "**Proposed Amendment to the Order**"), which reveals the full extent of the revised payments legislation.[2] On the same day, the FSA announced, in addition to the Proposed Amendment to the Order, a partial amendment (draft) to the "Administrative Guidelines (Part 3: Financial Companies Related)" and "Comprehensive Guidelines for Supervision of Major Banks, etc." (the "**Proposed Amendment to the Guidelines**").[3] The Proposed Amendment to the Guidelines introduces measures intended to address issues that came to light in 2020 where a funds transfer service account regulated under the Payment Services Act was fraudulently linked to a bank account.[4]

[1] https://www.fsa.go.jp/common/diet/index.html
[2] https://www.fsa.go.jp/news/r2/sonota/20201225-2/20201225-2.html
[3] https://www.fsa.go.jp/news/r2/sonota/20201225-4/20201225-4.html
[4] Public comments procedures have been made on both the Proposed Amendment to the Order and the Proposed Amendment to the Guidelines, and the deadline for acceptance of comments was Monday, January 25, 2021.

This newsletter outlines the key aspects of the revisions under the Proposed Amendment to the Order.[5]

The purpose of the Amendment Act is to amend the regulations on payments and intermediaries of cross-sectional financial services in response to the report issued on December 20, 2019 by the Working Group on Regulations Regarding Payments and Intermediaries of Cross-Sectional Financial Services, a sub-group of the FSA's Financial System Council (the "**WG Report**"; the working group, the "**WG**"). In particular, the payments-related provisions of the Payment Services Act are amended.[6]

II. Remittance Services

1. Remittances and "collection agency services"

(1) Scope of Remittances under the amended Funds Transfer Service Ordinance

A business operator that provides a so-called "collection agency service," where it is entrusted by a creditor to collect payment from its debtors, was formerly exempted from the payments regulation under the Payment Services Act and did not have to obtain a registration under the Act. However, the recent proliferation of operators in this area has given rise to concerns that the services are, in substance, remittance services and should be regulated accordingly in the interests of user protection. Accordingly, the amended Funds Transfer Service Ordinance specifically stipulates that a purported "collection agency" transaction is considered to be a remittance (*Kawase Torihiki*) if the following requirements are satisfied:

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[5] In this newsletter, the Payment Services Act is referred as the "**Payment Services Act**" or the "**Act**", the Enforcement Order for the Payment Services Act is referred as to the "**Order"**, the Cabinet Office Ordinance for Prepaid Payment Instruments is referred to as the "**Prepaid Payment Instruments Ordinance**", the Cabinet Office Ordinance for Funds Transfer Service Providers is referred to as the "**Funds Transfer Service Ordinance**", the Administrative Guidelines (Part 3: Financial Companies Related, Section 5: Issuers of the Prepaid Payment Instrument Related) is referred to as the "**Prepaid Payment Instruments Guidelines**", and the Administrative Guidelines (Part 3: Financial Companies Related, Section 14: Funds Transfer Service Providers Related) is referred to as the "**Funds Transfer Service Guidelines**". In addition, when referring to the laws, regulations, and guidelines that are subject to amendment in the Amendment Act, the Draft Cabinet Order, and the Proposed Amendment to the Guidelines, the description refers to "before amendment" or "after amendment" after the name of the laws, regulations and guidelines. However, when referring to provisions that are not amended by the Amendment Act or the Draft Cabinet Order, there may be cases where only the name of the laws and regulations is stated.

[6] https://www.fsa.go.jp/singi/singi_kinyu/tosin/20191220.html

① a person who holds a monetary claim (a "**Creditor**") entrusts, assigns or by similar means appoints as its agent for the collection of such claim a third party (the "**Agent**");

② the Agent itself or through its delegate accepts on behalf of the Creditor funds for repayment of the claim from the debtor or its delegate (including two levels of delegation, collectively, the "**Debtor**");

③ Agent transfers the funds to Creditor (excluding the transfer of funds by way of physical delivery); and

④ the Creditor is an individual (excluding individual Creditors such as sole proprietors who appoint an Agent for business purposes).

The transaction must also fall within any of the following cases:

a. The obligation of the Debtor pertaining to a monetary claim of the Creditor is not extinguished by payment by the time when the Creditor or its delegate receives the funds as payment (Article 1-2 (1) of the Funds Transfer Service Ordinance);

b. Where the Creditor's monetary claim has arisen from the provision of credit through the lending of funds, the payment of the Debtor is by way of subrogation in its capacity as a joint and several obligor, and the funds are to be transferred for the collection of said monetary claim (Article 1-2(2) of the amended Funds Transfer Service Ordinance); or

c. All of the following requirements are fulfilled (Article 1-2(3) of the amended Funds Transfer Service Ordinance):

1. The services in question do not comprise escrow services or similar arrangements where the Creditor is obligated to provide a counter-benefit to the Debtor pertaining to the Creditor's monetary claim, the Agent accepts the funds as repayment from the Debtor prior to or at the same time as the provision of the counter-benefit and it is not intended that the funds be accepted by the Agent after the Creditor provides the counter-benefit; and

2. The services in question do not comprise an online platform or similar arrangement where the Agent plays an essential role in the formation of the contract giving rise to the monetary claim and receives funds from the Debtor and transfers the said funds to the Creditor with the consent of the Creditor.

Among the above requirements, ① through ③ relate specifically to the nature of "collection agency services", while requirement ④ draws a line between services where the Creditor is an individual (except where the Creditor is acting in the course of business) (Article 1-2 of the amended Funds Transfer Service Ordinance), which will continue to be exempt from the requirements under the Act.[7]

The following section examines requirement ④ and explains the types of services where the Creditor is an individual and which will be subject to regulation under the amended Act.

(2) Cases where the Creditor is an individual: services for which the repayment of debts is not completed at the time of the receipt of funds by the Agent (Article 1-2(1) of the amended Funds Transfer Service Ordinance – Requirement ④a)

Requirement ④a (Article 1-2(1) of the amended Funds Transfer Service Ordinance) provides that among "collection agency services" in which an individual is the Creditor, those for which the obligation of the Debtor will not be extinguished by the time the funds are received as repayment by the Debtor shall be categorized as remittances. Accordingly, it can be concluded that if the obligation of the Debtor is extinguished by the time the funds are received by way of repayment from the Debtor (that is, at the time of receipt of funds or prior to the receipt thereof by the Agent), the transaction is not considered to fall within the category of remittances (unless it falls under any other category of remittance).

