### CHAMBER OF DIGITAL COMMERCE

The Chamber of Digital Commerce is the world’s largest trade association representing the blockchain industry. Our mission is to promote the acceptance and use of digital assets and blockchain technology. Through education, advocacy, and working closely with policymakers, regulatory agencies, and industry, our goal is to develop a pro-growth legal environment that fosters innovation, jobs, and investment.

### TOKEN ALLIANCE

The Token Alliance is an industry-led initiative of the Chamber of Digital Commerce, developed to be a key resource for the emerging industry surrounding the generation and distribution of tokens using blockchain technology. Comprised of more than 400 industry participants, the Alliance includes blockchain and token and legal experts, technologists, economists, former regulators, and practitioners from around the globe. The Token Alliance develops community-driven guidelines for the responsible development of tokens.

### CHAMBER OF DIGITAL COMMERCE INDUSTRY INITIATIVES & WORKING GROUPS

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I. INTRODUCTION

Although the concept of digital tokens does not exist under Japanese law, the concept of “virtual currency”, a subset of digital tokens, does. While virtual currency is a concept different from fiat currencies and securities, as detailed below, almost all of the digital tokens that are not denominated in fiat currency are deemed to be virtual currency. Therefore, when contemplating a business involving digital token transactions, it is necessary to consider regulations governing virtual currency.

Several laws in Japan comprise the regulatory framework around virtual currency. The Payment Services Act (the “PSA”) is the primary law within the framework; however, the Financial Instruments and Exchange Acts (the “FIEA”); the Act Regulating the Receipt of Contributions, Receipt of Deposits and Interest Rates; and the Money Lending Business Act (among others) should also be examined when determining whether to engage in business activity related to virtual currency. These laws are enforced by the Japanese Financial Services Agency (the “JFSA”), which supervises the virtual currency industry and works with the Japanese Virtual Currency Exchange Association (the “JVCEA”), the industry’s self-regulatory organization.

Following the hack of Mt. Gox, a virtual currency exchange that was headquartered in Japan, and the Financial Action Task Force’s (“FATF”) guidance in 2015, recommending that “virtual currency exchange service providers” be registered or licensed and subject to AML standards substantially similar to that of other financial institutions, prompted Japan to take regulatory action swiftly. Hence, amendments to the PSA and the Act on Prevention of Transfer of Criminal Proceeds (the “AML Law”) came into effect as of April 1, 2017 (the “Effective Date”). The PSA, as amended, included stipulations for the terms “virtual currency”, “virtual currency exchange service”, and “virtual currency exchange service provider”.

Where the relevant digital token is deemed virtual currency under the PSA, depending on the manner in which such virtual currency is transacted, the regulation imposed on virtual currency exchange service providers needs to be examined. For example, amendments to the AML Law in 2017 subject virtual

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1 In December 2018, the Japanese government proposed to replace the term “virtual currency” with “crypto asset”. The laws, however, have not yet been updated to reflect the proposed change.
4 Act No. 22 of March 31, 2007.
currency exchange service providers to the regulations for anti-money laundering and counter-terrorism financing ("AML/CTF").

Where quasi-financial instruments are transacted concerning digital tokens, there may be a case where the regulations pursuant to the FIEA\(^5\) should be investigated. While digital tokens will not fall under financial instruments, in principle, they may nonetheless be regulated by the FIEA under certain circumstances, such as if tokens are issued in an attempt to circumvent the FIEA or in an initial coin offering ("ICO") scheme entailing dividends.

Depending on the form of the transaction, applicability of other laws, such as the Act Regulating the Receipt of Contributions, Receipt of Deposits and Interest Rates\(^6\) and the Money Lending Business Act may well be considered.\(^7\)

The JFSA imminently contemplates reforming crypto asset regulations to address the problems that arose after Phase 1 of the virtual currency legislation which became effective in April 2017. The JFSA published a draft bill for the amendments to the PSA and the FIEA on March 15, 2019. The discussion in Sections II and III below is based on the current state of laws. For the outline of the amendments proposed in the bill, please refer to Section IV below.

