

# Modernization of Payment Systems Law in Japan

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## I. INTRODUCTION

### *1. The Aim of this Paper*

Though not as eye-catching as the reform of corporate governance or the Civil Code, payment systems law has also been the subject of reform recently in Japan. In 2016, much progress was made: The Law on Payment Services was amended to introduce regulations on virtual currency, while the Installment Sales Act, which regulates credit card transactions, has been significantly modernized. Banks have also decided to address the complaints that the Japanese inter-bank settlement system is outdated and they have unveiled a plan to improve it.

This paper will look into these reforms. More specifically, it analyses *why* reform was required and examines *how* it was agreed on. With regard to the latter issue, an interesting point relates to political leadership. In contrast to the widely held view that the bureaucracy takes the lead in forming Japanese regulations, recent reforms have often been advanced under strong political initiative, as in the case of the consumer credit regulation in 2006<sup>1</sup> or the corporate law reform in 2014.<sup>2</sup> Political initiative sometimes

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1 See S. KOZUKA/L. NOTTAGE, Re-regulating Unsecured Consumer Credit in Japan: Over-indebted Borrowers, the Supreme Court and New Legislation, in: Parry/Nordhausen/Howells/Twigg-Flesner (eds.), *The Yearbook of Consumer Law 2009* (Ashgate 2008) 197; S. KOZUKA/L. NOTTAGE, The Myth of the Cautious Consumer: Law, Culture, Economics and Politics in the Rise and Partial Fall of Unsecured Lending in Japan, in: Niemi/Ramsay/Whitford (eds.), *Consumer Credit, Debt & Bankruptcy: Comparative and International Perspectives* (Hart 2009) 199; L. NOTTAGE/S. KOZUKA, Lessons from Product Safety Regulation for Reforming Consumer Credit Markets in Japan and Beyond, *Sydney Law Review* 34 (1) (2012) 129.

takes the form of the Cabinet's leadership because it possesses the institutional power to override the existing regulation.

With regard to the question regarding the policy of the reforms, or why reform was required, the payment systems law faces two requirements that sometimes contradict each other. One is to accommodate technological innovation, while the other is to enhance consumer protection. New technologies, in particular those relating to information technology and the Internet, improve user convenience, but they also bring hitherto unknown risks to consumers. Thus, regulation often struggles between two demands: While it does not wish to prevent the development of new services based on the new technology, it has to fight against new types of fraud to ensure that consumers' interests are not affected. The reform in 2016 has attempted to shift the balance point between these two demands.

The paper starts with a description of what payment methods are used in Japanese society (I.2.). Then, the reforms concerning virtual currency (II.), credit card regulation (III.) and the inter-bank settlement system (IV.) are examined, respectively. Based on a comparison of these three reforms, conclusions are made on the questions regarding the "why" and "how" of the reforms (V.).

## 2. *Payment methods in Japan*

As is well known, Japan is a society heavily reliant on cash. In daily life, most people use cash to pay for their shopping. Cash registers accept all kinds of coins and bank notes and pay out the exact amount of change. Consumers are accustomed to withdrawing relatively large amounts of money from the ATMs from time to time.

Credit cards are widely used, but often as a simple payment method and not for the sake of credit. Nearly 90 percent (43 trillion yen out of 48.5 trillion yen in 2016) of payment by credit cards is settled the next month, which is called "*mansurī kuriā* (monthly clear)" in Japanese.<sup>3</sup> In contrast, debit cards are not at all popular. According to the Bank of Japan, the amount of payment by debit cards was 0.9 trillion yen in 2016.<sup>4</sup> This may

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2 G. GOTO/M. MATSUNAKA/S. KOZUKA, Japan's Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis, in: Puchniak/Baum/Nottage (eds.), *Independent Directors in Asia* (Cambridge University Press, forthcoming).

3 Statistics by the Japan Consumer Credit Association [http://www.j-credit.or.jp/information/statistics/download/toukei\\_03\\_c\\_170630.pdf](http://www.j-credit.or.jp/information/statistics/download/toukei_03_c_170630.pdf) (in Japanese).

4 BANK OF JAPAN, *Saikin no debitto kādo no dōkō ni tsuite* [On the recent trend of debit cards], <http://www.boj.or.jp/research/brp/psr/psrb170501.htm/> (2017) (in Japanese, with precise statistics in separate Excel files).

partly be due to regulations: While credit cards are governed by the Installment Sales Act and can be issued by non-banks as well as banks, debit cards are subject to the Banking Act and can only be issued by banks, as payment by the latter is considered to be payout of a bank deposit. Smart cards (known as “*denshi manē* (electronic money)”) appeared around 2000 and rapidly grew popular. The large issuers are railway companies, convenience store chains and a particular online mall operator. Smart cards are regulated as prepaid cards and are currently regulated by the Law on Payment Services.<sup>5</sup>

Firms used to rely on promissory notes for payment to another domestic firm and bills of exchange for international payments. Nowadays remittance through bank networks has become common and the number of promissory notes issued has become much smaller.<sup>6</sup> To replace promissory notes, electronically recorded claims have been introduced under the Law on Electronically Recorded Claims of 2007.<sup>7</sup> However, services under the law have not grown as much as was expected.

As these payment methods are mostly settled through bank accounts, the infrastructure to enable such settlements are the inter-bank clearing system of the Japan Bankers’ Association (*Zenkoku Ginkō Kyōkai* or *Zengin-kyō*), named the “Zengin System”, and the settlement system of the Bank of Japan (*Nihon Ginkō* or *Nichigin*), called the “Nichigin Net.” These infrastructure systems are robust and seldom encounter trouble, but they have developed parochially and are not capable of connecting to systems located in other regions. As Japanese companies have grown multinational, they have started to perceive these systems as inconvenient and frustrating their business.