In this regard, the WG Report states that "among collection agency services", services will continue to be exempted from regulation as a remittance if (i) the creditor is a business operator, or a national or local government, and (ii) the repayment of the debt will be completed at the time of payment to the Agent, and it is obvious under the relevant contract that the Debtor does not face the risk of double payment." Requirement ④a (Article 1-2(1) of the amended Funds Transfer Service Ordinance) states that even where the Creditor is an individual, if the underlying debt is extinguished upon receipt of the funds by the Agent, the transaction does not fall under the

[7] In this regard, as described in "2. Amended Funds Transfer Service Guidelines" below, it should be noted that Article 2-2 of the amended Act and Article 1-2 of the amended Funds Transfer Service Ordinance are merely to confirm that services that meet these requirements fall under remittances and that the fact that services do not meet the requirements does not immediately mean that services do not fall to be considered as remittances (i.e. the services are not subject to the regulations). In addition, "collection agency services" in which a business operator or a sole proprietor is the payee are basically not subject to the regulation, but will continue to be left to interpretation.

category of remittance.

(3) Cases where the Creditor is an individual: services for collecting monetary claims arising from the provision of credit (Article 1-2(2) of the amended Funds Transfer Service Ordinance – Requirement ④b)

Requirement ④b (Article 1-2(2) of the amended Funds Transfer Service Ordinance) provides that among "collection agency services" in which an individual is the Creditor, funds transfers conducted for the purpose of the collection of monetary claims arising in connection with the provision of credit by the Creditor to the Debtor, the payment of the Debtor by way of subrogation in its capacity as a joint and several obligor shall be categorized as a remittance.

In this regard, the WG Report stated that the substantial economic effects of services such as a bill-splitting apps could be regarded as equivalent to a case where a Creditor makes a request to the Agent for funds transfer based on the recipient's instruction. In addition, since both the Creditor and the Debtor pose a credit risk to the Agent in that case, the WG report indicated that such services should be treated as remittances.

While bill-splitting apps can be considered to be remittance services and, accordingly, regulated under the Payment Services Act as meeting the provisions specified in ④b (Article 1-2(2) of the amended Funds Transfer Service Ordinance, it should be noted that this provision is not limited to a particular type of service. In other words, in addition to the collection of funds based on loans by the lender and the collection of funds based on claims for reimbursement arising from subrogation by a joint and several obligor, the collection of monetary claims arising from "the provision of credit to the debtor pertaining to the monetary claim by a method similar thereto" are all considered to be remittances. Since the scope of "the provision of credit by a method similar thereto" is not exhaustively defined, the direction of regulatory interpretation of this concept needs to be carefully watched.[8]

[8] From the descriptions above, it seems that cases where so-called upfront payment is made and cases where a guarantor fulfills a guarantee or indemnity may fall under the category of remittances. However, Article 1-2(2) of the amended Funds Transfer Service Ordinance defines remittances as those that meet the requirements among "collection agency services" in which individuals are the payees, and those in which funds are first delivered to creditors by way of upfront payment or guarantee and later collected from debtors do not meet the definition of remittances set forth in Article 2-2 of the amended Act (specifically, the requirements ② and ③) and therefore will be considered to continue to not fall under the category of remittances.

(4) Cases where the Creditor is an individual: services that are not escrow services, or payment services provided by platform operators (Article 1-2(3) of the amended Funds Transfer Service Ordinance – Requirement ④c)

Requirement ④c (Article 1-2(3) of the amended Funds Transfer Service Ordinance) provides that among "collection agency services" in which an individual is the Creditor, a service (a) where, if the Creditor is obligated to provide a counter-benefit to the Debtor pertaining to the Creditor's monetary claim, the Agent accepts the funds as repayment from the Debtor prior to or at the same time as the provision of the counter-benefit and it is not intended that the funds be accepted by the Agent after the Creditor provides the counter-benefit; and (b) where the Agent plays an essential role in the formation of the contract giving rise to the monetary claim and receives funds from the Debtor and transfers the said funds to the Creditor with the consent of the Creditor, are not considered to fall within the category of remittances (unless they fall under another category of remittances).

In this regard, the WG Report states that it is not necessarily appropriate to subject escrow services to regulation immediately because such services provide a function of preventing disputes between the parties to a transaction, such as the sale of goods, by ensuring the simultaneous fulfilment of the obligations of both parties. Requirement ④c(a) (Article 1-2(3)(a) of the amended Funds Transfer Service Ordinance) is considered to be in line with this position stated in the WG Report.

In addition, requirement ④c(b) (Article 1-2(3)(b) of the amended Funds Transfer Service Ordinance) applies to platform operators, who are considered to "play an essential role in the formation of the contract giving rise to the monetary claim" and receive funds with the consent of the Creditor, as occurs in transactions for the purchase of goods or accommodation through online platforms.

2. Amended Funds Transfer Service Guidelines

Article 2-2 of the amended Act and Article 1-2 of the amended Funds Transfer Service Ordinance were enacted with a view to regulating "collection agency services" where the Creditor is an individual and regulation is considered desirable from the viewpoint of user protection. However, the wording of these provisions, on its face, suggests that these provisions are not limited to the

specific services considered in the WG Report. In addition, under amended Funds Transfer Service Guidelines I-2, while the regulatory authority is required to make a determination of whether a particular service should be deemed to be a remittance in the light of the requirements prescribed in Article 2-2 of the amended Act and Article 1-2 of the amended Funds Transfer Service Ordinance, these provisions are "only to confirm that services that meet the said requirements fall under remittances," and since "there is a possibility that new business models will emerge in the future," acts that do not fall under the category prescribed in Article 2-2 of the amended Act or that do fall under the acts stipulated in the same Article but do not meet the requirements stipulated in Article 1-2 of the amended Funds Transfer Service Ordinance are not to be treated as "not immediately falling under the category of remittance in the future, and it should be noted that whether or not an act of a business operator falls under the category of a remittance provider will ultimately be determined on a case-by-case basis, depending on the details of the transactions conducted by the business operator."

