

2011

lakkyara

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vol.110 (16.May.2011)

**Update on remittance services
since the Payment Services Act took effect**

Deregulation of remittance services by the Payment Services Act, which took effect April 1, 2010, created a stir in the media last year. Although the PSA has now been in effect for over a year, the remittance services market has seen few new entrants, mainly because of burdensome identity verification requirements and commercial viability issues. Identity verification is one of financial institutions' strengths. Operational alliances between financial institutions and remittance service providers should yield synergies that vitalize the remittance services market.

Japan's Payment Services Act (PSA), which took effect on April 1, 2010, has now been in effect for over one year.

The PSA legalized server-based prepaid payment instruments in addition to certificate-based ones¹⁾, prescribed information disclosure requirements, and mandated that prepaid payment instruments be backed by funds held on deposit or in trust. The PSA also deregulated the money transfer market by opening it up to non-bank entrants registered as money transfer agents.

The PSA's deregulatory provisions garnered intense media attention, most notably including predictions of a boom in remittance services in 2010. However, some commentators with first-hand knowledge of financial services expressed a more cautious outlook, warning of operational and commercial viability issues and predicting that non-bank remittance services would take time to gain prevalence.

Operational requirements imposed on money transfer agents

The biggest burden involved in operating a money transfer service is compliance with the Act on Prevention of Transfer of Criminal Proceeds, Japan's anti-money-laundering (AML) law. The many specific controls that must be complied with include the Ministry of Finance's FATF²⁾ recommendations, National Police Agency's Taliban list, Ministry of Foreign Affairs' list of Japanese government sanctions, Ministry of Economy, Trade and Industry's obligations imposed on designated businesses, and US Patriot Act. Money transfer agents are also required to monitor transaction flows to identify and report

suspicious transactions through comparison of customers' transaction histories and transaction patterns. They must conduct monitoring in cooperation with the Japan Financial Intelligence Center³⁾ (JAFIC) also. In sum, AML compliance imposes a heavy operational burden.

In the banking industry, which previously had a monopoly on remittance services, the Japanese Bankers Association compiles a list of such AML compliance requirements and serves as a liaison between banks and the JAFIC. New entrants to the remittance services market are subject to the same compliance requirements as banks, but individually they cannot feasibly realize in a short time the same level of compliance that banks have developed over many years through industry-wide cooperation. New entrants are therefore likely to initially offer realistically feasible remittance services through such means as utilizing existing service providers or limiting remittance counterparties to those whose identity has been verified in advance. However, to develop a truly deregulated and vibrant remittance services industry, remittance service providers are expected to develop support infrastructure. For example, the Japan Payment Service Association, which was established pursuant to the PSA, will fulfill such operational support functions on behalf of the entire industry.

Commercial viability and market development

The heavy operational burden imposed on remittance service providers has implications in terms of costs and commercial viability. With Japan's payment services market already replete with ATM networks and proprietary

payment services such as bill-paying services offered by convenience stores and wireless telecom carriers, new remittance services must be differentiated from existing payment services to gain popularity. However, the only differentiation factors likely to appeal to users are fees (monetary benefit), convenience, and speed. New entrants therefore have little prospect of substantially differentiating their services, except by charging less than banks' high remittance fees. Additionally, while prepaid payment instruments are required to be only 50% backed by funds held on deposit or in trust, money transfer services must be 100% backed by such deposits. This requirement constitutes a high barrier to entry to the market for electronic money services, which have a low degree of commercial viability as a standalone business.

Commercial viability is presumably the main reason that PayPal⁴⁾, a popular remittance service in the US and Europe, has refrained from registering as a money transfer agent in Japan as of March 31, 2011. Overseas, PayPal has succeeded with a business model that charges fees to business users for B2C and B2B remittance services (e.g., for online shopping), enabling it to provide C2C remittance services free of charge. In Japan, however, PayPal is not yet firmly entrenched as an online shopping payment method⁵⁾. It apparently will take a while longer before offering free C2C remittance services in Japan like it does elsewhere.

Overseas remittance services' solid start and future outlook

As mentioned above, consumers are unlikely to immediately use new remittance services to purchase goods in the Japanese market, where a wide variety of payment services already exist. However, demand for overseas remittance services is on the rise among Japan's growing population of foreign workers. With the Japanese population in decline, foreign workers constitute an attractive market that remittance service providers should target first.