Following two massive virtual currency hacking incidents, the JFSA tightened its oversight of virtual currency exchange service providers, including imposing stricter registration requirements and on-site inspections. It issued a number of business improvement orders and suspended a few virtual currency exchange service providers.

In light of highly volatile virtual currency prices and explosive trading volumes in 2017, a surge of ICOs in 2017, and hacking incidents in 2018, the JFSA created the Study Group on Virtual Currency Exchange Services\(^8\) in March 2018 to discuss appropriate crypto asset regulations. After eleven (11) sessions of discussion, the group published a final report in December 2018.\(^9\) The JFSA drafted bills based on this report and the national government submitted the draft to the Diet, Japan’s legislative body, on March 15, 2019. The discussion below focuses on the current laws and then compares it with the proposed laws.

The timeline for enactment remains uncertain. The national government submitted the amended bill to the Diet on March 15, 2019, and the Diet will discuss them. The following timeline is anticipated:

1. The Diet will approve the bill in May.
2. The JFSA will draft government ordinances and guidelines which are subordinated rules of the

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7 Act No. 32 of May 13, 1983.
amended laws and the drafts will be released for public review and comment around October to December 2019. The comprehensive list of the final public comment hearing results on the 2019 proposed government ordinances and guidelines and the final form thereof will be released around the end of 2019 to March 2020.

3. The amended law will be valid within one year after the enactment of the acts expected in around April or May 2020.

4. Some of the new regulations, such as regulation on custody and derivatives, have a six-month (6) transition period after enactment.

II. REGULATION OF VIRTUAL CURRENCY AS DEFINED UNDER THE PAYMENT SERVICES ACT

When contemplating a business involving digital token transactions, it is important to determine first, if it is a virtual currency and, second, if such business is deemed a virtual currency exchange service.

A. VIRTUAL CURRENCY

Under the PSA, virtual currencies are classified as either Type I or Type II virtual currencies based on their function:10

**Type I Virtual Currency:** property value (limited to that which is recorded on an electronic device or any other object by electronic means, and excluding the Japanese currency, foreign currencies, and currency-denominated assets; the same applies to the following item) which can be used in relation to unspecified persons for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services and can also be purchased from and sold to unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system.

**Type II Virtual Currency:** property value that can be mutually exchanged with what is set forth in the preceding item with unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system.

In short, digital tokens that can be used for the purpose of paying and can also be purchased from and sold to unspecified persons acting as counterparties are Type I virtual currency, such as bitcoin, litecoin, ether, and other virtual currencies that can be used as a payment method. Digital tokens that can be mutually exchanged with Type I virtual currency are Type II virtual currencies. Tokens that are linked to any fiat currency are regulated by another provision in the PSA.

In this regard, the JFSA currently deems almost all digital tokens (e.g., alt-coins, ICO tokens, and so on) to be virtual currency, except for fiat currency-denominated assets (e.g., Suica, a fiat-denominated...
prepaid e-money card). The JFSA broadly construes the elements of virtual currency such that it “can be used ... for ... paying”, it “can also be purchased”, and “can be mutually exchanged with” Type I virtual currency; i.e., digital tokens may be deemed Type I virtual currency (or Type II virtual currency, as the case may be,) so long as they have a possibility in the future to be used, purchased, and exchanged.11

**B. VIRTUAL CURRENCY EXCHANGE SERVICES**

Under the PSA, virtual currency exchange services are subject to registration requirements, various code of conduct rules, and supervision.

The term “virtual currency exchange service” means any of the following acts that are carried out on a regular basis12:

i. Purchase and sale of a virtual currency (i.e., exchange between a virtual currency and a fiat currency) or exchange with another virtual currency;

ii. An intermediary, brokerage, or agency service for the acts described above and;

iii. Management (custody) of a fiat currency or virtual currency on behalf of the users/recipients in relation to the acts described above in (i) or (ii).