In light of the above guidance, especially when considering a new business model, it is necessary to make a determination as to the application of the Act in light of the actual circumstances, rather than immediately taking the position that they are outside the scope of the regulation merely because such services do not correspond on their face to the provisions of Article 2-2 of the amended Act and Article 1-2 of the amended Funds Transfer Service Ordinance.

III. Funds Transfer Services

1. Three Types of Funds Transfer Service

The current regulations provide an upper limit of 1 million yen per funds transfer transaction (Article 2(2) of the current Act and Article 2 of the current Order). While the Amendment Act positions the currently regulated type of funds transfer services as "Type II Funds Transfer Service", it establishes two new categories of Funds Transfer Services: a "Type I Funds Transfer Service" that deals with high value funds transfers; and a "Type III Funds Transfer Service" that deals with low value funds transfers (Article 36-2 of the amended Act). The Proposed Amendment to the Order clarifies the specific regulation pertaining to the three types of Funds Transfer Service.

(1) Type I Funds Transfer Service

① Authorization of Business Implementation Plan

The Type I Funds Transfer Service permits transactions exceeding 1 million yen (no upper limit is imposed by the amended Act). Licensing in this category requires the authorization of a business implementation plan by the FSA (Article 40-2 of the amended Act). The Proposed Amendment to the Order sets out details of the application procedure for authorization and the mandatory content of the business implementation plan. (Articles 9-2 to 9-4 of the amended Funds Transfer Service Ordinance).

A key requirement of authorization is a risk assessment covering system risk and CFT/AML risk, taking into consideration the applicant's proposed transaction upper limit, and the development of a corresponding risk management system demonstrating an ability to carry out the service properly and reliably. (VIII-2-2(2) of the amended Funds Transfer Service Guidelines).

② Strict Retention Restriction

The amended Act imposes strict retention requirements on Funds Transfer Service Operators engaged in Type I Funds Transfer Services, and stipulates that an operator may not assume any obligation to its customers relating to funds transfer transactions for which "matters specified by the Cabinet Office Ordinance" are unclear (Article 51-2(1) of the amended Act). In response to this, the Proposed Amendment to the Order specifies such "matters" as (i) the amount of the funds to be transferred, (ii) the date on which the funds are to be transferred, and (iii) the identity of the recipient of the funds (Article 32-2(1) of the amended Funds Transfer Service Ordinance). The amended Funds Transfer Service Guidelines (III-1-1-1(1)①) clarify that if any of these matters are unclear, no specific instructions to effect a funds transfer transaction shall be deemed to have been given. In addition, the amended Funds Transfer Service Guidelines (III-1-1-1(1)①) further stipulate that the "date on which the funds are to be transferred" for purposes of (ii) above is the specific date on which the transfer of the funds is scheduled to be completed considering the funds transfer procedures expected at the time of the funds transfer request. The Funds Transfer Service Guidelines further state that, if the funds transferor does not give advance instructions as to the timing of completion of the transfer, the Funds Transfer Service Operator must propose a date for confirmation by the

transferor. The Funds Transfer Service Operator must also convey to the transferor the scheduled date for receipt by it of the funds from the transferor (to be calculated based on the scheduled completion date) and may not accept the funds from the transferor until such date.

In addition, a Type I Funds Transfer Service Operator may not assume any funds transfer obligations pertaining to the Type I Funds Transfer Service beyond the "period necessary for administering affairs concerning funds transfer and any other period specified by the Cabinet Office Ordinance" (Article 51-2(2) of the amended Act). In response to this, the Proposed Amendment to the Order specifies such period as the "period necessary for administering affairs concerning funds transfer (including the period necessary for remedying a situation where the funds cannot be transferred due to an erroneous recipient name or other reasons not attributable to the Funds Transfer Service Operator) (Article 32-2(2) of the amended Funds Transfer Service Ordinance).[9]

If funds are retained beyond the "period necessary for administering affairs concerning funds transfer", the Funds Transfer Service Operator is required to verify the cause and implement measures to prevent a reoccurrence if the cause was attributable to the Type I Funds Transfer Service Operator and to regularly report the results of such verification to the authorities (the amended Funds Transfer Service Guidelines III-1-1-1(1)⑤). If the cause is found to be attributable to the Type I Funds Transfer Service Operator, a report is also required with regard to measures to prevent reoccurrence (the amended Funds Transfer Service Guidelines III-1-1-2(2)).

③ Points to be noted regarding Type I Funds Transfer Services

As described above, the Type I Funds Transfer Service is subject to strict retention restriction. Therefore, while there are no restrictions on the amount of funds to be transferred, one-shot funds transfers are typically covered under the Type I Funds Transfer Service. For example, a Type I Funds Transfer Service Operator may neither provide a service that enables its customers to withdraw deposited funds through ATMs using a card

[9] The amended Funds Transfer Service Guidelines (III-1-1-1(1)②) stipulate that the "period necessary for administering affairs concerning funds transfer" is such period as may be necessary in light of operational and technical considerations and is reasonably calculated by taking into account the minimum period required for the administrative aspects of processing individual funds transfer transactions, such as the confirmation and verification required under AML/CFT requirements, communication with overseas offices and overseas banks, and wire transfers to customer bank accounts. If an event occurs that is not attributable to the Funds Transfer Service Operator, the period necessary for resolving the event is also included in that period.

issued by the Operator, nor a service where (i) a transferor pre-funds its account with a Type I Funds Transfer Service Operator in exchange for a certificate (i.e. money order) issued by the Operator for the equivalent amount and delivers the same to the recipient, and (ii) the recipient receives cash in exchange for the certificate (the amended Funds Transfer Service Guidelines III-1-1-1(1)②, note 4).

