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New Law & Regulations on Virtual Currencies in Japan

Japanese lawmakers amended the Act on Settlement of Funds (Act No. 59 of 2009, as amended, the **Amended Settlement Act**) in May 2016 to regulate businesses handling virtual currencies (**VCs**), which provide exchange services between VCs and traditional real currencies, such as Japanese yen or foreign currencies (**VC Exchangers**). Following the amendment to the Act, the Financial Services Agency of Japan (**JFSA**) has published a draft of relevant regulations in connection with the Amended Settlement Act. The draft regulations, which are currently subject to the public comment process, set forth the specific matters that relate to the registration and operation of VC Exchangers and protection of customers (the **Draft VC Regulations**).

Background

In 2014, Mt. Gox, which was then world's biggest exchange of a virtual currency, bitcoin, went bankrupt in Japan due to the misappropriation of customers' assets by the operator of Mt. Gox. Recognizing the risk of abusing VCs for money laundering or other purposes, the Financial Action Task Force, an inter-governmental body established in 1989 by the Ministers of G7 countries to develop policies and measures to combat money laundering, terrorist financing and other related threats to the integrity of the international financial system, has recommended that countries register or license natural or legal persons that provide money or value transfer services in the country, and ensure their compliance with the relevant AML/CFT measures.

In response to these background events, Japanese lawmakers enacted the Amended Settlement Act with three pillars of regulation as follows:

- Registration requirements on VC Exchange Business in Japan;
- Regulation against money laundering and terrorist financing; and
- Introduction of rules to ensure customer protection.

As delegated by the Amended Settlement Act, this time the JFSA issued detailed regulations which will implement the framework of regulations on VC Exchangers set by the Amended Settlement Act.

Key Features of the New Regulation

Definition of Virtual Currency

The VC is defined in the Amended Settlement Act as follows:

- (i) Value that may be used to perform obligations in compensation for purchasing or borrowing of goods, or receiving services, against unspecified persons, which may be purchased from or sold to unspecified persons and are transferrable by an electronic data processing system, provided, however, that such value is limited to those recorded on an electronic device, etc. in an electronic form, and does not include Japanese or foreign currencies, or assets denominated in such currencies; or
- (ii) Value that is mutually exchangeable with the value in item (i) above against unspecified persons, which is transferrable by an electronic data processing system.

For example, reward points granted under a specific point program are not regarded as VCs as specified in item (i) above, if the points can only be used at a specified number of shops or cannot be exchanged with real currencies without any limitation posed by a point issuer such as Amazon.com. VCs must be convertible to real money and accepted in an open community as set forth under item (i), or freely exchangeable with other VCs without any limitation posed by the issuer of VCs as set forth under item (ii).

Virtual Currency Exchange Business

Under the Amended Settlement Act, “**VC Exchange Business**” means conducting the following acts as business:

- (i) Purchase or sale of VCs, or exchange of VCs with other VCs;
- (ii) Intermediation, brokerage or acting as an agent for the act listed in item (i) (collectively with item (i), **VC Exchange, Etc.**); or
- (iii) Administration of customers’ cash or VCs in relation to the act listed in item (i) or (ii) above.

So-called “eWallet services,” which are generally services to pay for the purchase of goods/services or to keep or transfer real money on behalf of customers (as opposed to so-called “virtual currency wallet” for VCs), are currently conducted by money transfer business providers in Japan to the extent permissible under the Settlement Act and other applicable laws and regulations. One of the restrictions on the money transfer business under the Settlement Act is a limitation on transfer amounts of JPY 1 million (approx. USD 8,700) per transaction. In contrast, VCs are not subject to such a restriction. From the definition above and other proposed regulations as discussed below, the Draft VC Regulations permit VC Exchangers to hold VCs and cash related to VC Exchange, etc. for their customers and do not set forth a maximum amount on VC transfer. Therefore, eWallet service providers may potentially expand their scope of service by including VCs in their service. As this is a developing and complicated area of law, please contact us for a more detailed explanation.

Further, the futures contracts, underlying assets which are the price of a VC, would not be regulated as a VC Exchange Business if they are contract-for-difference transactions, i.e., not physically settled by cash or VCs. Such futures contracts are not regulated as derivatives transactions under the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended). Therefore, such services may in theory be offered to Japanese investors without any regulatory restrictions. As the product would be subject to other statutes in Japan, it is strongly recommended that businesses carefully design these products before actually offering them to Japanese investors.