Examples of businesses that might be deemed as conducting a virtual currency exchange service are:

» Exchanges in which users can sell and/or purchase virtual currency from other users;

» Shops that purchase and/or sell virtual currency;

» Bitcoin ATM operators;

» ICO issuers; and

» Brokerage firms that intermediate purchases or sales of virtual currency

Examples of businesses that do not fall under the definition of “virtual currency exchange services” are:

» Persons who trade virtual currency for their own investment purposes

» Mining firms

» Software developers

Currently, the PSA regulates virtual currency exchange businesses but excludes from regulation businesses that only offer custody services. The definition of a virtual currency exchange business

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11 The term “virtual currency” appears solely in the PSA and the AML Law but in no other statutes.
12 Paragraph (7) Article 2, PSA.
above does not include custodial operations unrelated to the purchase and/or sale of virtual currency (e.g., a wallet service provider who does not engage in the purchase or sale of a virtual currency).

C. OBLIGATIONS OF VIRTUAL CURRENCY EXCHANGE SERVICE PROVIDERS

Virtual currency exchange service providers are obliged to register with the relevant local finance bureau (sub-division of the JFSA) that is authorized by the Prime Minister. As of March 27, 2019, nineteen (19) companies are registered with the JFSA to perform virtual currency exchange services.¹³

Virtual currency exchange service providers are under the following duties, amongst others, pursuant to the PSA:

» Establishment and maintenance of a business management system
» Compliance with the laws and regulations
» Customer identity verification at the time of transaction
» Measures for user protection
» Elimination of relationships with anti-social forces
» Management of users’ assets (segregated management of funds or virtual currency deposited by the users)
» Management of information regarding the users
» Complaints management, financial ADR system, management of system risk
» Management of outsources and vendors
» Preparation and preservation of books and documents concerning virtual currency exchange service
» Submission of reports concerning virtual currency exchange service

Further, registered virtual currency exchange service providers are committed to abiding by the self-regulation rules drawn up by the JVCEA, Japan’s virtual currency self-regulatory organization, which was established on April 23, 2018 by sixteen (16) registered virtual currency exchange service providers.¹⁴ On October 24, 2018, the JVCEA was certified by the JFSA as a Certified Association for Payment Service Providers under the PSA.¹⁵ The JVCEA established self-regulation rules in furtherance of the existing regulations that are based on, amongst others, the PSA, the AML Law, and the

¹³ The companies are: bitFlyer, Tech Bureau, QUOINE, bitbank, DMM Bitcoin, GMO Coin, SBI Virtual Currencies, BTC BOX, BIT Point, FISCO Cryptocurrency Exchange, Money Partners, Bit Ocean, Xtheta, Huobi Japan, TaoTao, Bitgate, Coincheck, Rakuten Wallet, DeCurret. List of Companies Registered with the JFSA, https://www.fsa.go.jp/menkyo/menkyo/kasoutuka.pdf.
Guidelines for Administrative Processes concerning virtual currency exchange service providers ("FSA Guidelines") with a view to better protect users in light of the current service practice (such rules are roughly itemized below).

Items of self-regulation:

» Handling of virtual currency
» User property management
» Management of system-risk and information security
» Contingency
» AML/CFT
» Complaint processing and dispute processing
» Solicitation and advertisement
» User management
» Order management system
» Prevention of illicit transactions
» Management system of virtual currency related information
» Financial management

The self-regulation rules were drawn up with reference to the self-regulation rules pursuant to the FIEA concerning financial instruments exchange business (defined therein) implemented by the Japan Securities Dealers Association, a self-regulatory organization within the securities industry.

D. THE STATUS QUO OF REGISTRATION SCREENING

The JFSA’s review process for granting registrations was tightened after the NEM-equivalent of approximately fifty-eight (58) billion yen was hacked from Coincheck, a virtual currency service provider, in January 2018. As a result, the JFSA did not approve any new virtual currency service providers to offer their services from when the incident occurred until January 11, 2019, when it approved Coincheck’s application to offer virtual currency services. Two other applicants, Rakuten Wallet and DeCurret, subsequently became registered as virtual currency exchange service providers on March 25, 2019.
On February 1, 2018, all registered virtual currency exchange service providers and deemed registered virtual currency exchange service providers were ordered to report on system risks. On-site inspections were first conducted on Coincheck and then on each registered and deemed registered virtual currency exchange service provider. Business improvement orders, business suspension orders, and refusals of registration were issued to the majority of the registered virtual currency exchange service providers and deemed registered virtual currency exchange service providers.

