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# Open Banking in Japan

Amendments to Japan's Banking Act in 2016 and 2017 have enabled banks to form or acquire FinTech companies and, in order to promote collaboration between banks and FinTech companies or subsidiaries, also imposed an obligation on banks to make efforts to open up their application programming interfaces ('APIs'). It is expected that, through subsidiaries jointly funded by banks and FinTech companies, or through collaboration with FinTech companies that are external third parties, these changes will help to advance Open Banking in Japan. Naoki Kanehisa and Kenichi Tanizaki of Atsumi & Sakai, provide details on the impact of the amendments to Japan's Banking Act and the development of Open Banking in the country.

## FinTech companies within a banking group

### *The Amended Banking Act of 2016*

Japan's Banking Act strictly regulates the scope of business that banks and their subsidiaries are permitted to be engaged in. Because of these strict regulations, it was pointed out that it might be difficult for banking groups to engage in innovative businesses or make investments in FinTech companies in response to the surge in FinTech companies. Under these circumstances, the predominant view is that a framework that enables more flexible business expansion for banking groups should be established.

In line with this trend, the Amended Banking Act of 2016 allows banks to hold as subsidiaries 'companies engaged in activities which contribute to or are

expected to contribute to advancement of banking activities performed by a bank or improvement in the bank's users' convenience using information and communication technologies or other technologies' (defined as a 'Banking Activity Advancing Company,' which includes FinTech companies). According to the amended Banking Act, banks are permitted to expand into new innovative businesses through such subsidiaries.

This amendment enables, for example, a bank to invest in and hold, as a subsidiary, an operating company for an EC mall (e-commerce market), as a result of which the bank would be able to obtain a vast amount of transaction data which it could then use for the assessment of creditworthiness. This amendment may also lead to adopting

advanced technology through investment in, or acquisition of, companies handling data processing, companies developing systems using AI, or companies developing apps for smartphones.

Moreover, through such advanced technology obtained from a Banking Activity Advancing Company, a bank would be able to provide new services that provide benefits for them, such as the discovery of needs for financing transactions, enhanced investment management, and household accounts services, etc. Recently, major banks have held 'hackathons' that have made use of parts of the banking system and this has resulted in discoveries leading to the establishment of new IT companies. Using these hackathons,



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continued

many startups have been established and have commenced operations.

A bank is required to obtain individual authorisation from the Financial Services Agency ('FSA') to hold an investment in a Banking Activity Advancing Company as a subsidiary. The purpose of this requirement is to maintain a regime under which banks or banking groups are, in principle, permitted to be engaged in only a limited scope of businesses.

#### *Trends among major banks in response to the 2016 amendment*

Japanese banks (mainly major banks) and IT companies have already jointly established companies, making use of the introduction of the Banking Activity Advancing Company.

Sumitomo Mitsui Financial Group has established several Banking Activity Advancing Companies. One of these is a company operating a personal verification platform business using multiple biometric identification factors. Another is a company incorporated with a major IT company as a Banking Activity Advancing Company within the Sumitomo Mitsui Financial Group, which, by using the know-how and resources of both groups, has as its main business the planning, development, data analysis and digital marketing etc of apps and services.

Mitsubishi UFJ Financial Group has also established several Banking Activity Advancing Companies. One of them has developed a new user interface making use of IoT devices, including voice recognition, motion detection systems, and AI, which has led to the development of a next-generation financial user interface ('UX') and a more comfortable and frictionless user experience. This company has already formed strategic

business alliances with, and begun businesses with, several dozen regional banks to provide its services. Following the recent diversification of work styles (working from home, second jobs, working beyond the standard retirement age, etc.), the MUFG Group is paying particular attention to more people in the workforce becoming detached from Japan's lifetime employment system and becoming 'crowdworkers' (a new employment system that allows workstyles to be adjusted to fit lifestyles and life stages) so that they can maintain the desired work-life balance. In order to respond to such diversification of work styles, the MUFG Group incorporated a Banking Activity Advancing Company to provide financial services suitable for workers with diversified work styles, such as sole proprietors and freelance workers.

#### **Collaboration with third party FinTech companies**

##### ***The Amended Banking Act of 2017***

In order to encourage banks to make customer data available to third parties, the Amended Banking Act of 2017, which came into force on 1 June 2018, enables the FSA to develop a registration system for electronic settlement agents providing payment initiation services and/or account information services, which is expected to be simpler than the existing system applicable to funds transfer service providers, to promote innovation and ensure user protection.