## II. INTRODUCING REGULATIONS ON VIRTUAL CURRENCIES

### 1. *The Insolvency of a Bitcoin Exchange*

Although Bitcoins are said to be based on the scheme published in a paper under a Japanese-like name, Satoshi Nakamoto,<sup>8</sup> not many Japanese had been familiar with Bitcoins until February 2014. When it was reported on

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5 Law No. 59 of 2009. On the background of this law, see S. KOZUKA, Case No. 32, in: Bälz/Dernauer/Heath/Petersen-Padberg (eds.), *Business Law in Japan – Cases and Comments* (Wolters Kluwer 2012) 339.

6 On the practice of business to business payment, see H. UCHIDA et al., *Interfirm Relationships and Trade Credit in Japan: Evidence from Micro-Data* (Springer 2015).

7 Law No. 102 of 2007.

8 S. NAKAMOTO, *Bitcoin: A Peer-to-Peer Electronic Cash System*, <https://bitcoin.org/bitcoin.pdf> (2008).

26 February that access to the website of a Bitcoin exchange – “Mt. Gox” – had been suspended, few people realized how serious a scandal would follow. A few days later, however, the exchange revealed its insolvency and filed for civil rehabilitation at the Tōkyō District Court. Television shows started to feature the exchange located in Roppongi, one of the best known (or most notorious) districts in Tōkyō, and its CEO of French nationality. Mt. Gox was in fact the largest Bitcoin exchange in the world at that time and its claimants allegedly numbered 127,000. Only 0.8 percent of them were Japanese. Some of the claimants sat before the exchange in protest, holding a board saying: “Where is our money?”<sup>9</sup> In the meantime, Mt. Gox also filed under Chapter 15 of the US Bankruptcy Code with the US Federal Court in Texas.

The Tōkyō District Court dismissed the application after finding that the business of Mt. Gox had no prospect of reorganization. On 24 April 2014, the District Court decided to commence the bankruptcy procedure, which is a liquidation process. As the procedure went forward, the suspicion arose that the CEO had embezzled the “assets” (Bitcoins) of the exchange. In August 2015, the CEO was arrested.

When the protestors occupied the street in Roppongi, a Councillor of the Diet raised questions in writing about the nature of Bitcoins and their possible regulation.<sup>10</sup> In response, the government issued two written replies and stated, among other regards, (i) that the government was collecting information about Bitcoins and had no firm view about their economic value; (ii) that Bitcoins were not legal tender or foreign currency under existing Japanese law; (iii) that no legislation was foreseen to regulate Bitcoins; and (iv) that there was no regulation over, or government agency in charge of, a Bitcoin exchange.<sup>11</sup>

A few months later, a group of Liberal Democratic Party (LDP) members discussed the issue and made a proposal that the government should not regulate virtual currencies at that stage. The group’s Interim Report recommended avoiding the term “virtual currency” and suggested a new term: “valuable

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9 On the facts of the bankruptcy of Mt. Gox, see C. DECKER/R. WATTENHOFER, Bitcoin Transaction Malleability and Mt Gox, in: Kutyłowski/Vaidya (eds.), *Computer Security – ESORICS 2014* (Springer 2014) 313, at 318; M. KOBAYASHI, *Bittocoin nado kasō tsūka no dōkō: kasō tsūka no “hikari” to “kage”* [Developments in virtual currency, including Bitcoins: the light and shadow of virtual currency], <http://www.nli-research.co.jp/report/detail/id=53846?site=nli>, 3–4 (2016) (in Japanese).

10 Question no. 28 of the 186<sup>th</sup> session of the Diet by Councillor Tsutomu Okubo, 25 February 2014; Question no. 39 of the 186<sup>th</sup> session of the Diet by Councillor Tsutomu Okubo, 10 March 2014.

11 Response no. 28 of the 186<sup>th</sup> session of the Diet, 7 March 2014; Question no. 39 of the 186<sup>th</sup> session of the Diet, 18 March 2014.

record” (*kachi kiroku*), which would connote its *sui generis* nature, being neither money nor property (a thing). It then argued that no law was necessary to regulate valuable records and that establishing a business association and having it adopt voluntary guidelines would be preferable, as it would most effectively facilitate businesses in regard to valuable records.<sup>12</sup>

In October 2014, the Financial System Council set up the Study Group on Settlement Services to discuss several issues related to settlement services. Apparently in line with the proposal of the LPD group, the Study Group did not find it necessary to address Bitcoins or other virtual currencies.<sup>13</sup> In the meantime, the Japan Authority of Digital Assets (JADA; *Nihon Kachi Kiroku Jigyō-sha Kyōkai*) was established.<sup>14</sup>

## 2. International Pressure for a Harmonized Regulation

The situation changed rather quickly as the international community grew anxious about the possible abuse of virtual currencies. As virtual currencies, in particular Bitcoins, are governed autonomously and are not subject to the control of any government or central bank, it is feared that they may be readily utilized for financing terrorist activities or money laundering. Experts had been discussing these issues within the Financial Action Task Force (FATF) since 2014. In June 2015 the FATF published Guidelines for a Risk-Based Approach to Virtual Currencies and, while recognizing the financial innovation, pointed out that “VC [virtual currency] payment products and services (VCPSP) present money laundering and terrorist financing (ML/TF) risks and other crime risks that must be identified and mitigated.”<sup>15</sup> The Guidelines recommended that countries consider applying the relevant [anti-money laundering]/[countering the financing of terrorism] requirements specified by the international standards to convertible virtual currency exchangers.<sup>16</sup>

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12 T. HIRAI/M. FUKUDA, *Bitcoin o hajime to suru “kachi kiroku” e no taiō ni kansuru chūkan hōkoku* [The Draft Interim Report on the Policies over Bitcoins and Other Valuable Records], [http://activeictjapan.com/pdf/kachikiroku\\_20140618.pdf](http://activeictjapan.com/pdf/kachikiroku_20140618.pdf) (19 June 2014) (In Japanese).

