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# lakkyara

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**Changes in settlement services  
and group strategy**

By virtue of recent regulatory reforms, technological innovations, and changes in consumer behavior, standardized international settlement services are at last showing signs of gaining prevalence in Japan also. The time has come for Japanese bank groups to rethink their settlement service strategies.

### Highly efficient international settlement services

In the US and Europe, banks and other financial institutions issue internationally branded<sup>1)</sup> credit cards, debit cards, and prepaid cards. These cards generate fee income for the banks and are also instrumental in customer retention.

International brands identify issuers with card numbers<sup>2)</sup> that conform to an international standard and settle charges incurred by cardholders. Issuers bill their cardholders for charges incurred. With a credit card, the charges are paid at a later date; with a debit card, funds are transferred immediately from the cardholder's account; and with a prepaid card, funds are deducted from a balance previously loaded on the card. Banks overseas thus mainly issue Visa or MasterCard credit, debit, and prepaid cards and provide efficient service by virtue of a common usage environment (e.g., merchant terminals, data specifications, data communication networks) shared across card brands, countries, and payment methods.

### Japan's card settlement services have evolved independently

In Japan, by contrast, these settlement services have developed independently of each other. When credit cards were first introduced in Japan around 1960, banks were legally prohibited from directly issuing credit cards. They therefore established card companies, the current generation of which include Sumitomo Mitsui Card and Mitsubishi UFJ Nicos. Visa and MasterCard became entrenched as credit card brands. After card issuance was deregulated in 1985, banks themselves began to issue credit cards. Nonetheless, credit cards are still strongly associated with card companies' business. Japanese credit card issuers continue to use data communication

specifications unique to Japan. They also operate inefficiently on a stand-alone basis, duplicating bank operations such as card issuance, customer management, collection, and fraud detection. They have the potential to improve the efficiency of such operations and related IT systems, with the banks playing a central role.

Aside from credit cards, other card settlement services have yet to gain widespread prevalence in Japan. Debit cards made their advent in Japan in 1999 in the form of the J-Debit service, which enables users to make purchases with a bank ATM card. In 2009, debit card transaction volume totaled some ¥740 billion<sup>3)</sup>, equivalent to less than 2% of credit card transaction volume. Although debit card transactions can be processed on credit card terminals, debit cards are basically a separate scheme with their own dedicated networks and operations. They cannot be used for online shopping, an increasingly popular mode of consumer spending. Moreover, debit card transaction volume is shrinking due largely to self-regulation for the sake of consumer protection.

Prepaid cards have rapidly gained popularity in recent years in the form of electronic money, issuance of which began in earnest in 2007<sup>4)</sup>. In fiscal 2009, e-money transaction volume exceeded ¥1.3 trillion<sup>5)</sup>, but e-money services each have their own transaction processing terminals and network infrastructure. Due to high costs, e-money services have yet to achieve profitability as a stand-alone settlement business.

The settlement services business is hardware-intensive and entails a large-scale infrastructure buildout. Japanese settlement services that build and operate separate infrastructure for different services or payment methods are highly inefficient.

### Noteworthy changes stemming from regulatory reform or technological innovation

However, settlement services that are in widespread use overseas will not gain widespread prevalence in Japan without adapting to the local market. For example, in Europe and the US, where checks are used as a means of payment, credit card users generally pay minimum monthly payments on their revolving credit balances by check. Debit cards' automatic funds transfer is reportedly perceived as a convenience. In this respect, Japanese credit cards can be said to already offer the convenience of debit cards, given that most users pay off their balances in full by automatic fund transfer. Recently, however, non-credit-card settlement services are showing signs of gaining popularity in response to legal reforms, technological innovations, and changes in consumer psychology.