Furthermore, where a Type I Funds Transfer Service Operator also holds a registration as a Type II Funds Transfer Service Operator, while it is still permitted for Type II Funds Transfer Service Operators to provide services involving wallets and cards, it is not possible to provide funds transfer services utilizing funds received from customers under the Type II Funds Transfer Service registration (for example, the balance of the wallets and cards) for the purpose of the Type I Funds Transfer Service since this would be considered to be a circumvention of the strict retention restrictions applicable under the Type I Funds Transfer Service registration (Article 30-4(2) of the amended Funds Transfer Service Ordinance).[10]

(2) Type II Funds Transfer Service

The current framework under the Act will be basically maintained with respect to the Type II Funds Transfer Service and the upper limit of transferred funds will remain at 1 million yen (Article 36-2(2) of the amended Act and Article 12-2(1) of the amended Order).

However, the amended Act introduces certain funds retention restrictions. Specifically, a Funds Transfer Service Operator (regardless of the type of registration) is required, pursuant to the provisions of the Ordinance, to take measures to refrain from the retention of customer funds that are found not to be used for funds transfer transactions (Article 51 of the amended Act). In response to this, the Proposed Amendment to the Order requires a Type II Funds Transfer Service Operator to develop a system for confirming whether or not the funds received from the customer under its Type II Funds Transfer registration is to be used for the purpose of funds transfer transactions when the amount of funds received exceeds 1 million yen (Article 30-2(1) of the amended Funds Transfer Service Ordinance).

[10] Precisely, Article 30-4(2) of the amended Funds Transfer Service Ordinance provides that: "in the event that a Funds Transfer Service Operator (being a person who engages in Type I Funds Transfer Services and Type II Funds Transfer Services) accepts funds from a customer (and which are accepted in relation to the Type II Funds Transfer Service; hereinafter the same shall apply in this paragraph) and assumes funds transfer obligations under the Type II Funds Transfer Service, it shall take measures to prevent such funds transfer obligations from being changed to funds transfer obligations under the Type I Funds Transfer Service."

It is also provided that a Funds Transfer Service Operator (regardless of the type of registration) is required, with regard to funds received from a customer that are found not to be intended to be applied to funds transfer transactions, to take measures to return the funds to the customer or otherwise refrain from retaining the funds (Article 30-2(2) of the amended Funds Transfer Service Ordinance).[11]

It should be noted that, while the WG intended that this prohibition on retention should be applied only to the Type II Funds Transfer Service, the Proposed Amendment to the Order clarifies that Article 30-2(2) of the amended Funds Transfer Service Order applies to the Type I Funds Transfer Service and the Type III Funds Transfer Service as well, with the consequence that any type of Funds Transfer Service Operator is required to take measures to return funds to customers as explained above.

In order to decide whether funds received from a customer are to be used for a funds transfer transaction, it is necessary to comprehensively consider, with respect to each customer, ① the amount received, ② the period of retention, ③ the actual amount of previous transfers, and ④ the purpose of use. For example, if it is found that a customer account holds an amount exceeding 1 million yen, it is necessary to determine whether or not a funds transfer transaction is scheduled and whether or not the amount of the balance is larger, and the period of retention is longer, compared with the customer's past transaction history. If it is determined, based on such inquiry, that there is a low probability that such funds will be used for funds transfer transactions, the Funds Transfer Services Operator is required to transfer the amount so determined back to the customer's registered bank account (IV-1-1, notes 1 and 2 of the amended Funds Transfer Service Guidelines).

(3) Type III Funds Transfer Service

According to the Proposed Amendment to the Order, the upper limit of small amount funds transfers that can be handled under the Type III Funds Transfer

[11] The amended Funds Transfer Service Guidelines (II-2-2-1-1 (5)) sets out the following factors: ① whether there is a method for returning funds received that are found not to be for the purpose of funds transfer transactions by customers; ② where the method of returning the received funds or other related measures are to be implemented by means other than a transfer back to a bank account registered in advance by the customer, whether such method is appropriate from the viewpoint of speed and convenience for the customer; and ③ whether a system is in place for obtaining from the customer in advance the information necessary to conduct the return in accordance with the method implemented. In addition, if interest is paid on the outstanding amount of the customer funds, it is considered that there is a mechanism in place to induce the acceptance of customer funds for purposes other than funds transfer transactions, and thus that it is likely to violate the prohibitions on the receipt of deposits under the Act Regulating the Receipt of Contributions, the Receipt of Deposits, and Interest Rates.

Service is 50,000 yen (Article 36-2(3) of the amended Act and Article 12-2(2) of the amended Order). In addition, the upper limit of the Operator's obligations with respect to customer funds is also set at 50,000 yen (Article 51-3 of the amended Act and Article 17-2 of the amended Order).

Type III Funds Transfer Service Operators are not subject to the strict security requirements applicable to Type I and Type II Funds Transfer Service Operators (discussed below) with respect to customer funds. In lieu of such security arrangements, Type III Funds Transfer Service Operators are permitted to secure customer funds by means of segregated bank deposits, subject to satisfactory ongoing audits by a certified public accountant or an audit firm (Article 45-2 of the amended Act and V of the amended Funds Transfer Service Guidelines).

This is based on the idea that, compared with other types of Funds Transfer Services, the economic impact of the bankruptcy of a Type III Funds Transfer Service Operator is relatively small.

It is also possible to provide wallets and cards under the Type III Funds Transfer Service, but it is necessary to keep in mind that it is not possible to have a balance exceeding 50,000 yen. The amended Funds Transfer Guidelines require a mechanism to reject requests from each customer for funds transfer transactions in excess of 50,000 yen, and a mechanism to ensure that outstanding obligations applicable to each customer do not exceed 50,000 yen.[12]

2. Regulations on Security for Customer Funds

In order to further improve customer protection and reduce compliance costs, the amended Act revisits the existing regulations on securing customers' funds, and revises both the calculation frequency of the maximum required amount of security and the maximum permitted time lag between receiving and securing the Operator's obligations with respect to customer funds.

