



JAPAN UPDATE

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Deregulation of Fund Transfer in Japan

In June 2009, the Japanese Diet passed legislation concerning Fund Settlement (the “Fund Settlement Act”). That legislation is expected to become effective as of April 1, 2010.

Changes to the Fund Settlement Act include regulations whereby the fund transfer of JPY1 million or less, for example, for the purpose of online shopping, will be possible without the license required for a banking business. On the other hand, server-based electronic money will be regulated in the same manner as vouchers and prepaid cards.

1. Opening the Fund Transfer Business to Enterprises Other than Banks

First, the Fund Settlement Act will allow nonbank companies or businesses to conduct small-amount *kawase* transactions (fund transfers).

Before this Act, only banks with a banking license could conduct fund transfer in Japan. However, because banks are open only for limited hours and the overseas remittance fees charged by banks are costly, there has been a need for less costly and more convenient fund transfers in Japan, especially with respect to small-amount settlement for individuals.

In response to this need, and because nonbank companies or businesses are allowed to conduct transactions equivalent to *kawase* transactions in the U.S. and Europe, the Fund Settlement Act (and the Enforcement Order) will allow nonbank companies or businesses to conduct fund transfers of no more than JPY1 million by registering as a Fund Transfer Company.

Pursuant to the Fund Settlement Act, a Foreign Fund Transfer Company (*i.e.*, a company with registration/permission similar to the registration under the Fund Settlement Act in such foreign country pursuant to the foreign equivalent of the Act) is also allowed to engage in the fund transfer business in Japan by registering under the said Act. Because of the expanding demand for cross border money transfers in online shopping and the demand for remittance to their home countries by foreign workers, small-amount money transfers can be a substantial business opportunity in Japan. Several of the major foreign net settlement companies and foreign money transfer companies have started considering or expressed their full-scale entry into such a market in Japan.

However, a Foreign Fund Transfer Company that wishes to be registered as a Fund Transfer Company must have a business office in Japan and a representative who is a resident of Japan. Further, for the purpose of protecting customers from the

bankruptcy of the Fund Transfer Company, it will be required, as a measure to preserve assets, to deposit a sum, in principle, equal to the maximum exposure to customers (and certain fees for refund) during the latest week but in no event less than JPY10 million or to obtain a bank guarantee, as in the case of domestic companies. It may also choose to maintain in a trust on each business day a sum, in principle, equal to the exposure to customers (and certain fees for refund) on the immediately preceding business day but in no event less than JPY10 million. In addition, duties to administer information safely and to verify identification of the sender (*i.e.*, Know Your Customer obligation) will be imposed, among others.

It should be noted that Foreign Fund Transfer Companies not registered under the Act are not only prohibited from conducting fund transfers within Japan, but also will be prohibited from making solicitation of fund transfer to those who are in Japan. According to the publicly available FSA guidelines, an act of a Foreign Fund Transfer Company posting fund transfer advertisements on its website would highly likely constitute an act of “solicitation,” unless reasonable measures (the guideline lists examples of such measures) are taken, so that such advertisements would not lead to fund transfer transactions with customers in Japan.

2. New Regulations on “Server-Based” Electronic Money

The Fund Settlement Act will regulate server-based prepayment methods in addition to paper-based and IC-based prepayment methods.

Currently, only prepayment methods such as gift vouchers on which the amount available is recorded (paper-based) and prepaid cards in which IC chips are embedded (IC-based) are regulated. Electronic monies, of which the values are managed by central servers (server-based electronic monies), not by vouchers or cards at hand, are currently out of the scope of the regulation. However, there is no difference in the economic features between the server-based electronic

money and the paper-based/IC-based prepayment method, and sometimes their physical appearances are also similar. Further, server-based electronic monies have come to be widely used. Therefore, the paper-based prepayment method, the IC-based prepayment method, and the server-based prepayment method will all be categorized as “prepayment methods” under the Act, and regulated as one category.

In order to be engaged in the business of issuing/selling prepayment methods, filing or registration will in general be necessary depending on the type of the prepayment method (whether the prepayment method can be used only vis-a-vis the issuer or also vis-a-vis third parties). If a foreign company wishes to make such a filing or obtain registration, it would require a business office in Japan. Further, in order to protect the users from the bankruptcy of the issuer, it is required, as a measure to preserve assets, to deposit or entrust a sum, in principle, a half or more of the unused balance (calculated as of certain base dates) of amounts subject to the prepayment methods or to obtain a bank guarantee, as in the case of domestic companies. In addition, duties to furnish information and to safely administer information will be imposed, among others.

It should also be noted that a foreign operator of prepayment methods that has not completed filing or registration is not only prohibited from issuing/selling prepayment methods in Japan but also is prohibited from making solicitations of its foreign prepayment methods to people in Japan. As in the case of Foreign Fund Transfer Companies mentioned in Section 1, the act of a foreign issuer of prepayment methods posting advertisements concerning the prepayment methods on its website would highly likely constitute an act of “solicitation,” unless reasonable preventing measures are taken.

3. Establishing a System for Inter-Bank Fund Settlements

Currently, inter-bank fund settlements are intensively conducted by a non-governmental system called the “national bank data communication system” (the “Zengin System”), which is run by the Tokyo Bankers Association. Although the Zengin System is renowned for its high security and efficiency, no specific laws regulate it. There have been calls to establish a fair and transparent governance system that ensures the legal certainties and stabilities of settlement processes.

Under the Act, engaging in the business of inter-bank fund settlement will require a license and will be subject to governmental supervision. The Tokyo Bankers Association is expected to obtain such a license after the Act becomes effective. Further, under the Act, even if a bankruptcy procedure should commence with respect to a settlement participant (*i.e.*, a bank), settlements will be effective as set forth in the business operation document (*gyoumu-houhou-sho*), which will increase the legal stability of inter-bank settlements.

If you have any questions regarding this update, please contact the Sidley lawyer with whom you usually work.

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