The Amended Banking Act of 2017 also imposes obligations on banks to make efforts to open up their APIs to electronic settlement agents by 2020. Before this amendment was introduced, only a few banks had opened up their APIs to FinTech companies and, as a result, it was necessary for FinTech companies to use account scraping methods to aggregate customers' information from

the deposit accounts of customers provided by the banks. The FSA's main aim is to enhance the effectiveness of open APIs by encouraging banks to develop their API systems and to promote the smooth circulation of private sector data concerning individuals, through prohibiting discriminatory treatment among service providers (i.e., electronic settlement agents).

Major points from the Amended Banking Act of 2017 are as follows:

#### **(a) Adoption of a registration system for electronic settlement agents. The following service providers are defined as 'electronic settlement agents,' and, as such, became subject to registration:**

- (i) Providers of electronic money transfer services, which convey money transfer instructions to relevant banks according to depositor's entrustment by way of using electronic data processing systems; and
- (ii) Providers of account information management services, which obtain account information in relation to a depositor from banks and provide that information to the depositor according to the depositor's entrustment by way of using electronic data processing systems.

#### **(b) Obligations of electronic settlement agents:**

Electronic settlement agents, when carrying out electronic settlement agency services, are required to clarify to users such things as their own authority, complaints procedures and help desk services, and to take the necessary measures to avoid giving rise to the misconception that such

services are being provided by banks, as well as security management, and management of external vendors. In addition, electronic settlement agents, prior to carrying out electronic settlement agency services, are required to execute with banks an agreement regarding electronic settlement agency services which includes certain requisite items.

#### (c) Measures required to be taken by banks:

Upon the execution of the aforementioned agreement with an electronic settlement agent, each bank is required to stipulate and make public the criteria with which the electronic settlement agent must comply. The bank must also endeavour to establish a system for carrying out interconnection through an API by a deadline determined by Cabinet Order, within two years from the enforcement of the Amended Banking Act.

Security and user protection are also important aspects for API interconnection. Banks are currently considering these issues by referring to the 'Report of Review Committee on Open APIs,' drafted by the Japanese Bankers Association, and the 'API Connection Checklist (preliminary version)' published by the Center for Financial Industry Information Systems ('FISC'). Banks are also obliged to establish and make public their policies regarding collaboration and cooperation with electronic settlement agents, which they have done.

#### *Banks' approach to Open Banking APIs*

According to the 'Policy regarding collaboration and cooperation with electronic settlement agents,' published by financial institutions, 130 Japanese banks have expressed their

intention to introduce an open API. We anticipate that the collaboration and cooperation between banks and FinTech companies will increase, and that more innovative financial services will be offered to customers.

#### *Establishment of guidelines for bank agency businesses*

When carrying out API interconnection, or collaboration with an electronic settlement agent, it is necessary for both FinTech companies and banks to scrutinise whether the business operated by an electronic settlement agent falls under the definition of a bank agency business. If, hypothetically, it falls under the definition of a bank agency business, then it will require a licence from the FSA (which requires more onerous criteria than those required for registration as an electronic settlement agent), in addition to the registration as an electronic settlement agent. However, whether a business falls within the scope of a 'bank agency business' is not always clear under the current Banking Act. Accordingly, the FSA is attempting to improve the existing situation which makes it extremely difficult for FinTech companies using open APIs to share data or revenue with banks due to restrictions on bank agency businesses.

To achieve this objective, the FSA has established a guideline regarding bank agency businesses and, in the form of a reply to a public comment, is clarifying which acts fall under the scope of bank agency business. This guideline indicates that a business may not be a bank agency business in cases where (i) the fee payable to a system provider from a bank is paid as compensation for a usage charge for the system furnished by the system provider, (ii) the fee payable to the service provider from the bank is paid as compensation

for advertising, and (iii) the fee is paid to a service provider from a bank as a fee attributable to the service provider.

#### **Several concerns from a practical perspective**

When the Amended Banking Act of 2017 came into effect, the FSA provided its interpretation and elaborated on certain implications regarding the definition of 'electronic settlement agent,' and based on these, the scope of 'electronic settlement agent' is regarded as over broad. For example, a collection agent which is entrusted by a depositor to withdraw a certain amount from the depositor's bank account might be an 'electronic settlement agent,' which incurs obligations to register with the FSA and execute an agreement with banks regarding electronic settlement agency services. It is hoped that the FSA will clarify its views and resolve this confusion.

#### **Future regulatory trends**

It is reported that the FSA has started to consider establishing a new legal framework by revising relevant laws with the goal of popularising FinTech. It intends to regulate and supervise services such as settlement and remittance with one law and enable banks and internet service providers to compete with each other on the same basis. If, by using leading edge IT, costs can be reduced, it would be expected that the cost for financial services will decrease and that lower cost financial services will benefit customers. These discussions within the FSA are focused on the development of an open API friendly environment which will require the reorganisation of existing regulations and the development of systems by participating financial institutions, although FinTech companies will still be subject to a registration system.