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Japan: Trends & Developments
Keiji Tonomura, Shu Sasaki, Shu Takami and Shin Mitarai
Nagashima Ohno & Tsunematsu

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Trends and Developments

Contributed by:

*Keiji Tonomura, Shu Sasaki, Shu Takami and Shin Mitarai
Nagashima Ohno & Tsunematsu see p.8*

Impact of the Pandemic

Increasing popularity of cashless payments in Japan

Many businesses and services have been affected by the pandemic, and the payment culture in Japan has been no exception. In Japan, for a long time, cash was the primary means of payment in daily business transactions. It was common for people to pay in cash at supermarkets, in taxis, and when they were short of cash, to withdraw cash at ATMs located throughout the city. However, given the impact of the pandemic, both stores and customers wish to handle as little cash as possible, and the use of cashless payments, especially contactless payments, is on the rise in Japan.

However, compared to South Korea, the United States, China, and other countries where cashless payments account for a large share of total payments, this share remains low in Japan, even compared to 2020, when the share increased significantly compared to 2019. One reason for this is high payment fees payable by member stores, which are particularly burdensome for small and medium-sized businesses. How to remove such hurdles to further raise the rate of cashless payments still remains under discussion.

Conversely, major online malls, communication apps, and other platform providers offer their own smartphone payment services and compete fiercely for members, resulting in a huge number of cashless payment services on the market. Against such background, it is notable that, in March 2021, LINE (a communication app company with more than 80 million users

in Japan) and Z Holdings (which owns Yahoo! Japan and other companies) entered into a business combination. Through this business combination, “LINE Pay,” the payment service operated by LINE, is expected to be integrated with “PayPay,” the payment service operated by Z Holdings, in 2022. These market developments should be closely followed.

Buy now pay later (BNPL)

BNPL, a payment service that allows customers to pay for their purchases later without incurring fees, is gaining popularity overseas. Although this service is not yet widely available in Japan, it is likely to become even more popular in the future, given the increased use of credit cards and other forms of deferred payment due to the COVID-19 pandemic. In fact, there have been developments in Japan recently, with the announcement of M&A deals and IPOs for BNPL service providers. One such deal was PayPal’s acquisition of all of Paidy’s shares, which was announced in October 2021. In addition, in December 2021, the shares of Net Protections Holdings, Inc were listed on the First Section of the Tokyo Stock Exchange.

To provide similar services in Japan, registration under the Instalment Sales Act as a comprehensive credit purchase intermediary or an individual credit purchase intermediary may be required, depending on the nature of the services. However, if a company provides a deferred payment service under which payment for merchandise is received by a predetermined date within two months of the date of the sales contract (ie, the so-called monthly clear) without issuing a card, etc, as stipulated under the Instalment Sales

Act, such service may be provided without the registration under the Instalment Sales Act mentioned above. If registration under the Instalment Purchase Act is not required and no money lending services are provided, such as no cash advance services, verification at the time of the transaction may not be required under the Act on Prevention of Transfer of Criminal Proceeds where BNPL services are provided.

Growing digitalisation

Digitalisation is being embraced not only in the area of payments but also by the government, as evidenced by the establishment of the Digital Agency on 1 September 2021, in accordance with the “Basic Act on the Formation of a Digital Society.” At the direction of Prime Minister Kishida’s new Cabinet, which took office in October 2021, the Digital Agency will examine and implement digital and regulatory reform and comprehensively address cross-cutting administrative reform issues based on a set of “digital principles.” In addition, since November 2021, the Digital Agency has been holding Digital Provisional Administrative Reform Council meetings aimed at implementing essential structural reforms required for the “New Capitalism” initiative envisioned by the Kishida Cabinet.

These digital principles include “digital completion and automation” (ie, rules requiring written, in-person, sight, and periodic inspections should be based on digital completion and automation) and “use of a common digital infrastructure” (ie, a common digital infrastructure should be used for digital infrastructures, IDs, and base registries, rather than building proprietary systems separated by sector), which will likely foster cross-sector regulatory reform. The potential impact of digitalisation on the fintech sector should also be monitored.