The JFSA reviewed registration screenings and monitoring processes, taking account of the reality and issues found in inspections. As a result, the requisite level for virtual currency exchange service providers to attain for successful registration (e.g., internal control system, governance structure, system for system risk management, etc.) became at least as high as that of financial institutions, therefore significantly higher than that intended to be required when the PSA, as amended, was implemented.

Implementation of the said self-regulation rules has also effectively raised the bar for registration. However, the JFSA did not cease to register new virtual currency exchange service providers. The JFSA continues to review new registration applications, and multiple applicants are expected in the near future to be registered as virtual currency exchange service providers.

E. PROPOSED AMENDMENTS TO THE PSA

The Diet will review the following proposals to amend the PSA: 1) the term “virtual currency” will be altered to “crypto assets” in the amendments to the PSA; and 2) additional duties will be imposed on crypto asset exchange services.

Crypto assets exchange service providers will be subject to the following requirements in addition to the requirements that are currently imposed. Amongst the newly-added requirements are:

» To manage crypto assets in cold wallets. Certain crypto assets that satisfy prescribed conditions may be managed in a hot wallet.

» To hold and reserve proprietary crypto assets of the same kind and of the same value as the customer’s crypto assets managed in a hot wallet.

» To prohibit advertisement and solicitations to indicate false or misleading information or to induce speculative trading.

» To make prior notification to the JFSA of any change in tradable crypto assets or scope of crypto assets exchange service.

16 The PSA avails certain interim measures for those early market entrants that started their Virtual Currency Exchange Business no later than 31 March 2017 (before the effective date of the amendments to the PSA to stipulate Virtual Currency Exchange Service). To the extent such business operator applied for registration, and such application was officially received by JFSA on or before 30 September 2017, it is permitted to continue as a Virtual Currency Exchange Business until registration is granted or refused.
Clearly, one of the most onerous burdens would be the second item. The definitions of “hot wallet” and “cold wallet” are not stipulated in the draft law, and we believe that the JVCEA will take this up.

Moreover, under the amended PSA, in the event of insolvency of a crypto asset exchange service provider, customers will be vested with the right to receive payment in preference to other creditors. Meanwhile, the amended FIEA will regulate unfair trading — not only crypto asset exchange service providers but every person, including customers. Unfair trading includes engaging in fraudulent or deceptive acts, intimidation, and market manipulation; it does not include insider trading, which is not specifically prohibited.

The prohibition of unfair trading includes engaging in fraudulent acts, following but does not include prohibition of insider trading:

» Prohibition of unfair trading

» Prohibition of fraudulent acts, spreading rumors, using fraudulent means or intimidation

» Prohibition of market manipulation.

As set out in the discussion around virtual currency exchange services, the PSA regulates virtual currency exchange businesses but not standalone custody service providers. The amended PSA will regulate such custody service. The definition of custody is “to manage crypto assets for others except for the case such business is allowed in other laws.” Such custodial service providers will not be able to provide service to Japanese residents without a license.

As the definition of “custody service” is unclear, the types of custody businesses that will be regulated are still uncertain. Generally speaking, we believe that businesses that hold customers’ private keys and send/transfer crypto assets for customers will be regulated.

Amongst the regulations on crypto asset exchange service providers, the regulations on the management of the crypto assets (e.g., duty of customer identification/ KYC, segregated management of customers’ assets) would be applied to crypto asset custodial services, with the details thereof awaiting the cabinet office order on crypto assets exchange service providers to come.

III. REGULATIONS FOR ICOS

An ICO is a form of fundraising by selling so-called “coins” or “tokens”. The ICO remains a global topic that is being followed with untiring enthusiasm. Whereas, it was pointed out that such ICOs originated as breakthroughs to allow retail investment, some ran counter to user protection principles (e.g., the rights represented by the tokens were obscure, the business plan was lax/sloppy, or the scheme itself was fraudulent).
On October 27, 2017, the JFSA publicized its view in the paper “Initial Coin Offerings (“ICOs”) — users and service providers warning about the risks of ICOs”.