In the case of Type I Funds Transfer Service, the Amendment Act stipulates that the calculation frequency for the adequacy of security is "each business day" and that the permissible time lag between the receipt of funds and the

[12] For instance, the amended Funds Transfer Service Guidelines stipulate that "for example, if a customer transfers 30,000 yen to another customer with an account balance of 40,000 yen, the account balance of the latter customer (i.e. the recipient) will be 70,000 yen if the customer receives the full amount of the transfer in its account, thereby causing the account balance to exceed the upper limit of 50,000 yen. Therefore, it is necessary to take measures to prevent this as follows: if the sum of the account balance of the recipient and the expected transferred amount exceeds 50,000 yen, the funds transfer must be rejected; or a contract executed with the customer to ensure that any surplus amount (i.e., 20,000 yen) will be automatically transferred back to a bank account designated by the customer" (V-1-1② of the amended Funds Transfer Service Guidelines).

establishment of security for the obligations with respect to those funds is "within the period of one week or less as specified in the Cabinet Office Ordinance from each business day" (Article 43(1), Item (i) of the amended Act). In response to this, according to the Proposed Amendment to the Order, the latter time lag is stipulated as "two business days (Sundays, Saturdays, holidays prescribed in the Act on National Holidays, January 2, January 3, and December 29 to December 31 shall not be included in the calculation, and if the period so calculated exceeds one week, it shall be deemed to be one week)" (Article 11(1) of the amended Funds Transfer Service Ordinance).

In the case of Type II Funds Transfer Service and Type III Funds Transfer Service, the Amendment Act stipulates that the calculation frequency is "every period determined by the Funds Transfer Service Operator for each type of Funds Transfer Service, which must be equal to or shorter than the period of one week" (namely, at least once a week) and that the time lag between the receipt of funds and the establishment of security for the obligations with respect to those funds is "within the period determined by the Funds Transfer Service Operator for each type of Funds Transfer Service, which must be equal to or shorter than the period of one week or less specified in the Cabinet Office Ordinance from the end of such period" (Article 43(1), Item 2 of the amended Act). In response to this, according to the Proposed Amendment to the Order, the latter time lag is stipulated as "three business days (Sundays, Saturdays, and holidays prescribed in the Act on National Holidays, January 2, January 3, and December 29 to December 31 shall not be included in the calculation, and if the period so calculated exceeds one week, it shall be deemed to be one week)" (Article 11(2) of the amended Funds Transfer Service Ordinance).

In addition, since strict retention restrictions are imposed on Type I Funds Transfer Service, it is conceivable that funds transfer transactions will be completed at a time between the time of calculation of the outstanding obligations with respect to the customer's funds and the deadline for securing those obligations, with the result that the outstanding obligation corresponding to such completed funds transfer transaction will be extinguished prior to the time when it would otherwise count towards obligations that must be secured. Given this, if the Type I Funds Transfer Service Operator specifies a time for calculating the amount of completed funds transfer transactions that falls between the time of calculation of the corresponding outstanding obligations and the deadline for securing those obligation, such Type I Funds Transfer Service Operator may deduct the amount corresponding to completed funds transfer transactions from the amount of the outstanding obligations that need

to be secured as of such time (Article 11 (4) of the amended Funds Transfer Service Ordinance).

In addition to the deposit of cash collateral with an official depository, the following methods permitted under the current Act for securing obligations with respect to customers' funds are retained: (i) obtaining a performance guarantee from a bank and (ii) entrusting assets pursuant to a trust agreement with a trust bank.

The amended Act now permits that all three of these permissible methods may be utilized in parallel (Articles 43 to 45 of the amended Act). In addition, with respect to the cash deposit method of securing outstanding obligations, if a Funds Transfer Service Operator is engaged in two or more types of Funds Transfer Service and has the same calculation period for outstanding obligations falling under both types of Funds Transfer Service, the same start date for calculating obligations with respect to customer funds and the same deposit deadline for all or part of the types of services, such Operator may make a blanket deposit with an official depository subject to the submission of a prior notification (Article 58-2 of the amended Act). Details of the notification procedures to make a blanket deposit are provided for in the Proposed Amendment to the Order (Articles 36-2 and 36-3 of the amended Funds Transfer Service Ordinance).

3. Other Amendments

The Proposed Amendment to the Order introduces new measures related to customer protection (Article 51 of the amended Act) and expands existing measures.

(1) Provision of Information to Customers

When a Funds Transfer Service Operator conducts funds transfer transactions with a customer, it shall provide the customer with information on the following items by the delivery of documents or other appropriate measures (Article 29-2 of the amended Funds Transfer Service Ordinance):

① the type of Funds Transfer Service;

② the method of securing customer funds (whether deposit of cash collateral, a performance guarantee from a bank or a trust arrangement with a trust bank, and in the case of the latter two methods, the counterparty's name, trade name or company name;

③ the applicable calculation period and the deadline for establishing the necessary security, depending on the type of Funds Transfer Service;
④ where Article 45-2(1) (Securing Funds through Bank Deposit, etc.) of the Act applies, the ratio of the obligations secured through bank deposit, etc. and a description of the rights subject to Article 59(1) (Refund of Cash Collateral) of the Act;
⑤ policy on compensation and other measures for losses of a customer arising from instructions given by a person who does not have authority in connection with the Funds Transfer Service; and
⑥ any other matters relevant to the matters listed in the preceding items.

Where a Funds Transfer Service Operator considers it necessary in respect of fraudulent transactions, it must take appropriate measures to disseminate to persons who are not customers (e.g. customers of partner banks) its policy on compensation for losses and other measures in case of such persons incurring losses in connection with Funds Transfer Services (Article 31, Item 4 of the amended Funds Transfer Service Ordinance). When providing its Funds Transfer Services in conjunction with a money remittance service provided by third party banks, the Funds Transfer Service Operator must establish a compensation policy that must include the policy mentioned in ⑤ above in relation to its customers and a separate policy in relation to non-customers, and provide such information to its customers as well as keep such information in a readily accessible manner for non-customers who are likely to incur a loss in the event of a fraudulent transaction (II-2-2-1-1(3) and II-2-6-1 of the amended Funds Transfer Service Guidelines).