13 *Kin'yū Shingi-kai kessai gyōmu tō no kōdoka ni kansuru sutadi gurūpu, ‘Chūkan seiri’* [The Interim Report of the Financial System Council’s Study Group on the Enhancement of Settlement Services] [http://www.fsa.go.jp/singi/singi\\_kinyu/tosin/20150428-1/01.pdf](http://www.fsa.go.jp/singi/singi_kinyu/tosin/20150428-1/01.pdf), 20 (28 April 2015) (in Japanese).

14 Interestingly, the English translation used for this entity chooses to translate *kachi kiroku* as “digital asset” rather than “valuable record”.

15 FATF, Guidelines for a Risk-Based Approach to Virtual Currencies, para. 2 <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf> (June 2015).

16 *Id.*, para. 14.

Prior to the publication of the final FATF Guidelines, the political leaders of the G7 countries met in Schloss Elmau, Germany, for the G7 Summit meeting. The meeting adopted a statement that included the following passage:

“The fight against terrorism and terrorist financing is a major priority for the G7. [...] 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.”<sup>17</sup>

Thus it had become inevitable that some regulations were to be introduced to address these international concerns.

Japan’s Financial System Council responded quickly. The Study Group on Settlement Services evolved into the Working Group on the same subject, which published its Final Report in December 2015. The Final Report discussed the issue of virtual currencies in an independent chapter and noted the international developments urging that the problems of money laundering and the financing of terrorists be addressed. It also mentioned the bankruptcy of the Mt. Gox exchange and remarked that the framework for protecting users was also an issue.<sup>18</sup>

To be more specific, the Report proposed that an exchange where virtual currencies can be changed for real currencies be registered with the government and subject to regulations. A registered exchange would be subject to the duties owed under the Act on Prevention of Transfer of Criminal Proceeds,<sup>19</sup> which is the statute for anti-money laundering and countering the financing of terrorism in Japan. As regards the protection of users, a registered exchange would have to adopt a set of measures, among which is the segregation of a user’s money and virtual currencies from the exchange’s own assets.

Based on the Report, the bill to amend the Law on Payment Services was drafted. The Diet passed the bill without any changes in May 2016, two years after the LDP group argued against regulating the subject. In opposition to the LDP group’s suggestion to use a new term “valuable records,” the amendments have introduced the term “virtual currency” and defined it as either (1) proprietary value which can be used for payment to unspecified people when one purchases or leases goods or receives services and which can be purchased from or sold to unspecified people,<sup>20</sup> subject to transferabil-

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17 Leaders’ Declaration G7 Summit 7-8 June 2015, p. 9, <http://www.mofa.go.jp/files/000084020.pdf>.

18 *Kin’yū Shingi-kai kessai gyōmu tō no kōdoka ni kansuru wōkingu gurūpu*, ‘Hōkoku’ [The Report of the Financial System Council’s Working Group on the Enhancement of Settlement Services] [http://www.fsa.go.jp/singi/singi\\_kinyu/tosin/20151222-2/01.pdf](http://www.fsa.go.jp/singi/singi_kinyu/tosin/20151222-2/01.pdf), 26–30 (22 December 2015) (in Japanese).

19 Law No. 22 of 2007.

ity by computers (other than the legal currency of Japan or foreign countries) or (2) proprietary value that can be exchanged with unspecified people for the value specified in (1).<sup>21</sup> Then the amendments define the “exchange service of virtual currencies” as (1) sales of virtual currencies or change of one exchange currency for another; (2) intermediary services, commissioning or agency services under (1); or (3) taking custody of a user’s money or virtual currency in the course of providing services under (1) or (2).<sup>22</sup>

Under the amended Law on Payment Services, an operator of “an exchange service of virtual currencies” must register itself with the Prime Minister (Financial Services Agency).<sup>23</sup> Such an operator owes the duty to take measures to protect its users. They are:

- to take security measures to protect the data;
- to provide information about its service (i.e. to explain that conversion into legal tender is not guaranteed);
- to segregate the users’ money and virtual currencies from those of its own;
- to be subject to an external audit;
- to designate an ADR (alternative dispute resolution) institution.<sup>24</sup>

The Bill also includes amendments to the Act on Prevention of Transfer of Criminal Proceeds and adds an operator of exchange services for virtual currencies to the list of specified operators. Under this Act, a specified operator has a duty to examine the identification of its customers and to report suspicious transactions.

### 3. *Private Law Aspects of Virtual Currencies*

Apparently the political initiative not to introduce the regulation at an early occasion failed in the face of the international calls for suppressing the abuse of virtual currencies. The proposal of the new term of “valuable records” never gained support, and the international regulator’s preference for the term “virtual currencies” prevailed. The Japan Authority of Digital Assets has also been renamed as the Japan Blockchain Association (JBA). Still, the introduced regulations remained minimal and did not deal with the private law nature of virtual currencies. In this respect, the preference for avoiding extensive regulation survived.

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20 The requirement “that can be exchanged with unspecified people” is intended to exclude “currencies” used only within an online game from the definition of virtual currency.

