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Regulatory reforms are tailwind for one-stop online financial services

Katsutoshi Takehana

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Executive Summary

Japanese FSA's Financial System Council is discussing potential changes to laws and regulations regarding cross-sectoral financial service intermediaries. If the changes come to fruition, financial services should become more conveniently accessible via mobile apps.

Katsutoshi Takehana
Senior Researcher
Financial Market & Innovation Research Department

Financial services set to become more conveniently accessible via mobile apps

In Japan, the Financial System Council's Financial System Study Group (FSSG) is currently discussing potential changes to laws and regulations regarding cross-sectoral financial service intermediaries. The clearest example of such services is portal apps that allow users to do everything including transferring funds, making payments, trading investment trusts and applying for insurance and loans. Such apps that feature a personal financial tracker and in-app advertising may also recommend, say, investment trusts or insurance products based on the data stored in the app.

Additionally, cross-sectoral financial service intermediaries are expected to launch services for not only consumers but SMEs and micro-enterprises also. For example, a cloud accounting service could make optimally timed loan recommendations to its user companies based on their financial information or billing and payment history, referring them to an allied lender offering the best interest rate. If such services prove popular, they should not only improve user companies' capital efficiency and cultivate new loan demand for financial institutions but also earn referral fees for their providers.

A few such services are already on the market. A big reason why there are not more of them is regulatory red tape.

One-stop business model was not anticipated when regulatory regime was designed

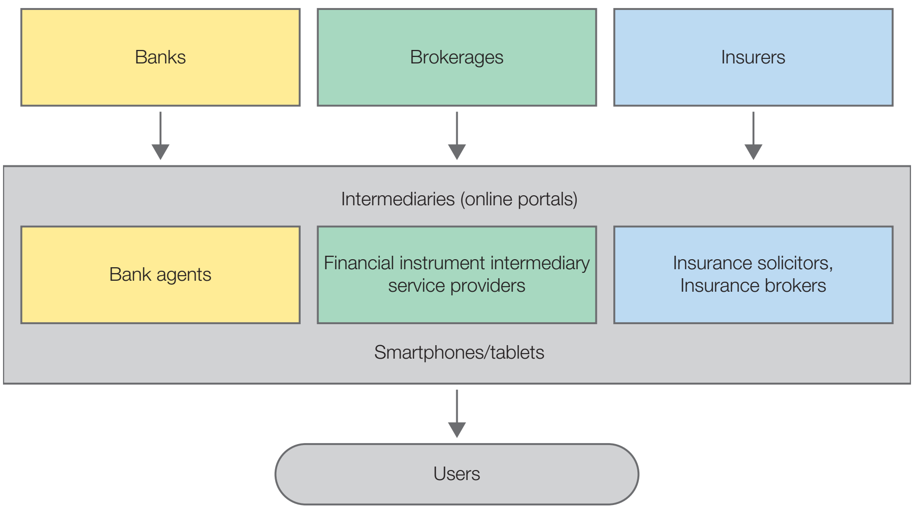
Online one-stop financial services (which I refer to as "intermediary services") act as an intermediary between providers and users of financial products and services. Under current Japanese law, they must be licensed or registered in an intermediary capacity (e.g., bank agent, financial instrument intermediary service providers, insurance solicitor, insurance broker) in each market in which they operate (see diagram below).

At first blush, complying with existing licensing or registration requirements does not seem to be a tall order, and some intermediaries have in fact already complied with them. From the standpoint of scalability going forward, however, the current regulatory framework is problematic in at least two respects.

First, cross-sectoral financial service portal providers must register as an intermediary in multiple capacities. From their standpoint, this requirement results in duplication of registration procedures and communication with regulatory authorities. While such regulatory compliance costs perhaps rightfully should be borne by the portal providers, they undeniably could end up being passed on to users or posing a barrier to entry.

Second, bank agents, financial instrument intermediary service providers and insurance solicitors operate under the supervision of their principals (the financial institutions on whose behalf they act as intermediaries). Additionally, if an intermediary harms a user or goes bankrupt while in the possession of users' funds, the principal financial institution would be liable for damages. In

Exhibit: Structure of one-stop online financial services under existing regulatory regime



Source: NRI, based on information from Financial Services Agency other words, the principal financial institution assumes responsibility for certain functions essential to providing financial services, including regulatory compliance and consumer protection. The problem is that this principal-agent framework is predicated on the assumption that intermediaries will have relationships with no more than a few principal financial institutions. Business models where a single intermediary works with many financial institutions were not envisioned. A portal provider representing the products or services of 20-30 financial institutions would be subject to supervision by all of the financial institutions, a situation presumably never anticipated when the current regulatory regime was designed.

Cross-sectoral financial service intermediaries figure prominently in national growth strategy

The FSSG has so far met multiple times to discuss the need to reform how online one-stop financial portal business models are regulated, including the issues highlighted above. At its most recent meeting (April 22, 2019), the FSSG apparently reached a general consensus in favor of (1) reducing the existing registration system's red tape by streamlining duplicative procedures and standardizing requirements as much as possible and (2) scaling back financial institutions' duty to supervise intermediaries and assume liability for damages by loosening the principal-agent framework that currently governs relationships between intermediaries and the financial institutions they serve. To compensate for easing the principal-agent rules, the FSSG is in favor of restricting portal providers to offering products and services that pose little risk from a consumer protection standpoint and ensuring that they have the wherewithal to assume liability for damages by regulating their financial condition more strictly.

How the new regulatory regime for cross-sectoral financial service intermediaries will be harmonized with existing industry-specific laws and industry self-regulation remains to be seen. One key question is whether existing laws and enforcement regulations will be revised or a separate new law enacted. Another question is the specific criteria by which products and services will be designated as low-risk from a consumer protection standpoint. While many such issues remain to be clarified, I hope that the actual changes will at least be undertaken from a growth-oriented perspective that aims to promote competition from new entrants and increase convenience for consumers.

The government sees cross-sectoral financial service intermediaries as a major pillar of its national growth strategy for the financial sector, as Financial Services Minister Taro Aso acknowledged at a February 13, 2019, meeting of the Council on Investments for the Future. With the government planning to also legalize use of digital currencies to pay wages[1], change should soon be afoot in both financial services' supply structure and household-sector fund flows originating from smartphones. Such change should spark growth throughout the financial sector by creating new demand for financial services.

NOTE

1) See "Impact of legalization of digital currency paychecks" (https://www.nri.com/en/knowledge/publication/fis/lakyara/lst/2019/03/01).

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Inquiries to : Financial Market & Innovation Research Department
Nomura Research Institute, Ltd.
Otemachi Financial City Grand Cube,
1-9-2 Otemachi, Chiyoda-ku, Tokyo 100-0004, Japan
E-mail : kyara@nri.co.jp

http://fis.nri.co.jp/en/publication/kinyu_itf/backnumber.html