(2) Measures to Prevent Utilization of Customer Funds as Loans

Funds Transfer Service Operators that have concluded a performance guarantee from a bank to secure its obligations with respect to customer funds must take measures to prevent the funds received from customers being utilized as loans or in other lending activity (Article 30-3 of the amended Funds Transfer Service Ordinance)[13]. This is to prevent an Operator engaging in

[13] The amended Funds Transfer Service Guidelines (II-2-2-1-1 (6)) describes the following aspects: ① whether funds received from customers and funds to be utilized for loans are separately held in different bank accounts or whether, even if the funds are held in a single bank account, there are reasonable measures to confirm that funds received from customers are not to be utilized for loans (for example, a measure that enables the Operator to calculate the lendable amount, being its own funds minus the customer funds, in a timely and appropriate manner and to confirm that any loaned amount is within the lendable amount), ② whether the method applied pursuant to the above is timely and properly evaluated and, if the funds are managed in separate bank accounts, whether there is timely and proper evaluation

lending activities without obtaining a banking license and to mitigate against potential liquidity issues if customer funds were to have the attributes of loans, a less liquid class of asset.

(3) Necessary Measures when Operating Two or More Types of Funds Transfer Service

For the convenience of customers, it is now permitted for the same Funds Transfer Service Operator to operate two or more types of Funds Transfer Service. In this case, however, measures are required to be taken to enable each customer to easily know its balance and other activity for each type of Funds Transfer Service (Article 30-4(1) of the amended Funds Transfer Service Ordinance).

Specifically, a Funds Transfer Service Operator engaging in two or more types of Funds Transfer Service is required to take measures to enable each customer to easily understand the outstanding balance of funds received, the record of funds transfer transactions and other customer activity for each type of Funds Transfer Service (VI-1-1(1)① of the amended Funds Transfer Service Guidelines). In addition, security arrangements as discussed above must be created for customer funds under each type of Funds Transfer Service. Furthermore, considering that a Funds Transfer Service Operator is required to annually report the status of profit and loss for each type of Funds Transfer Service, it is also necessary to establish separate accounts and carry out separate accounting for each type of Funds Transfer Service (VI-1-1(1)② of the amended Funds Transfer Service Guidelines).

(4) Dissemination of Policies on Compensation for Losses and Other Responses

Recently, multiple instances of fraud in the area of funds transfers have occurred in Japan. For example, one pattern of fraud involves the theft of bank account information to link with a funds transfer account, which is then charged from the bank account. Taking these circumstances into consideration, under the Proposed Amendment to the Order, in cases where a Funds Transfer Service Operator considers it necessary in respect of fraudulent transactions, it must take appropriate measures to disseminate to

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to ensure that the funds received from customers will not be utilized for loans, and ③ from the viewpoint of preventing incidents and fraud, whether there are measures to prevent customer funds and funds for loans being managed by the same person.

persons who are not customers of the Funds Transfer Service its policy on compensation for losses and other measures in case of such persons incurring losses in connection with the Funds Transfer Service (Article 31, Item 4 of the amended Funds Transfer Service Ordinance).

In addition, the Proposed Amendment to the Guidelines adds new sections: "II-2-5 Coordination with Services Provided by Other Businesses such as Bank Transfer"[14] and "II-2-6 Compensation for Loss arising out of Fraudulent Transaction"[15][16].

IV. Prepaid Payment Instruments

1. Measures Concerning User Protection

Under the Amended Act, the Issuer of Prepaid Payment Instruments ("PPIs") must, pursuant to the provisions of a Cabinet Office Ordinance, take necessary measures to protect the users of PPIs and to ensure the sound and appropriate operation of the business of issuing PPIs (Article 13(3) of the amended Act). In response, the following measures are stipulated in the amended Prepaid Payment Instruments Ordinance.

(1) Provision of Information to Users

Under the Proposed Amendment to the Order, when issuing PPIs, the Issuer is required to provide the user with information on the following items by issuing documents or other appropriate methods (Article 23-2(1) of the amended Prepaid Payment Instruments Ordinance). As this will increase the burden on PPI Issuers with respect to the provision of information, it will be necessary for Operators to review and, if necessary, update the information

[14] In this section, the following five points are enumerated: ① establishment of internal controls; ② security; ③ notice to customers; ④ monitoring of fraudulent transaction; and ⑤ responsible response to customers.

[15] In this section, it is required to establish a policy to compensate for losses caused by fraudulent transactions and the provision of information to customers. The compensation policy needs to include at least ① the types of incident qualifying for compensation and the details and the requirements for such compensation; ② procedures for compensation; ③ the sharing of compensation with a partner party; ④ the contact point for compensation; and ⑤ the disclosure standards of fraudulent transactions.

[16] As a part of the Proposed Amendment to the Guidelines, the Comprehensive Supervisory Guidelines for Major Banks are also amended with the addition of new sections such as "Coordination with Third party Payment Service Operators", meaning that the necessary rules are established both on the side of banks and payment service operators.

provided to users[17][18].

① the substance of the matters prescribed under Article 14(1) of the Act (Cash Deposit for Issued Amount) and a description of the right prescribed in Article 31(1) of the Act (Refund of Cash Deposit for Issuance);

② the method of securing issued amounts (whether deposit of cash collateral, a performance guarantee from a bank or a trust arrangement with a trust bank), and in the case of the latter two methods, the counterparty's name, trade name or company name; and

③ the policy on compensation for loss incurred by a user as a result of unauthorized instructions given by a third party, and other response measures.

(2) Preventive Measures against Inappropriate Use of PPIs Capable of Transferring Unused Balances

Under the Proposed Amendment to the Order, the Issuer of PPIs which incorporate the right of the holder to transfer all or part of its unused balance to another user by means of an electronic data processing system or by other means upon the instructions of the holder is obliged to set an upper limit on the amount that may be transferred out of the unused balance, establish a system to monitor the status of transferred balances, and take other appropriate measures to prevent the inappropriate use of the relevant PPIs (Article 23-3, Item 1 of the amended Prepaid Payment Instruments Ordinance)[19]. This provision is newly established in response to the WG Report. The

[17] As well as the obligation to provide information under Article 13(1) of the Act, exceptions have been established for Addition-Type PPIs (i.e. instruments where the balance of value is tabulated automatically by electronic means) and details of any alternative dissemination by the authorized payment services association (Article 23-2(2) and (3) of the amended Prepaid Payment Instruments Ordinance).