21 Art. 2(5) Law on Payment Services, as amended.

22 Art. 2(7) Law on Payment Services, as amended.

23 Art. 63-2 Law on Payment Services, as amended.

24 Arts. 63-8 to 63-12 Law on Payment Services, as amended.

As a result, it has become the role of the court to consider the legal nature of Bitcoins. One of the users of the Mt. Gox exchange, who allegedly had 4,588,812,618 BTC in his account, brought suit against the bankruptcy trustee of the exchange and sought return of these Bitcoins, arguing that he held a title of ownership (*Aussonderungsrecht*) under the Bankruptcy Act. The title of ownership is a right to demand the return of property of which the claimant has ownership when the bankruptcy trustee possesses the property. Thus, the court faced the question whether one can “own” Bitcoins under Japanese law.

The Tōkyō District Court rejected the argument that Bitcoins can be subject to ownership and dismissed the claim.<sup>25</sup> In so holding, the court reasoned that ownership can exist only in a “thing”, which is defined in the Japanese Civil Code as a tangible asset.<sup>26</sup> The Court also required the capability of exclusive control and non-humanity as conditions for the existence of ownership, given that ownership is a right to exclude other persons’ control and given that the dignity of individuals forms a fundamental principle of law (i.e. subjecting a human being to the ownership of another human being is prohibited). As regards Bitcoins, the court concluded that they are digital and thus not tangible in the sense that they do not occupy any space. The Court further considered the mechanism of transactions in Bitcoins carefully and found that there is no record of transacted Bitcoins or a remaining amount as such, but that the transaction is based on a series of records held and documented on the Blockchain (distributed ledger). The Court held that such a mechanism inevitably requires people other than the parties to complete a transaction, which means that the “holders” of Bitcoins do not enjoy exclusive control over them.

Thus, an issue that the amendments left unaddressed was solved through litigation. However, it is only one case decided by one lower court. Furthermore, the court’s decision examined only Bitcoins and no other type of virtual currency. Given that the technology and transaction mechanisms of virtual currencies are diverse, the private law nature of virtual currencies will remain the subject of discussions among lawyers.

### III. ENSURING SOUNDNESS IN CREDIT CARD TRANSACTIONS

#### 1. *Consumer Complaints and the Aspiration of a “Cashless Society”*

Unlike the regulation on virtual currencies, the review of credit cards regulation was anticipated. The last amendments to the Installment Sales Act,<sup>27</sup>

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<sup>25</sup> Tōkyō District Court, 5 August 2015, reported in D1-law.com.

<sup>26</sup> Art. 85 Japanese Civil Code.



which enhanced consumer protection in several respects, were in 2008. The amendments obligated the government to conduct a review five years after those amendments' entry into force, which was December 2009.<sup>28</sup> Therefore, the Ministry of Economy, Trade and Industry (METI) was obligated to invite the Industrial Structure Council to make the fifth-year review of the Installment Sales Act.

On this occasion, the Consumer Commission raised an argument for stricter regulation in the context of these discussions. The Consumer Commission, established in 2009, is in charge of identifying problems negatively impacting the interests of consumers and has the power to make recommendations to other government agencies.<sup>29</sup> As an exercise of this power, the Consumer Commission made the following recommendations to the METI:

- (i) to introduce a duty of the acquirer and the PSP (see below) to monitor the merchants involved in credit card transactions;
- (ii) to introduce a defense allowing one to refuse payment to credit card companies even if the amount is to be settled the next month (i.e. *mansurī kuriā*); and
- (iii) to advance further consumer education on credit card transactions.<sup>30</sup>

These arguments were presented to the Industrial Structure Council for consideration in the process of the fifth-year review.

Behind these arguments lay the problem of fraudulent transactions involving consumers, in particular on the Internet. In some cases the merchant commits fraud (for example, sales of fake branded goods); in some others the merchant does not deliver the goods; in still others the merchant does not allow the consumer to terminate a subscription. A consumer realizes the trick after some time but does not know what to do except contacting the credit card company and demanding that payment to the merchant be withheld. However, the Installment Sales Act allows such a demand only in the case of installment sales (i.e. sales with credit), which are technically defined as either (a) sales for which payment is made over three or more months in two or more installments or (b) sales with revolving credit.<sup>31</sup> The dissatisfied consumer now starts arguing that the credit card company is

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<sup>27</sup> Law No. 159 of 1961 as amended.

<sup>28</sup> Art. 8 Supplementary provisions accompanying the 2016 amendments to the Installment Sales Act.

<sup>29</sup> Art. 6(2) Law to Establish the Consumer Affairs Agency and Consumer Commission (Law No. 48 of 2009).

<sup>30</sup> See the Consumer Commission's, 'Research Report on Consumer Issues Related to Credit Card Transactions and Outline of Recommendations', August 2014 <http://www.cao.go.jp/consumer/doc/proposal14.pdf>.

<sup>31</sup> Art. 2(1) Installment Sales Act.

“responsible” for remaining oblivious to the “improper” business of the merchant while earning profit by trading with it. It is obvious that the complaints of the consumer in these cases are about the underlying contract and not in regard to the credit card transaction as such. However, viewed as a measure to suppress consumer problems, their lodging of complaints can be understood as a mechanism relying on credit card companies to become a gatekeeper who denies access to malicious merchants. The requests for consideration by the Consumer Commission intended to give these arguments of defrauded consumers a legal basis.