Introduction of Financial Services Intermediary Business

The amendment to the Act on Sales, etc, of Financial Instruments, which came into effect on 1 November 2021 (the name of the act was changed to the “Act Concerning Provision of Financial Services” as a result of the amendment) (the “Amendment”), introduces a system for the registration of one-stop intermediary service providers of financial services covering all areas of banking, securities, and insurance.

Thanks to recent advancements in information and communication technologies, it is now possible to provide financial services online. Against this background, fintech companies are expected to provide cross-industry services such as providing services that allow users to check their account balances and deposit account income/expenses and introducing accessible financing, comparing and recommending financial services based on users’ financial needs. However, in the past, the following problems arose when intermediaries attempted to provide financial services across multiple industries (ie, banking, securities, and insurance):

- multiple registrations were required depending on the type of intermediary (ie, bank agency service, financial instruments intermediary service provider, insurance agent/broker, and others); and
- such intermediaries were required to be members of specific financial institutions. If they intended to act as intermediaries for products and services offered by several financial institutions, they would be required to comply with the guidance issued by each financial institution of which they were members.

Therefore, providing online financial services across multiple industries has been burdensome for fintech companies. In fact, as of the end of December 2019, there were only five companies

operating in Japan as intermediaries for all banking, securities, and insurance services.

However, this situation has been addressed with the introduction of the new category of “financial services intermediaries” under the Amendment. Financial services intermediaries will be able to offer intermediary services in all areas of banking, securities, and insurance under a single registration, although they need to be screened for each type of business. They are also not required to be members of any specific financial institution. Therefore, they are not required to follow any guidance issued by any financial institution, regardless of whether they act as intermediaries for products or services offered by such institutions.

In addition, if online financial services are provided, the following services are expected to be provided simultaneously:

- the services under which bank transfer requests are made to banks on behalf of users (ie, bank transfer transmission services); and
- services under which information such as the balance and usage history of deposit accounts, among other information, is obtained from banks and provided to users (ie, account information services).

In principle, registration as an electronic payment service provider under the Banking Act is required to provide the services above. However, following the Amendment, entities registered as financial service intermediaries may now provide the services mentioned above by filing the prescribed notification, even if they are not registered as an electronic payment service provider, as long as they meet certain requirements.

The Amendment is expected to result in an increase in the number of fintech companies offering multiple online services.

However, as of 1 November 2021, when the Amendment came into effect, only two companies have been registered as financial service intermediaries, and therefore, their use is not yet widespread. Although the reasons for this are unclear, it is believed that one factor is that financial service intermediaries are not allowed to sell profitable products, such as foreign currency-denominated insurance, due to restrictions on the provision of financial services that require a high level of explanation to consumers.

The Japan Financial Service Intermediary Business Association, a self-regulatory organisation, has been established and is also certified by the Commissioner of the Financial Services Agency as an authorised financial services intermediary business association. It is expected that rules necessary for the proper operation of the financial service intermediary business conducted by members will be established and that guidance and recommendations will be provided to members to ensure compliance with the Act Concerning Provision of Financial Services.

Amended Payment Services Act and Digital Payroll

Amended Payment Services Act

Amendments to the Payment Services Act came into effect on 1 May 2021. The amendments mainly cover the following:

- clarification on the applicability of “funds transfer transactions” to collection agency services;
- classification of funds transfer services into three categories;
- revisions to regulations for funds transfer services; and

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- establishment of some regulations on advance payment methods.

The remittance business subject to regulations relating to the funds transfer business or banking business is that concerning “funds transfer transactions.” However, this term is not clearly defined in the Banking Act and the Payment Services Act. In practice, its meaning has been examined based on criteria established in judicial precedents. The amendment has made it clear that certain transactions in which the recipient is an individual constitute funds transfer transactions. However, it is important to note that this does not imply that transactions other than those expressly defined as funds transfer transactions by the amendment will not constitute funds transfer transactions. Therefore, it is still necessary to examine such transactions on a case-by-case basis to determine whether they constitute funds transfer transactions.

Before the amendment, remittances under the funds transfer business were limited to JPY1 million per transaction. Under the amendment to the Payment Services Act, a new category (“Type I Funds Transfer Business”) that permits the remittance of over JPY1 million was established. A Type I Funds Transfer Business operator is subject to stricter regulations than before. Moreover, another new category (“Type III Funds Transfer Business”) that sets the maximum amount of remittance per case at JPY50,000 was established. A Type III Funds Transfer Business operator is subject to less stringent security regulations than before. The former funds transfer business now falls under “Type II Funds Transfer Business.”