[18] As with Funds Transfer Service Operators, the Issuer of PPIs is required to disseminate to non-customers its compensation policy. To be precise, in cases where a PPI Issuer considers it necessary in light of the content and method of issuing the PPIs, the Issuer must take appropriate measures to disseminate to non-customers its policy on compensation for losses and other measures in case of such persons incurring losses (Article 23-3, Item 2 of the amended Prepaid Payment Instruments Ordinance). When issuing PPIs in conjunction with a money remittance service provided by third party banks, etc., the PPI Issuer must establish a compensation policy that must include the policy mentioned in ③ above in relation to its customers and a policy in relation to non-customers, and provide such information to its customers as well as keep such information in a readily accessible manner for non-customers who are likely to incur losses in the event of fraudulent transactions (II-2-1-1(4) and II-2-9 of the amended Prepaid Payment Instruments Guidelines).

[19] In this respect, the amended Prepaid Payment Instruments Guidelines newly established the "II-2-6 Measures to Prevent Inappropriate Use", which stipulates the following aspect as main points of focus: ① whether the one-time or daily upper limit of any transferable unused balances is reasonable in light of actual demand, giving consideration to ensuring that such balances not be used for inappropriate transactions, ② whether a system is in place to detect unusual transactions, such as identifying users who repeatedly receive transferred funds above a certain amount, and ③ whether necessary measures are in place, such as the temporary suspension of users engaged in unusual transactions, and whether necessary confirmations are made as to the subject and the substance of the underlying transaction.

WG Report indicates that certain types of payment instruments should permit balance transfer and that this type has the merit that the history of transfers can be easily monitored by the Issuer's system, provided that it is necessary to prevent transferred from being used in inappropriate transactions that harm public order and morals.

(3) Dissemination of Policies on Compensation for Losses and Other Responses

In the same manner as the amendments to Funds Transfer Services described in "III. Funds Transfer Services, 3. Other Amendments, (4) Dissemination of Policies on Compensation for Losses and Other Responses" above, under the Proposed Amendment to the Order, provisions concerning the dissemination of policies related to compensation for losses and other responses to losses incurred by non-customers has been newly established for PPI Issuers (Article 23-3, Item (ii) of the amended Prepaid Payment Instruments Ordinance). The Prepaid Payment Instruments Guidelines are also revised to include items related to "II-2-8 Coordination with Services Provided by Other Businesses such as Bank Transfer" and "II-2-9 Compensation for Loss arising out of Fraudulent Transaction."

While there is an alternative dissemination system in place for users to obtain information from the Japan Payment Service Association (the "**JPSA**") (instead of the Issuer) (Article 23 and Article 23-2(3) of the amended Prepaid Payment Instruments Ordinance), there is no explicit provision that non-customers may obtain information from the JPSA. Nevertheless, the inclusion of information for non-customers in the alternative dissemination system offered by the JPSA may also contribute to protecting consumers.

2. Management of Outsourcees

Under the amended Act, when an Issuer of PPIs outsources any activities under its regulated business of issuing PPIs (including two level outsourcing), it is required, pursuant to the provisions of the Prepaid Payment Instruments Ordinance, to provide guidance to the outsourcee and take other necessary measures to ensure the proper and secure execution of the outsourced activities (Article 21-2 of the amended Act). In response, the Proposed Amendment to the Order sets out the following requirements (Article 45-2 of the amended Prepaid Payment Instruments Ordinance). While current

outsourcing arrangements may be adequate, it is necessary to review whether they are adequate in light of the new requirements.[20]

① measures to ensure that the outsourcee has the ability to perform the outsourced activities in a proper and secure manner;

② measures to ensure that necessary and appropriate supervision is conducted with regard to the outsourcee, including measures to verify whether the outsourcee's performance is proper and secure, for example, by conducting regular or ad hoc checks of the outsourcee's performance and implementing any improvements as necessary;

③ measures necessary for appropriately and promptly processing complaints from users pertaining to the outsourced activities;

④ measures to prevent any interference with the protection of users of the PPIs, such as the prompt cancellation of the outsourcing agreement and the appointment of a new outsourcee in the event that a situation arises in which the outsourcee cannot properly perform the outsourced activities; and

⑤ measures such as amending or terminating the relevant outsourcing agreement if necessary for ensuring the sound and appropriate operation of the PPI issuance business and the protection of users.

3. Other Amendments

(1) Refunds Approved by the Authority

In principle, an Issuer of PPIs is prohibited from refunding the unused balance of the PPI except pursuant to the procedure stipulated by law (Article 20(5) of the Act). In this respect, Article 42 of the Prepaid Payment Instruments Ordinance provides for cases where a refund may, exceptionally, be permitted. The Proposed Amendment to the Order amends the refund provisions to provide that a refund may be permitted "in cases where a person who does not have authority, against the will of the holder of the PPI, by means of unauthorized access through a telecommunications line, uses the PPI, or in other circumstances where it is deemed that there is a risk of interference with the protection of the interests of the holder of the PPI, and where the approval of the Commissioner of the Financial Services Agency[21] is obtained

[20] In this respect, the amended Prepaid Payment Instruments Guideline (II-3-3) includes a new item "Outsourcing", which stipulates the points to note. Some of the points use the same description of outsourcing as the current Prepaid Payment Instruments Guideline (for example II-2-3-1).

[21] Approval will be delegated to the Director-General of the Local Financial (Branch) Bureau under Article 29(1) of the Order.

on the basis that a refund in such cases is unavoidable " (Article 42(1), Item 4 of the amended Prepaid Payment Instruments Ordinance). The Commissioner of the Financial Services Agency shall not grant approval unless the Issuer of the PPIs is deemed to have sufficient financial resources to ensure the refund of all of the PPIs issued by the Issuer (Article 42(3) of the amended Prepaid Payment Instruments Ordinance). The standard processing period for refund approval is 20 days (Article 56(2) of the amended Prepaid Payment Instruments Ordinance).[22]

The above amendment was not specifically discussed in the WG Report, but it is noteworthy that the draft of the Proposed Amendment to the Order amends the limitations on refunds. However, Article 42(1), Item 4 of the amended Prepaid Payment Instruments Ordinance seems to be drafted with a large-scale refund in cases of fraud in mind and the requirement for regulatory approval suggests that this new procedure for refunds has limited application.