Finally a somewhat different momentum toward the modernization of credit card transactions was brought about by the Cabinet’s leadership. Transition from a cash-reliant society to a “cashless” society has become a political agenda, with the target year being 2020, when the Olympic Games are to be held in Tōkyō. The policy suddenly appeared in the 2014 version of the Japan Revitalization Strategy adopted by the Cabinet.<sup>32</sup> The idea is to accommodate foreign tourists coming to Olympic Games with a system they are familiar with. In fact, foreign tourists often complain about credit card transactions in Japan. Many terminals still read only magnet stripes and do not accept PIN entries, reflecting the fact that not all the credit cards issued in Japan are equipped with IC chips. At department stores, shops do not have their own terminals and sales clerks (very politely and always with a smile) take the customer’s card to the back office, a practice which frightens most foreign customers. Apparently, the true issue is the security level of the credit card system in Japan, and the reference to the Olympic Games is intended to make resistance difficult.

Although the enhancement of the security level will contribute to consumer interests in the broad sense, the issue is remote from the Consumer Commission’s arguments that intend to address consumers’ complaints about the underlying transactions. As a result, the reform deliberations had to address two issues of a different nature, which obscured the goal of the reform. The discussions on the subject were consigned to the Installment Sales Subcommittee under the Commerce, Distribution and Information Committee of the Industrial Structure Council.

## 2. *Deliberations at the Installment Sales Subcommittee of the Industrial Structure Council*

Soon after the deliberations started in September 2014, it became apparent that the structure of the Installment Sales Act was too outdated to respond

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32 “Japan Revitalization Strategy Revised in 2014 – Japan’s Challenge for the Future”, p. 113 (24 June 2014), <http://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/honbunEN.pdf>.

to the challenges raised. As its name suggests, the Act was originally drafted to apply to one-off installment transactions and to regulate installment sales sellers as well as the non-banks that provide credit to the buyers. The latter companies used to be called “installment sales intermediaries (*kappu kōnyū assen gyōsha*).” This three party structure (seller-buyer-intermediary) has been assimilated to credit card transactions, under which credit card companies are regulated as “installment sales intermediaries,” which were renamed “comprehensive credit sales intermediaries (*hōkatsu shin’yō kōnyū assen gyōsha*)” by the amendments of 2008.

The regulatory structure worked until the 1990s, when most credit card issuers in Japan maintained their own network of approved merchants.<sup>33</sup> However, the industry has globalized since then, and most issuers have been franchised by international brands (VISA, MasterCard and JCB). As a result, under the current practice, the card issuer that issues a credit card to the holder and the acquirer that collects receivables from the merchants are now different. The regulation under the Installment Sales Act has not kept pace with such developments.

To make matters more complicated, new types of services for merchants have burgeoned recently. In some cases, an entity called a PSP (payment service provider) provides the shop owner with a device (mobile reader) which can be attached to tablets. The customer swipes his or her card over this device and the merchant accepts the credit card payment, even though the latter is not an approved merchant. This service helps small businesses that are not eligible to become an approved merchant. Legally speaking, the PSP in such a transaction scheme is the approved merchant and the shop using the device is its sub-merchant.

The problem has been that the term PSP is used loosely in practice. A PSP can be: an agent of the acquirer authorized to recruit merchants, who does not, however, become a party to any agreement; or an agent of the merchant that facilitates the agreement between the acquirer and merchant; or a master merchant that enables its sub-merchant to accept payments by credit cards. It is not easy to define a PSP accurately as a legal term.

In the eyes of consumers, these developments in credit card transactions are a source of frustration. As mentioned above, a consumer dissatisfied with the underlying transaction often contacts the “credit card company,”

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33 Following a 2000 stay in Tōkyō, Professor Mann recorded his surprise upon finding “on the windows of Tōkyō merchants more than a dozen different credit-card networks whose cards the merchants accept, with some locations sporting more than 25 different card brands that they accept”. See R. J. MANN, Card-Based Payment Systems in the United States and Japan, IMES Discussion Paper No. 2001-E-2, p. 26, fn. 100.

which is in fact the credit card issuer. The issuer, however, can only forward the complaints to the acquirer, since the issuer has no contact with the merchant under the current scheme. The acquirer may look into the case and later recontact the issuer, which can then forward the response to the complaining consumer – but it does not always work like that. The acquirer may not be very helpful when the merchant refuses to cooperate, or the acquirer may simply ignore the complaint forwarded by the card issuer. In some cases the acquirer is a foreign company, in which case communications must be conducted in English. This could be a problem if the card issuer is a small, local bank in Japan and the number of staff available to address consumer complaints is limited.

The consumer representatives, therefore, attempted to make the issuer responsible for all the problems arising from credit card transactions by arguing, for example, that the acquirer can be seen as an agent of the issuer.<sup>34</sup> But this argument has never been successful. Issuers and acquirers are connected only through the settlement network of the international brand. Before the settlement is made, the issuer never knows which acquirer it is going to trade with. It is unrealistic to expect the issuer to be responsible for monitoring the “improper” merchants, by way of the acquirer or otherwise.

Thus there was only one conceivable way forward: to restructure the regulation entirely and treat acquirers adequately. Accordingly, the acquirer can then be held responsible for monitoring the merchants. This will not only be effective in addressing consumers’ complaints but will also be useful for improving the security of credit cards. The acquirer – and the PSP where relevant – can and should assume the responsibility that the merchant takes adequate measures for enhancing the security of credit card transactions. The Installment Sales Subcommittee published a Report along this line in July 2015.<sup>35</sup>

### 3. *Achieved Amendments and the Remaining Difficulties in Practice*

The 2016 amendments to the Installment Sales Act introduced a new defined term: “granter of authority for a credit card number handling agree-

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34 See the paper that Mr. Ikemoto (a lawyer advocating consumer interests) submitted to the 11<sup>th</sup> meeting of the Installment Sales Subcommittee of the Industrial Structure Council, held on 30 April 2015 [http://www.meti.go.jp/committee/sankoushin/shojo/kappuhanbai/pdf/011\\_s02\\_01.pdf](http://www.meti.go.jp/committee/sankoushin/shojo/kappuhanbai/pdf/011_s02_01.pdf) (in Japanese).