The JFSA alerted users and service providers of the risks of an ICO, specifically referring to the possible applications of the PSA and the FIEA as triggered by the structure of the token offering. The JFSA, seemingly, deems most ICO schemes to be subject to the regulations by the PSA and requires registration of the ICO issuer/platformer as a virtual currency exchange service provider. For the purpose of registration as an ICO issuer, the requisite level is still under discussion and remains to be defined by the JFSA. Consequently, ICOs that have launched after December 2017, when the JFSA began reviewing the registration process for ICOs, have done so without registering with the JFSA and may not be in compliance with the laws since registration is required.

A. THE REQUIREMENT TO REGISTER A VIRTUAL CURRENCY EXCHANGE SERVICE FOR ICOS

In order to conduct an ICO, even where the ICO tokens issued do not serve as a means of settlement or exchange facing unspecified persons, registration as a virtual currency exchange service and notification of the use of ICO tokens to the JFSA are required. The JFSA broadly construes the elements “can be used … for … paying”, “can also be purchased”, and “can be mutually exchanged with”, i.e., digital tokens may be deemed as Type I virtual currency (or Type II virtual currency, as the case may be) for so long as such coins have a possibility in the future to be used, purchased, and exchanged. By such interpretation by the JFSA, any ICO tokens may theoretically be used for settlement, sold or exchanged, etc.; thus, ICO tokens generally are deemed virtual currency.

Raising funds in fiat currency or in other virtual currency (such as bitcoin or ether) in exchange for an issuance of ICO tokens would constitute a virtual currency exchange service as in the definition of purchase and sale of a virtual currency (i.e., exchange between a virtual currency and a fiat currency) or exchange with another virtual currency.

B. THE POSSIBILITY OF BEING SUBJECT TO FUND REGULATIONS

As detailed above, some ICO tokens meet the definition of securities as well as the definition of virtual currency. Thus, amongst the statutorily defined items of securities, the term “collective investment schemes (fund)” is a broad and diverse concept. Certain ICOs may fall under such collective investment schemes, specifically where an ICO is intended (i) to collect fiat money from others, (ii) to invest in a business, and (iii) to pay dividends to holders.

C. REGULATIONS FOR ICOS TO BE LAUNCHED IN JAPAN

The regulations delineated above will apply indiscriminately to the ICOs carried out by foreign service providers so long as any Japanese resident is targeted or solicited for a subscription of tokens.

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In the event that any non-Japanese residents conduct an ICO while disregarding these regulations, the JFSA will alert such non-resident providers of the applicable Japanese regulations.

Currently, those wishing to solicit Japanese residents for subscriptions of ICO tokens must choose from the following two options while taking care to avoid inadvertently triggering the application of the fund regulations indicated above. The first such choice is to register as a virtual currency exchange service provider and sell tokens directly. The second is to delegate the sale of ICO tokens to a third party that is a registered virtual currency exchange service provider.

At the time of writing, no virtual currency exchange has been registered for the purpose of conducting an ICO, and from December 2017 onwards, no ICO has been launched as unequivocally in compliance with the laws. Still, ICO regulations are actively being discussed by the JFSA and JVCEA; thus, it is possible that Japan may be speedily equipped to host clear-cut legal ICOs in the near future. For the time being, however, since the timeframe for the registration process and the focal items examined in screenings remain obscure, it is virtually impossible to carry out an ICO in Japan under current law.

IV. THE FINANCIAL INSTRUMENTS EXCHANGE ACT

A. COMMON VIRTUAL CURRENCIES SUCH AS BITCOIN AND ETHER DO NOT FALL UNDER THE DEFINITION OF SECURITIES

The FIEA regulates financial instruments/securities/derivatives by exhaustively stipulating and defining them. For the FIEA to apply, the case must involve either “Negotiable Instruments/Securities” or “Derivatives” as defined therein. Common virtual currencies such as bitcoin and ether are not included in either “Negotiable Instruments/Securities” or “Derivatives.” Hence, as a general rule, the Act does not apply to the sale and purchase or exchange of virtual currency.