The amended Money Lending Business Act, which fully took effect in June 2010, imposed total per-borrower debt limits on lenders. Effective December 2010, the amended Installment Sales Act requires card issuers to research cardholders' monthly payment capacity. Such consumer protection provisions are having an impact on credit card issuance. Consumers that do not have any credit cards are becoming increasingly common. The credit card business model is under pressure to change from growing claims for interest overcharge refunds and the escalating cost of adapting IT systems and business processes to comply with new regulatory requirements. Meanwhile, consumers are exhibiting a growing tendency to place priority on safety due to pessimism about the economic outlook and their personal income prospects<sup>6)</sup>. This trend implies growth in latent demand for prepaid cards and debit cards, which help consumers to control their spending within the limits of their available cash. Additionally, remittance services were liberalized by the Financial Settlement Act, which took effect in June 2010. Card usage could be an effective model for initiating remittance services<sup>7)</sup>. Such developments are spawning business opportunities for non-credit-card settlement services also.

On the technology front, bank ATM cards and credit cards that comply with international standards for contact IC cards<sup>8)</sup> are evolving into internationally standard

contactless IC cards, like IC-embedded drivers licenses and municipal resident ID cards. Various contactless services are starting to come into shared use throughout the world. These technological innovations are also expected to reduce the cost of cards and terminals for Japanese e-money<sup>9)</sup>, which currently functions based on standards unique to each service, by virtue of mass production with globally universal technologies. Such innovations will also enable card reading terminals to be used for non-settlement services such as loyalty points, healthcare, and public services. In sum, such innovations will give rise to efficient and effective services that use payment cards as media<sup>10)</sup>.

### Japanese settlement services' pending issues and future prospects

In Japan, certain issues remain to be resolved with respect to debit card usage, such as a documentary stamp requirement<sup>11)</sup> and lack of access to real-time sales data at some retail stores, which poses a risk of debit card sales being approved but later turning out to be uncollectible due to insufficient funds. With card companies struggling to comply with legal changes, such issues are unlikely to be resolved soon. In light of the changes discussed above, however, bank groups should be able to not only resolve these issues but also improve their operating efficiency and implement effective group strategies by promoting settlement services through group-wide efforts. Examples of potential initiatives include upgrading retailer sales data to a real-time basis, improving group-wide operating efficiency, devising risk mitigation measures, developing non-settlement card services (e.g., healthcare, public services), and implementing local economic revitalization measures linked to Chinese, Korean, and Taiwanese tourists' debit cards.

In retail financial services businesses, the deposit settlement function plays an important role. For banks that sell various financial products such as insurance and investment trusts in addition to making loans and taking deposits, the ability to ascertain customers' financial wherewithal is essential. By effectively providing efficient settlement services, banks will be better able to not only limit outflows of deposits and retain customers by

becoming their main bank but also collect information on customers' spending habits that is not available from account transfers alone. They should also be able to capture new revenue streams, such as settlement fees.

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#### Note

- 1) Visa, MasterCard, American Express, etc.
- 2) International brands assign card issuers an issuer identification number (IIN) in compliance with ISO/IEC 7812. Issuers issue cards with numbers that include their respective IINs. Issuers of internationally branded credit cards are identifiable by their IINs wherever the card is used throughout the world.
- 3) This total is based on data published by the Japan Electronic Payment Promotion Organization. In fiscal 2008, credit card purchases from retailers totaled ¥42,434.5 billion (per the Japan Consumer Credit Association's Consumer Credit Survey).
- 4) In spring 2007, PASMO, WAON, and nanaco commenced service.
- 5) According to "Recent Developments in Electronic Money in Japan (2010)," Bank of Japan, Payment and Settlement Systems Department.
- 6) Based on an NRI survey of 10,000 consumers.
- 7) Complying with the Act on Prevention of Transfer of Criminal Proceeds is extremely cumbersome. Remittance services are likely to initially be limited to "in-house remittances" between cardholders whose identity has already been verified at the time of card issuance.
- 8) Internationally branded credit cards have evolved from embossed cards to contactless IC cards, which are standardized to conform to ISO/IEC and EMV international standards, beginning with their physical dimensions. Japanese banks' IC-embedded ATM cards likewise conform to the same standards.
- 9) Most Japanese e-money services use FeliCa. FeliCa is an international standard for contactless communication between electronic devices but not for contactless IC cards.
- 10) Mobile phones equipped with contactless IC cards are another medium.
- 11) Based on the Japan's National Tax Agency's opinion that a debit card transaction corresponds to a monetary sales receipt (see FAQs on the NTA's website).

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