35 Sangyō Kōzō Shingi-kai, Shōmu Ryūtsū Jōhō Bunka-kai, Kappu Hanbai Shō-I'in-kai, 'Hōkoku-sho' [The Report of the Installment Sales Subcommittee of the Commerce, Distribution and Information Committee of the Industrial Structure Council] [http://www.meti.go.jp/committee/sankoushin/shojo/kappuhanbai/pdf/report\\_02\\_01.pdf](http://www.meti.go.jp/committee/sankoushin/shojo/kappuhanbai/pdf/report_02_01.pdf), 3 July 2015 (in Japanese).

ment (*kureditto kādo bangō tō toriatsukai keiyaku teiketsu jigyō-sha*),” which intends to refer to an acquirer. An agreement between the acquirer and the merchant is the “credit card number handling agreement (*kureditto kādo bangō tō toriatsukai keiyaku*).” The legislation goes on to require all the acquirers (granters of authority for a credit card number handling agreements) be registered with the government (METI).<sup>36</sup> The registration requirement applies whether or not the acquirer is a Japanese or foreign company. In fact, many complaints of consumers arise where the acquirer is a foreign company.

The amended Installment Sales Act also requires some, but not all, PSPs to register with METI.<sup>37</sup> Given that there are variations in the types of PSPs, the Report of the Installment Sales Subcommittee proposed to create an option for a PSP to register or not. Once registered, the PSP must take responsibility for monitoring merchants, while the acquirer that employs such a registered PSP is exempt from the duty to monitor the merchants to the extent the PSP monitors the merchants.<sup>38</sup> The intention was to leave the decision on whether or not to register the PSP to the negotiation between the acquirer and the PSP. Unfortunately, the proposal was not accepted by the drafters of the amendments. The 2016 amendments focus on the authority to approve a merchant: If the authority is delegated to the PSP, the PSP is to register with METI (and the acquirer is not), while the acquirer is to register if the authority remains with it, even if the PSP serves as recruiter. No discretion is left about which party is to register.

Based on the registration requirement of the acquirer or the PSP, the amendments introduce a duty of the registered acquirer and the PSP to monitor the merchant that it approves.<sup>39</sup> As elaborated in the Supplementary Report that the Installment Sales Subcommittee published a year later, the idea is to make acquirers and registered PSPs “gatekeepers” for credit card transactions.<sup>40</sup> Curiously enough, the text of the amended Act provides for their duty to monitor the merchants only as regards the security measures (proper handling of credit card numbers and other information as well as prevention of credit card abuse by the holder), and it does not mention the duty to address consumer complaints against the underlying transaction at

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36 Art. 35-17-2, no. 1, Installment Sales Act.

37 Art. 35-17-2, no. 2, Installment Sales Act.

38 ‘*Hōkoku-sho*’ (note 35) 18.

39 Art. 35-17-8 Installment Sales Act.

40 *Sangyō Kōzō Shingi-kai, Shōmu Ryūtsū Jōhō Bunka-kai, Kappu Hanbai Shō-I'in-kai, ‘Hōkoku-sho Tsuiho-ban’* [The Supplement to the Report of the Installment Sales Subcommittee of the Commerce, Distribution and Information Committee of the Industrial Structure Council] [http://www.meti.go.jp/committee/sankoushin/shojo/kappuhanbai/pdf/report\\_03\\_01.pdf](http://www.meti.go.jp/committee/sankoushin/shojo/kappuhanbai/pdf/report_03_01.pdf); 2 June 2016 (in Japanese).

all. In response, the Installment Sales Subcommittee was reconvened and discussed how the Ministerial Order to Implement the Installment Sales Act can be best drafted. The Subcommittee published a third Report in May 2017, which recommended that the Ministerial Order should require the acquirer and the registered PSP to monitor the merchants also with regards to the latter's "improper" transactions, in the sense that they are to take steps to correct behavior of the merchant if the latter commits fraudulent transactions or occasions too many complaints from the consumers.<sup>41</sup>

The question in practice is how an acquirer or PSP can conduct such monitoring. The difficulty arises from the fact that whether a transaction is "improper" is not an easy question. A consumer's complaint does not mean that the complaint is justified. The acquirer or PSP, unlike a judge, is not equipped with the power to examine evidence and make a judgment over the disputed claim. An acquirer could run the risk of being sued by the merchant if it terminates the acquiring agreement without sufficient basis, even when several consumers raise complaints about the transactions with that merchant. The Reports of the Installment Sales Subcommittee recommend a functional approach, suggesting that the Ministerial Order provide for only the outcome that must be achieved but admitting flexibility about how to do so.<sup>42</sup> On the other hand, the Report of 2016 suggests that the industry promulgate self-regulation about the monitoring methods. Apparently, while the industry does not like aggressive regulatory intervention, it does not prefer full discretion, either, and seeks some guidance on an industry-wide basis.<sup>43</sup>

While the amendments address consumers' complaints by relying on the acquirer and the registered PSP to take on the role as "gatekeeper", the Consumer Commission's recommendation about allowing for a defense against the card issuer when settlement is made the next month (i.e. *man-surī kuriā*) was not adopted. The Report of the Installments Sales Subcommittee argues that a credit transaction is different from one without credit in that consumers are not induced to complete the transaction as much as in the latter case.<sup>44</sup> More specifically, when the problem is arising from the underlying transaction, it is not good policy to impose the cost on the settlement service provider. Given that the card issuer is no longer the same

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41 *Sangyō Kōzō Shingī-kai, Shōmu Ryūtsū Jōhō Bunka-kai, Kappu Hanbai Shō-I'in-kai, 'Hōkoku-sho'* [The Report of the Installment Sales Subcommittee of the Commerce, Distribution and Information Committee of the Industrial Structure Council] 7–8, [http://www.meti.go.jp/report/whitepaper/data/pdf/20170510001\\_1.pdf](http://www.meti.go.jp/report/whitepaper/data/pdf/20170510001_1.pdf), 10 May 2017 (in Japanese).