B. COLLECTIVE INVESTMENT SCHEMES ARE REGULATED BY THE FIEA

A recent trend that we have seen in global markets, including in Japan, is that more funds are formed in virtual currency. Among ICO tokens, we observe tokens such as the ones designed to represent rights to the distribution of profit derived from the business carried out, as financed by the proceeds of the token sale. Based on these trends, these funds and ICOs may constitute a collective investment scheme under the FIEA. Hence, the current investment fund regulations likely do not apply to those funds raised in virtual currency or via ICO when raising virtual currency but not fiat currency.

Essentially, the FIEA defines a “collective investment scheme” as a structure that has the following three elements, irrespective of its legal form:

1. receipt of money (including those specified by the Cabinet Order as similar thereto, hereinafter referred to as “money, etc.”) or contributions from other persons;
ii. such money is used to do business/projects; then,

iii. to distribute dividends of profits arising from such projects or distribute the assets of said business to investors or contributors of the said money.

To conduct a public offering or private placement of collective investment schemes in Japan generally, a fund must register as a Type II Financial Instruments Exchange Business be subject to the FIEA fund regulations.

To be clear, when tokens are offered in exchange for payment in virtual currency, such as bitcoin or ether, the FIEA Fund Regulations are unlikely to come into play since bitcoin and ether are not “money, etc.” under Japanese law. However, if someone sells bitcoin or ether in exchange for cash to investors and then collects such bitcoin and ether from the investors as an investment to a fund, the chain of actions as a whole may be deemed to constitute collecting “money, etc.” and, thus, may be regulated. Further, where such FIEA regulated funds are tokenized to be freely transferable, only the Private Trading System/PTS licensed operators pursuant to the FIEA may provide a secondary market for such tokens. Some believe that the quasi-financial instruments that are contributed not in “money, etc.” but in virtual currency should likewise be regulated by the FIEA. Such views are discussed in a report published by the JFSA Study Group on Virtual Currency Exchange Services (April 2018–). A prospective reform of the laws in this regard would deserve continued attention.

C. PROPOSED AMENDMENTS TO THE FIEA

1. REGULATIONS ON STOS

Tokens that grant their owners the rights to receive dividend of profits (Securities Token Offerings or “STO”) are defined in the amended FIEA as the “property rights indicated and transferred electronically (PRITE)”. PRITEs fall under a type of financial instruments identified in the FIEA as Paragraph 1 Securities and are subject to the provisions of the amended FIEA. PRITEs are excluded from the definitions of the amended PSA as currently proposed.

In the amendments to the FIEA, STOs as categorized under Paragraph 1 Securities will be subject to the requirements for Disclosure of Corporate Affairs and Other Related Matters in the same manner that shares are subject thereto. The person engaged regularly in the purchase and/or sale with respect to STOs and intermediary or brokerage thereof must register itself as a Type I Financial Instrument Operator. If an issuer sells STOs by himself, he must register as a Type II Financial Instrument Operator, which is less complicated than Type I.

19 Paragraph (3) Article 2, FIEA. Most typical examples of the Paragraph 1 Securities are shares and bonds.
As for the regulation of ICOs other than STOs, no major changes are being made by the legislative reform at this time. To conduct/carry out ICOs, it is believed that the registration of crypto assets exchange service providers and the filing of the coins/tokens with the JFSA will be required.

2. CRYPTO ASSETS DERIVATIVE TRANSACTIONS

Under the current FIEA, no specific provisions are set out in respect of the derivatives transactions with crypto assets as underlying assets. In the proposed amendments, the crypto assets are included in the definitions of financial instruments and crypto assets or financial indicators derivatives will be subject to the regulatory provisions in the FIEA in the same manner the FX transactions are currently subject thereto. Therefore, registration of Type I financial instrument exchange businesses will be required for the businesses to regularly engage in derivative transactions pertaining to crypto assets.

3. FUND REGULATIONS

As was stated in the discussion of obligations of virtual currency exchange service providers, provisions of the current FIEA would not apply to any fund (collective investment scheme) to which contribution is made in a virtual currency. In the proposed amendments to the FIEA, the crypto assets contributed by those who have the right to receive dividend of profits are deemed money. Therefore, the regulatory provisions in the FIEA will apply to funds contributed in crypto assets as consideration.