The amendment has led to a diversification of remittance services, allowing funds transfer service providers to choose the type of service that best suits their business models. However, according to the list of funds transfer service

providers published by the Financial Services Agency, there are 80 funds transfer service providers (as of 31 January 2022). All of them appear to be only Type II Funds Transfer Business. Therefore, there does not appear to be a significant increase in the use of Type I and Type III Funds Transfer Businesses.

Digital payroll

One factor that is driving the use of funds transfer service providers is the lifting of the ban on digital wage payments. Wages are currently paid either directly in cash or by bank transfer. When digital wage payments are allowed, companies will be able to transfer wages to their employees’ accounts with funds transfer service providers. The Labor Policy Council of the Ministry of Health, Labor and Welfare has been discussing wage payments to accounts with funds transfer service providers. These discussions have raised the issue of whether such payments violate the labour regulations under the Labor Standards Act. The regulations on digital wage payments and the Council’s discussions should be followed closely.

Other Trends to Watch in 2022

Stablecoin

Currently, it is virtually impossible to distribute stablecoins circulating outside of Japan within Japan, partly because the applicability of the relevant laws to stablecoins is unclear and partly because there is no established regulatory framework for their distribution in Japan. In this regard, a report published by the Financial Services Agency on 11 January 2022 (the “Report”), indicates that specific rules are being considered to establish a regulatory framework for stablecoins. Further, the Financial Services Agency submitted to the Diet the bill for amending the Payment Services Act and other relevant laws on 4 March 2022, taking into account the contents of the Report.

The main issues to be addressed in the regulatory framework for stablecoins are regulations on intermediaries and the treatment of stablecoins issued outside Japan.

With regard to regulations on intermediaries, under the current regulatory framework, the issuer is deemed to be responsible for providing the service, and it is unclear whether the relevant laws apply to schemes such as stablecoins, where the issuer and the intermediary (the entity responsible for transfer and management) are separate. To this end, the Report addresses specific rules, such as regulations for the intermediary industry, with the aim of establishing a regulatory framework that would facilitate remittance and payment services in a manner that separates the issuer from the intermediary.

With respect to the treatment of stablecoins issued outside of Japan, in order for an issuer outside Japan to distribute stablecoins issued outside Japan (especially, those whose value is linked to legal tender) in Japan on its own (eg, the issuer solicits such coins by creating a website in Japanese), the issuer must obtain a banking business licence or register as a funds transfer service provider.

Further, if new industry-specific regulations regarding intermediaries are established, the next critical issue to be addressed will be whether intermediaries who have obtained an intermediary licence in Japan will be able to distribute stablecoins issued by issuers outside Japan. However, from the viewpoint that it is vital to adequately protect users' assets in the event of the issuer's insolvency, and to allow users to receive their payments smoothly, the Report requires that issuers have certain establishments in Japan and that the protection of assets be ensured, among others. These requirements may pose a significant obstacle for non-Japanese stablecoin issuers who wish to enter the Japanese market.

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As noted above, the regulations considered in the Report are stringent. However, since this is only the report stage and not the legislative stage, future trends in the discussions should continue to be closely monitored. It should also be noted that industry groups related to crypto-assets have published recommendations opposing the Report.

AML/CFT regulations

Rules on prepaid payment instruments from an AML/CFT perspective

Currently, issuers of prepaid payment instruments (eg, gift cards and prepaid cards) are subject to less stringent regulations than banks and funds transfer service providers, partly because prepaid payment instruments are, in principle, non-refundable to users. For example, there is no obligation to verify the identity of users when conducting transactions or to report suspicious transactions under the Act on Prevention of Transfer of Criminal Proceeds (APTCP), nor is there an upper limit on the amount that can be issued to each user under the Payment Services Act.

However, in recent years, the use of online platforms and credit card payment platforms of international brands has led to the emergence of Prepaid Payment Instruments that can be used in a wide range of stores to pay for a wide variety of goods and services. While there are limitations in that they are, in principle, non-refundable to users, they function similarly to cash.