42 '*Hōkoku-sho' tsuiho-ban*' (note 40) 12; '*Hōkoku-sho*' (note 41) 9.

43 '*Hōkoku-sho' tsuiho-ban*' (note 40) 13.

44 '*Hōkoku-sho*' (note 35) 14–17.

entity as the acquirer, such a policy would be even less justified. It is no surprise that the 2016 amendments, which have recognized the four-party structure (consumer-issuer-acquirer-merchant) of modern credit card transactions, have refused to adopt the argument of the Consumer Commission.

#### IV. MODERNIZING THE INTER-BANK SETTLEMENT SYSTEM

##### 1. *Political Leadership for Reform of the Inter-bank Remittance System*

The modernization of the inter-bank remittance system appeared in the “Japan Revival Vision” of the LDP. The LDP’s “Vision” was published in May 2014 as political input on the revision of the “Japan Revitalization Strategy.” The “Japan Revitalization Strategy,” whose original version was published in June 2013, is an instrument adopted by the Cabinet. It is the administration’s commitment to a collection of economic policies. As its revision was expected in June 2014, the LDP apparently attempted to take the lead in formulating economic policy by publishing the “Japan Revival Vision” one month in advance.

Among other reasons, the “Japan Revival Vision” attracted the public’s attention by proposing corporate governance reform, in particular a requirement for all listed companies of independent directors operating on a “comply or explain” basis.<sup>45</sup> Though much less conspicuous, it also advanced important policy proposals with regard to the inter-bank settlement system. The policies proposed in the “Japan Revival Vision” included the 24/7 availability of money transfers so as to increase consumer convenience. The current money transfer system is such that after 3:00 pm an ATM user can only make a booking for a transfer of money on the next day. The “Vision” also proposes that the text format of messages accompanying the remittance be improved. The current system relies on *katakana* and the maximum length of the text is twenty characters. According to the “Vision”, such an outdated system frustrates EDI messaging.<sup>46</sup>

The reform proposals were adopted as the government’s policy and were included the next month in the revised “Japan Revitalization Strategy”.<sup>47</sup> The reform formed part of the efforts to improve the business environment of Japan, so that Japan would rank within the top three in the World Bank’s Doing Business ranking on business environment.<sup>48</sup> Apparently regulatory competition is working here.

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45 GOTO/MATSUNAKA/KOZUKA (note 2).

46 The Liberal Democratic Party of Japan, Japan Economic Revival Headquarters, ‘Japan Revival Vision’, 43–44 [http://jimin.ncss.nifty.com/pdf/english/news/Japan\\_Revival\\_Vision-Provisional\\_Translation20140523.pdf](http://jimin.ncss.nifty.com/pdf/english/news/Japan_Revival_Vision-Provisional_Translation20140523.pdf) (23 May 2014).

47 “Japan Revitalization Strategy Revised in 2014” (note 32) 77.

Still, as was the case with the corporate governance reform, political leadership was not by itself determinative. The policy proposal was tabled before the Financial Services Council and deliberated on by its members. In the Report of the Study Group on Settlement Services as well as in the later Report of the Working Group on Settlement Services, the LDP's proposal was agreed to.<sup>49</sup> Still, other various proposals to modernize the settlement system have also been made, besides the two originating from the LDP's "Japan Revival Vision." The two Reports of the Financial Services Council, for example, mention the need to adopt the globally harmonized format (SWIFT format) not only for international settlement but for domestic settlement as well. They also emphasize the need to introduce an infrastructure for low-cost – even if not maximally fast – money transfers by connecting the Japanese clearing network to the Automated Clearing Houses (ACH) abroad.<sup>50</sup>

## 2. Prospects for Reform

The two Reports of the Financial Systems Council identified no need to amend the law to achieve the proposed reforms. The response in practice was found sufficient.

With regard to the 24/7 service of inter-bank remittance, the Japan Bankers Association offered to provide for a second system additional to the existing "Zengin System" around 2018.<sup>51</sup> The fact that the proposed new system is in addition and not alternative to the existing system implies that not all the banks will participate in the new system. It will only be such financial institutions that can afford participation in the additional system and which can at the same time benefit from such participation. A smaller, local financial institution may not benefit from participating in the upgraded system if their customers do not demand such services under the new system.

As regards the message accompanying the remittance, it was found that XML messages are available on the current Zengin System, but that the idiosyncratic *katakana* messaging format is also still in use. The Report expects that the old *katakana* messaging system will be terminated by 2020 so that only the XML format will be available. This will bring the Japanese system in line with the system currently in use globally.<sup>52</sup>

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48 See "Japan Revitalization Strategy Revised in 2014" (note 32) 102.

49 'Chūkan seiri' (note 13) 13–15; 'Hōkoku' (note 18) 21–22.