(2) Notification of Violation of Laws and Regulations

The Proposed Amendment to the Order introduces provisions concerning requirements for the notification of regulatory violations. Where an Issuer of PPIs learns about a regulatory violation or circumstances that interfere with the sound and appropriate operation of the Issuer's PPI business, it is required to submit a written notice containing the following matters to the Director-General of a Local Finance Bureau within two weeks from the day on which the matter was discovered (Article 53-2 of the amended Prepaid Payment Instruments Ordinance).[23]

① the name of the business office or office where the act occurred;
② if the person who performed the act is an officer or employee of the Issuer, their name and position; and
③ a summary of the act.

[22] In this respect, the amended Prepaid Payment Instruments Guidelines (II-3-4-1②) provides guidance to the effect that, when applying for approval of a refund under Article 20(5) of the Act and Article 42, Item 4 [sic] of the amended Prepaid Payment Instruments Ordinance, it should be confirmed by reference to the issuer's balance sheet that the issuer is able to ensure refunds of all issued PPI, in order to prevent a situation where there are insufficient funds to refund all PPI holders and not just those subject to a refund request. In addition, approval of a refund request will be considered when, for example, a server-type PPI is subjected to cyber attack and remains at risk of fraud.

[23] In this respect, the amended Prepaid Payment Instruments Guidelines (II-1-3) newly established the item "Response to Irregularities", which stipulates a policy for supervisory measures in the event of irregularities.

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The Amendment Act amends the provisions concerning business improvement orders issued by the regulator to an Issuer of PPIs in a manner consistent with the provisions applicable to a Funds Transfer Service Operator (Article 25 of the amended Act). The requirement for notification of regulatory violations has also been revised in a manner consistent with the provisions applicable to Funds Transfer Service Operators (Article 39 of the amended Funds Transfer Service Ordinance).

PUBLICATIONS

- Article "Japan: New rules for financial services"
  Publication OneTrust DataGuidance (November 2020)
  Author Atsushi Okada, Ryo Yoshino (Co-Author)

- Article "Insurance solicitation using web conferencing systems"
  Publication International Law Office (November 24, 2020)
  Author Masakazu Masujima, Kazuo Yoshida, Tomonori Ogawa

- Article "The Pertinence of Insurance Business to Diversifying Insurance Services (Part 2) - Interpretations that May Change with the Development of IT Business"
  Publication Weekly Kinzai No.3370
  Author Tomonori Ogawa

- Article "Legal Commentary: Investment Crowdfunding Regulations and Related Issues - A New Method of Financing Drawing Attention in the COVID-19 Pandemic"
  Publication Business Houmu (November 2020)
  Author Suguru Miyata

- Article "The International Comparative Legal Guide to: Cybersecurity 2021 - Japan Chapter"
  Publication The International Comparative Legal Guide to: Cybersecurity 2021
  Author Hiromi Hayashi, Masaki Yukawa, Daisuke Tsuta

FINANCIAL REGULATION BULLETIN

NEWS

➢ Top Ranking Received From The Legal 500 Asia Pacific 2021

Mori Hamada & Matsumoto has been ranked in the top tier of recommended law firms in Japan, Myanmar and Thailand for several areas of practice in The Legal 500 Asia Pacific 2021 and the following lawyers have been recommended as “Hall of Fame” and “Leading individuals” in those practice areas.

For more information, please refer to the Legal 500's website.

https://www.mhmjapan.com/en/news/articles/2021/18.html

➢ Top Ranking Received From Chambers FinTech 2021

Mori Hamada & Matsumoto and our lawyers are recognized in the Legal category of Chambers FinTech 2021.

Japan

Legal – FinTech

- Masakazu Masujima
- Takane Hori

For more information, please refer to the Chambers' website.

➢ Top Ranking Received From Chambers Asia-Pacific 2021

Mori Hamada & Matsumoto and our lawyers are recognized in the practice areas named below in Chambers Asia-Pacific 2021. Our Yangon Office and Bangkok Office (Chandler MHM Limited), and their lawyers have also received prestigious rankings as shown below.

For more information, please refer to the Chambers' website.

https://www.mhmjapan.com/en/news/articles/2020/18578.html

➢ Top rankings received from IFLR1000’s thirtieth edition

Mori Hamada & Matsumoto has been ranked in the top tier of recommended law firms in following category in Japan by IFLR1000’s thirtieth edition. Thirty-one of the firm’s lawyers have received prestigious rankings. Our Bangkok Office (Chandler MHM Limited) and six of its lawyers have also received prestigious rankings as shown below.

For more information, please refer to the IFLR1000 website.

https://www.mhmjapan.com/en/news/articles/2020/18533.html

FINANCIAL REGULATION BULLETIN

- Top Rankings in "asialaw Profiles 2021"

  Mori Hamada & Matsumoto has achieved top rankings as one of the "Recommended firms" in Japan, Myanmar and Thailand in the "asialaw Profiles 2021" due to its impressive reputation in all of the practice areas mentioned below.

  Our Yangon Office is selected as one of the "Recommended firms" and to receive such high rankings. Our Bangkok Office (Chandler MHM Limited) has also been selected as one of the "Recommended firms" as shown below.
  https://www.mhmjapan.com/en/news/articles/2020/18519.html

- High evaluation received from " Who's Who Legal: Japan 2020"

  21 lawyers from Mori Hamada & Matsumoto have been selected as National Leaders in the following categories in Who's Who Legal: Japan 2020.
  https://www.mhmjapan.com/en/news/articles/2020/18518.html

- High evaluation received from "Who's Who Legal: Global 2020"

  18 lawyers from Mori Hamada & Matsumoto have been selected as Global Leaders in their respective practice areas by Who's Who Legal: Global 2020.
  https://www.mhmjapan.com/en/news/articles/2020/18513.html

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