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Open APIs are essential to Japanese banking innovation

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Executive Summary

Over 18 months have passed since Japan amended its Banking Act to promote banking APIs (application programming interfaces). While Japanese banks appear to proceeding apace with API deployments according to survey data, they have not bought into open APIs entirely. They need to reaffirm open APIs' value as an innovation driver.

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Japanese banks' API initiatives

Japan's Banking Act was amended[1] in June 2018 to promote open APIs in the banking industry. Following is an update on Japanese banks' API initiatives over the 18 months since.

The FSA reported that nearly all banks in Japan, excluding foreign ones, have announced plans to implement APIs as of September 30, 2019 (Exhibit 1). Additionally, the Japanese Bankers Association (JBA) informed the Payments Council on Financial Innovation in June 2019 that 95 of 130 banks that announced API implementation plans had already deployed APIs as of March 31, 2019. The JBA reported on other areas of progress also, including publication of sample API agreement clauses. The government's national growth strategy[2] set a KPI target of at least 80 banks with open APIs in operation by June 2020. With this target

Exhibit 1: Banks' API deployment plans

Category	Number	Deployers	Refrainers
Category	4	4	0
Regional banks (RB)	64	64	0
Second-tier RBs	39	39	0
Trust banks	14	8	6
Foreign banks	56	0	56
Other banks*	16	15	1
Totals	193	130	63

*"Other banks" mainly include Aozora Bank, Japan Net Bank, Shinsei Bank, SBI Sumishin Net Bank, Seven Bank, Japan Post Bank and Saitama Resona Bank.

Source: NRI, based on data published on FSA's website[3]

NOTE

1) Act Partially Amending the Banking Act (Act No. 49 of 2017).

2) Headquarters for Japan's Economic Revitalization, Follow-up on the Growth Strategy (June 21, 2019)

3) The data were current as of September 30, 2019.

already surpassed, the banking API rollout appears to be progressing exceptionally well.

Usage fees have emerged as problem

The rollout, however, has not been entirely smooth. A stumbling block has arisen with respect to charging for API access. The amended Banking Act imposes various duties on banks and payment service providers. For example, payment service providers must seal the contract with banks by May 31, 2020[4]. With this deadline looming less than six months ahead, the two sides remain at loggerheads over the usage fee issue.

4) As a transitional measure, the amended Banking Act granted a two-year grace period for payment service providers to negotiate agreements on read-only services with banks (Article 2(4) of the amended Banking Act's Supplemental Provisions). The grace period expires on May 31, 2020.

The dispute revolves much more around write-access APIs than the read-only APIs. The former are more costly security-wise than the latter. To defray API maintenance costs, banks are starting to charge payment service providers to access their APIs. Some banks are attempting to charge utterly unaffordable fees that exceed the annual revenues of the payment service provider with which they were negotiating. Payment service providers, by contrast, argue that API access should basically be free to promote open innovation. The two sides are at an impasse.

With banking APIs still in their infancy in Japan, usage-fee norms have yet to be established. A model agreement (sample contract clauses) published by the JBA in December 2018 addresses most matters of concern to both sides but not the issue of API usage fees (Exhibit 2). If the current impasse persists, the two sides may fail to reach an agreement by the deadline, in which case banking APIs might end up fizzling out in Japan. Some observers fear that such an outcome would prompt FinTech services to revert to screen scraping (using customer-provided login credentials to access a financial institution's online services on behalf of the customer), a practice that raises security concerns.

Exhibit 2: JBA's sample contract clause on API usage fees

Article 4 (license fees)
License fees paid by an API accessor to a bank shall be negotiated separately between the two parties[5].
Commentary
Under the sample contract clause, license fees are to be set by separate agreement. The JBA's Review Committee on Open APIs has not discussed the issue of license fees

Source: JBA's sample API usage agreement clauses compliant with Banking Act (December 27, 2018)

5) According to a November 2019 FSA report on the status of negotiations between banks and payment service providers, only 57 of 130 banks that had announced plans to deploy APIs have reached agreements with payment service providers (as of September 30).

How banks should approach open APIs

From the standpoint of resolving their differences with payment service providers, banks should keep three points in mind when pursuing open API initiatives.

First, banks need to remember that APIs not only make banking more convenient for customers but also boost their own earnings. Many banks apparently fail to see APIs as a revenue source. They seem to believe APIs just give payment service providers access to lots of proprietary customer information without materially benefiting themselves, but they are wrong. If payment service providers' write-access API services are convenient and inexpensive enough, bank customers who have, for example, been making payments with cash withdrawn from ATMs would switch to electronic fund transfers via the API services. In such an event, banks would earn additional EFT fees.

In May 2019, GMO Aozora Net Bank launched a free write-access API in addition to a pre-existing read-only API[6]. MUFG Bank has announced plans to offer an identity authentication API service[7]. Both are good examples of forward-thinking Japanese banking APIs. If such API releases continue, Japanese regulators would have no need to impose restrictive regulations on banking APIs like in Europe[8].

Second, banks should look at API-related expenses and revenues in the context of their overall P&L, not as a standalone profit center. Japan's cash payment infrastructure costs some ¥1.6tn annually to maintain[9]. Much of this cost is borne by banks to pay for, e.g., ATMs, ATM operating expenses and armored cash transport services. If APIs catch on, banks would be able to downsize their ATM networks and spend the resultant cost savings on APIs.

Third, banks need to make special accommodations for their organizational units working on APIs. Such accommodations might include granting exceptions to internal operational rules. FinTech businesses differ markedly from conventional banking, particularly in terms of speed and risk aversion. They accordingly should be governed by a different set of rules. If granting special treatment to selected organizational units is not feasible, banks have the option of setting up a subsidiary to run their API businesses. Fukuoka Financial Group has already done so. It established and is now expanding iBank Marketing as a subsidiary segregated from its banking subsidiaries.

6) The write-access API was announced in a May 21, 2019, press release issued by GMO Aozora Net Bank.

7) The service will provide personal information (e.g., names, addresses, dates of birth) in MUFG Bank's databases to businesses required by anti-money-laundering laws to authenticate users' identity. The service is expected to reduce costs by obviating the need for such businesses to, e.g., use non-forwardable mail delivery.

8) For example, under the EU's Revised Payment Services Directive (PSD2; adopted November 2015; effective January 2018), financial institutions are generally prohibited from charging customers an extra fee for basic information accessed via an API. This prohibition is considered conducive to innovation, competition among banks and improved user convenience, partly because it incentivizes financial institutions to develop premium APIs that allow them to charge for value-added information.

9) According to a May 2018 METI report on FinTech in Japan.

Banking APIs are not solely for the benefit of payment service providers. They are also a means of open innovation. Banks need to innovate by making liberal use of APIs.

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