Registration Requirements

In order to conduct VC Exchange Business in Japan, a firm is required to register as a VC Exchanger. A Foreign VC Exchanger, which is a foreign firm that is registered or otherwise permitted by the regulators of its home jurisdiction to conduct VC Exchange Business or a similar business, may not conduct VC Exchange Business in Japan until that firm is registered as a VC Exchanger under the Amended Settlement Act. Unregistered Foreign VC Exchangers are prohibited from soliciting Japanese residents in order to provide services related to VC Exchange Business. Draft Guidelines Concerning VC Exchangers, also issued by JFSA, state that online advertising by a Foreign VC Exchanger is generally considered as solicitation to Japanese residents unless reasonable measures are taken to prevent the firm from providing services related to VC Exchange Business to Japanese residents. Therefore, it is practically impossible for a Foreign VC Exchanger to market to Japanese residents through its website or web advertising.

An applicant is required to submit an application form with certain documents attached. Information included in the application form will be registered and subject to public disclosure. Such information includes, but is not limited to, trade name, address, stated capital, name of each director, executive officer and representative in Japan, contents and method of VC Exchange Business, other business conducted by the applicant, method of segregation custody, office address and contact information for customer claims or inquiries.

The following are some of the documents that are required to be attached to the application (this list is not exhaustive):

- A document describing the firm's staffing and organization, demonstrating the ability to conduct VC Exchange Business properly and reliably;
- A list of shareholders;
- A document certifying that the Foreign VC Exchanger is registered or otherwise permitted in its home jurisdiction;
- A balance sheet and income statement;
- Internal rules concerning the VC Exchange Business;
- Form of contracts with customers;
- Form of contracts with service providers, if any; and
- A document describing measures for claim handling and dispute resolution.

An applicant must meet certain requirements, which include, but are not limited to, the following:

- It must be a *Kabushiki Kaisha* (joint-stock company) under Japanese law or a Foreign VC Exchanger that has a business office in Japan;
- If the applicant is a Foreign VC Exchanger, the applicant must have a representative in Japan who is a Japanese resident, but not necessarily a Japanese national;
- The applicant must have JPY 10 million (approx. USD 87,000) in stated capital and positive net assets;
- The applicant must have sufficient staffing and organization to conduct VC Exchange Business properly and reliably; and
- The applicant must have a sufficient staffing and organization to satisfy the relevant provisions under the Amended Settlement Act.

Regulation on the Operation; Protection of Investors

A registered VC Exchanger is required to take necessary measures for (i) sufficient management of its system for VC Exchange Business, (ii) safe administration of individual customers' information, (iii) proper use of undisclosed information including sensitive information of individual customers, (iv) management of delegated services, (v) preventing misunderstanding between VCs and real currencies, and (vi) other matters related to customer protection as required under the Amended Settlement Act.

A VC Exchanger must provide certain information (e.g., description of the intended service, risk of loss that may be caused by the fluctuation of the value of VC, amount or calculation method of fees or other expenses, etc.) in a written form or other appropriate way to its customers before providing services related to VC Exchange Business.

Customer cash must be segregated in a bank (with an account name identifying that it is customers' account) or in a trust. VCs belonging to customers must be clearly segregated from the VC Exchanger's own VCs and held in a way where each customer's VCs may be identified immediately on its books.

VC Exchangers must prepare and keep books and records on their business and submit a business report to regulators for each fiscal year as required under the Amended Settlement Act.

AML/CFT

VC Exchangers are also subject to the amended Act on Prevention of Transfer of Criminal Proceeds (Act No. 22 of 2007, as amended, the **Amended AML Act**). VC Exchangers must conduct necessary "know-your-customer procedures" at customer intake and keep records on such customers and transactions as required under the Amended AML Act. VC Exchangers are further required to make a report to the regulators on any transactions that are suspected of involving assets related to criminal proceeds or customers' involvement in certain criminal acts.

Schedule

The Draft VC Regulations are subject to a public comment procedure that will close on Jan. 27, 2017. The new regulations on the VC Exchange Business are currently expected to go into effect in April 2017.

If you want to comment on the draft VC Regulations before the due date, please contact us for assistance.

End Note

The purpose of this memorandum is to provide a general overview of the new law and regulations on VC Exchange Business in Japan. It is not intended as a comprehensive and detailed analysis on all of the provisions of the regulations that may apply to each VC Exchanger or VC Exchange Business. Further, this memorandum is not intended to provide an overview or guidance regarding regulation of VC Exchange Businesses under any other applicable laws or regulations, including laws or regulations outside of Japan. Also, it is important to keep in mind that the new regulations are still subject to public comment and, thus, the regulations are not finalized yet. If you would like additional information on the VC Exchange Business in Japan that may affect your potential business or transaction with Japanese residents, please feel free to contact us.

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