50 'Chūkan seiri' (note 13) 9–13; 'Hōkoku' (note 18) 23–25.

51 See 'Hōkoku' (note 18) 22.

52 'Hōkoku' (note 18) 22.



## V. CONCLUSIONS

The year 2016 witnessed reform of Japan's payment systems law under two statutes. One is the Law on Payment Services which was amended to introduce some regulations on virtual currency. The other was the Installment Sales Act, whose amendments have reformulated the regulation consistent with modern credit card transactions. Furthermore, the inter-bank settlement system is also going to be modernized, though it involves no statutory amendments.

One of the reasons for reform was developments in practice. Virtual currency is a totally new phenomenon, whereas credit card regulation has lagged behind commercial practice for some years. The security issue, which takes the form of money laundering and the financing of terrorism in the case of virtual currency and the theft of card numbers in credit card transactions, may be counted as a component of the developments in practice. Consumer interests are another source of momentum, which the recently established Consumer Commission can speak for. While encouragement of new technology and the protection of consumer interests could conflict with each other, it appears that the attempts to find a proper balance are being achieved in an ad hoc manner.

As regards the process of reform, political initiative sometimes takes the lead. It may reflect the fact that the reform of business law is nowadays a part of the measures on economic policy and that legislators work under the pressure of international regulatory competition. Still, political leadership does not directly determine the outcome of reforms. Such an initiative is incorporated into the existing deliberation process, usually in the form of the government's council (*shingi-kai*). The systematized process guarantees that political initiative is not arbitrary or idiosyncratic. If globally harmonized rules emerge, they will prevail, as was the case with the regulation of virtual currency. Various stakeholders, including consumers, are also given the opportunity to advocate for their interests. Thus, the process of law reform in Japan remains a pluralist one, though more responsive to the pressure of regulatory competitions than in the past.

## SUMMARY

*In 2016, the Japanese law on payment system was reformed through amendments to the Law on Payment Services as well as to the Installment Sales Act. Consequently, the legal framework with regard to virtual currencies, inter-bank settlement systems, and credit card transactions was changed to reflect developments in business practice. The author first explains the context of the re-*

*forms, namely the payment methods used in Japan: Among the general population, cash is most common, followed by credit cards, while debit cards are hardly used. In contrast, Japanese businesses traditionally use promissory notes or bills of exchange, as well as remittances through bank networks and, more recently, electronically recorded claims.*

*Background to the reform in respect of virtual currency is the insolvency of the Mt. Gox Bitcoin exchange in 2014, which raised concerns regarding the state of non-regulation and potential abuse of virtual currencies. This led to the Law on Payment Services to be amended, introducing the term “valuable records” to refer to virtual currencies and regulations for exchange services of the same. Revisions of the Installment Sales Act came about through a five-year review of the Act. To increase consumer protection on the one hand and to further developments of a cashless society before the 2020 Tōkyō Olympic Games on the other, supervision of credit card intermediaries (payment service providers and those known as acquirers) was tightened. As for the inter-bank remittance systems, the Japanese government’s “Japan Revival Vision” gave the impetus for modernizing the system. This includes the introduction of an alternative to the existing “Zengin System” (Japan Bankers’ Association’s inter-bank clearing system) to allow 24/7 inter-bank remittance services.*

*(The Editors)*

#### ZUSAMMENFASSUNG

*In 2016 wurde das Recht über Zahlungssysteme in Japan durch Reformen des Gesetzes über Zahlungsdienstleistungen (Law on Payment Services) und des Teilzahlungsgesetzes (Installment Sales Act) erneuert. Dadurch hat sich der Rechtsrahmen in Bezug auf virtuelle Währungen, Interbankenabwicklungssysteme und Kreditkartentransaktionen geändert, um dem Wandel in der Geschäftspraxis Rechnung zu tragen. Der Beitrag gibt zunächst einen Überblick über den Kontext der Reformen. Die Bevölkerung Japans benutzt nach wie vor überwiegend Bargeld als Zahlungsmittel, gefolgt von Kreditkarten; Debitkarten werden dagegen selten eingesetzt. In der japanischen Geschäftspraxis werden hingegen Wechsel, Interbankenzahlungen und neuerdings elektronische Forderungen bevorzugt.*

*Hintergrund für die Reform der Regelung virtueller Währungen ist die Insolvenz der Bitcoin-Börse Mt. Gox in 2014. Diese hatte Zweifel an der unzureichenden Regulierung geweckt und die Sorge vor möglichen Missbräuchen solcher Währungen hervorgerufen, was zu der Reform des Gesetzes über Zahlungsdienstleistungen führte. Seither sind virtuelle Währungen als juristische Kategorie erfasst und deren Handel an elektronischen Marktplätzen ist gesetzlich geregelt. Die Überarbeitung des Teilzahlungsgesetzes erfolgte über einen Zeitraum*

*von fünf Jahren. Zur Stärkung des Verbraucherschutzes und zur Förderung der Entwicklung einer „bargeldlosen Gesellschaft“ vor den Olympischen Spielen in Tōkyō im Jahr 2020 wurde die Überwachung und Haftung von Mittelspersonen für Käufe mittels Kreditkartenzahlungen verschärft. Schließlich wurde das Interbankenabwicklungssystem neu geregelt. Dabei gab die „Japan Revival Vision“ der japanischen Regierung den Anstoß für verschiedene Neuerungen. Unter anderem wurde eine Alternative zum bisherigen Interbankenabwicklungssystem der Japanischen Bankenvereinigung („Zengin System“) eingeführt, um künftig Banküberweisungen rund um die Uhr zu ermöglichen.*

*(Die Redaktion)*