On July 15, 2010, Western Union⁶⁾, the world's largest remittance service provider, commenced money transfer service in Japan through Travelex⁷⁾. Initially, the service was offered at only 13 existing Travelex offices in central urban locations, but so many foreign workers visited the offices to send money to their home countries that they disrupted Travelex's currency exchange business. Travelex increased the number of its offices offering Western Union service to 24, including five newly opened offices dedicated exclusively to providing international remittance services. Travelex is not at liberty to divulge overseas remittance volumes, but they have exceeded expectations in both unit and value terms, spawning great hopes for the remittance business's future prospects.

Exhibit. Registered money transfer agents and overview of their services

Name	Overview of Services
Travelex Japan	Adapted Cash Passport prepaid card to comply with PSA
Rakuten	Adapted Rakuten Cash to comply with PSA
JTB	Clarified Global Cash's legal foundation.
Unidos	Provides remittance services to Peruvian residents of Japan and ethnic Japanese residents of Peru
Western Union	World's largest international remittance service. Has formed alliance with Seven Bank also.
Japan Money Express	Remittance service between Japan and Nepal
TransRemittance	Remittance service between Japan and the Philippines, run by a Philippine parcel delivery company
SBI Remit	Provides overseas remittance services in alliance with MoneyGram, the world's second-ranked international remittance service
Microfinance International	Remittance and microfinance service founded in North America by former Bank of Tokyo executive Atsumasa Tochisako
DSK	Plans to utilize electronic money transfers to improve the efficiency of direct marketers' refund operations related to merchandise returns

Note: The above is current as of March 31, 2011.

Source: NRI, based on the Financial Service Agency's list of registered money transfer agents and contacts with the listed companies

Western Union's appeal lies in its broad overseas network, low fees for small-denomination remittances, the speed with which its money transfers arrive at their destinations, and the peace of mind afforded by its face-to-face service. As an incumbent service provider, Western Union is already well-equipped to meet the burdensome compliance requirements described above. Travelex merely inputs the details of customers' remittance requests into computers linked directly to Western Union. Western Union's system conducts both filtering and monitoring in addition to completing inputted money transfers.

As of March 31, 2011, ten companies have registered as money transfer agents in Japan (see table). They include international cash card⁹⁾ issuers and remittance service providers that serve specific geographic regions. The ones most likely to emerge as popular full-service remittance service providers are Western Union, SBI Remit, and Seven Bank. SBI Remit is allied with MoneyGram, the world's second-ranked remittance service provider, while Seven Bank offers remittance services utilizing Western Union's overseas money transfer network pursuant to the Banking Act, not the PSA. They have built cost-efficient business models that mitigate operational burdens through adroit utilization of remittance service providers with overseas track records and know-how.

With the Act on Prevention of Transfer of Criminal Proceeds now in the process of being amended, identity verification will become an increasingly important function requiring specialized know-how and compliance requirements will increase even for financial institutions. Financial institutions can facilitate widespread growth in remittance services by commercializing their strong identity verification capabilities to the mutual benefit of both themselves and non-bank remittance service providers.

Note

- 1) Certificate-based prepaid payment instruments are issued in physical (e.g., paper, card) form. With server-based instruments, by contrast, prepaid balances are tracked by servers without issuance of a card or other physical medium.
- 2) Financial Action Task Force: a G20 working group concerned with financial activities.
- 3) A money laundering prevention unit of the National Police Agency's Organized Crime Control Department, Criminal Investigation Bureau.
- 4) A service whereby individuals can remit funds to each other, mainly in the US and Europe.
- 5) PayPal's fiscal 2010 press releases reveal that it is now focusing on expanding its network of participating merchants in Japan to increase its service's use for online shopping.
- 6) The world's largest remittance service provider.
- 7) One of the world's largest currency exchange service providers.
- 8) Cards that can be used to withdraw cash in local currency from an international ATM network (e.g., PLUS, Cirrus). Many are internationally branded (e.g., Visa, MasterCard) cards that can be used to not only withdraw cash but also make purchases.

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