Therefore, the Report proposes that certain prepaid payment instruments (eg, repeatedly chargeable, high upper limit of transfer amount and charge amount payments) considered as posing a particularly high risk of misuse for money laundering purposes should be deemed as

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“high-value electronically transferable prepaid payment instruments” and be subject to the rules such as the obligations to verify the identity when conducting transactions and report suspicious transactions under the APTCP.

Therefore, future trends on the amendment of relevant laws need to be closely monitored.

Joint AML/CFT operations of banks and other institutions

The Report also examines the use of joint agencies to filter and monitor transactions through outsourcing arrangements with banks and other institutions in the interest of improving AML/CFT effectiveness and operational efficiency through joint operations. One background for this discussion is the findings of the FATF’s “Fourth Round Mutual Evaluation Report of Japan” dated 30 August 2021. Specific rules are under consideration for the establishment of industry regulations for such joint agencies.

JAPAN TRENDS AND DEVELOPMENTS

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Nagashima Ohno & Tsunematsu is the first integrated full-service law firm in Japan and one of the foremost providers of international and commercial legal services based in Tokyo. The firm's overseas network includes offices in New York, Singapore, Bangkok, Ho Chi Minh City, Hanoi and Shanghai, and collaborative relationships with prominent local law firms. Finance has long been one of NO&T's core practice areas, and NO&T has an established reputation as a leading Japanese law firm with respect to financial transactions and has always been

regarded as a pioneer in the Japanese finance market, having been involved in numerous innovative and epoch-making transactions. NO&T's fintech team consists of experienced lawyers from among a wide variety of practice fields, including financial regulations, M&A/corporate, IT/technology, intellectual property, data protection, cybersecurity, antitrust and tax, and provides clients with innovative and comprehensive solutions suitable for the fast-developing fintech field.

AUTHORS



Keiji Tonomura is a partner at Nagashima Ohno & Tsunematsu. His practice focuses on M&A, IP/IT-related transactions, and data security/privacy matters. He has extensive experience

representing global and local clients on complex business transactions as well as regulatory matters, with a particular focus on the TMT sectors, including new business fields such as fintech, AI and blockchain. He has served as a member of the working group in the "Project Team on Study of NFT Policy" established in the Digital Society Promotion Headquarters, Liberal Democratic Party of Japan from February 2022. He is a member of Tokyo Dai-ichi Bar Association.



Shu Sasaki is a partner at Nagashima Ohno & Tsunematsu. His practice focuses on financial regulations/compliance and M&A for financial institutions. He has been advising on laws and

regulations applicable to banking institutions, securities companies, fund managers and other financial institutions and a wide variety of corporate legal matters. He is a graduate of Waseda University (LLB, 2005), Chuo Law School (JD, 2007) and Duke University School of Law (LLM, 2015). He worked for the Inspection Bureau of Financial Services Agency (2013–14) and for a private financial institution (2015–16). He is a member of the Tokyo Dai-ichi Bar Association.

*Contributed by: Keiji Tonomura, Shu Sasaki, Shu Takami and Shin Mitarai, **Nagashima Ohno & Tsunematsu***



Shu Takami has been an associate of Nagashima Ohno & Tsunematsu since 2016. His practice primarily focuses on M&A and corporate matters, as well as information technology-

related transactions and other related matters, including fintech, IoT, AI, and data privacy issues across a range of industry sectors; with a particular focus on the technology, media and telecom sectors and emerging business fields. He graduated with an LLB from the University of Tokyo in 2015.



Shin Mitarai has been an associate of Nagashima Ohno & Tsunematsu since 2018. His primary areas of practice involve financial regulations and fintech. He also provides legal services

for a large variety of corporate matters, including capital markets, tax, crisis management, white-collar crime and data protection. He speaks Japanese and English. He graduated with a JD from the University of Tokyo School of Law in 2017 and with an LLB from the University of Tokyo in 2015. He was admitted to the Japan Bar in 2018.

Nagashima Ohno & Tsunematsu

JP Tower
2-7-2 Marunouchi
Chiyoda-ku
Tokyo 100-7036
Japan

Tel: +81 3 6889 7000
Fax: +81 3 6889 8000
Web: www.noandt.com/en/

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