V. OTHER NOTABLE REGULATIONS

A. AML LAW REGULATIONS

The purpose of the AML Law is to prevent money laundering and the transfer of criminal proceeds and to ensure the appropriate enforcement of international treaties concerning the prevention of terrorist financing. The AML Law imposes such duties as listed below on certain specified business operators, including, but not limited to, financial institutions:

» Verification at the time of transaction of customer identification data (e.g., name, domicile, and date of birth).

» Preparation and preservation of verification records.

» Preparation and preservation of transaction records and other documents concerning prescribed transactions.

» Reporting of suspicious transactions (e.g., the proceeds of the transaction are suspected to be illicit) to the administrative agency with jurisdiction over the relevant specified business operator.
The AML Law now includes within its scope virtual currency exchange services. As a result, virtual currency exchange service providers are subject to the duties described above.

B. THE ACT REGULATING THE RECEIPT OF CONTRIBUTIONS, RECEIPT OF DEPOSITS, AND INTEREST RATES

When raising funds by way of ICO or virtual currency, care should be taken lest the fundraising inadvertently interfere with the Act that regulates the receipt of contributions, receipt of deposits, and interest rates (the Receipt of Contributions Act).

The Receipt of Contributions Act sets out provisions for, amongst others, restrictions on the receipt of contributions, the prohibition of receipt of deposits, punishment on usury, etc., but is all about transactions of money. Since virtual currencies do not, at least presently, qualify as money, an act of receiving deposits in virtual currencies is excluded from the regulations under the Receipt of Contributions Act.

On the other hand, raising fiat money by way of selling ICO tokens or virtual currency with a promise to refund the entire amount of the contribution or money equivalent to an amount exceeding the contribution as reimbursement at a later date might be deemed as such prohibited receipt of deposits under the Receipt of Contributions Act. When making a judgment if the Receipt of Contributions Act applies to any given transaction, consider first specifically and concretely the substance of such transaction such as a scheme but not whether the transaction technically is to receive contributions in virtual currency.

C. THE MONEY LENDING BUSINESS ACT

Where virtual currency is being lent as a business or on a regular basis, such business of lending virtual currency would not constitute “money lending” under the Money Lending Business Act by the fact that virtual currency may not be deemed as money.

Where a virtual currency exchange service offers advances or money lending to users through offering margin trading or leverage trade, pursuant to the Money Lending Business Act, the service provider shall be registered by the relevant local finance bureau that is authorized by the Prime Minister.

Making a loan in virtual currency currently does not constitute any act obliged to be registered as a virtual currency exchange service.

D. FOREIGN EXCHANGE AND FOREIGN TRADE ACT

Under the Foreign Exchange and Foreign Trade Act, (i) when a resident or a non-resident has received a payment made from Japan to a foreign state or a payment made from a foreign state to Japan, or (ii) when a resident has made a payment to a non-resident in Japan or in a foreign state, the resident
or non-resident in the case of (i), or the resident in the case of (ii) shall report such to the Minister of Finance, except cases specified by the Cabinet Order (e.g., payment not exceeding JPY 30 million). Such mandatory reporting to the minister of finance for payment or receipt of payment exceeding JPY 30 million, such as between residents and non-residents or from a foreign state to Japan, does not leave out relevant transfers just because they are settled in virtual currency, since the intent of the law is to grasp any such transfer “identified as equivalents” of extinguishment of claims and obligations or as a transfer of value.

VI. PREPAID PAYMENT INSTRUMENTS

Digital tokens deemed not to constitute virtual currency may be considered “Prepaid Payment Instruments” depending on their characteristics.

Under the PSA, “Prepaid Payment Instruments” means any of the following:

i. Certificates, electronic devices, or other items (“Certificates, etc.”) or numbers, markings, or other signs (including additions to the amount recorded in the Certificate by electronic or magnetic means in exchange for the receipt of consideration corresponding to the additional amount recorded) issued in exchange for the receipt of consideration corresponding to the amount (in cases where the amount is found each time to be converted to and indicated as an amount expressed in another unit, including the number of that unit; the same applies hereinafter) recorded in the Certificate or recorded using electronic or magnetic means (meaning in electronic form, magnetic form, or any other form that is impossible to perceive through the human senses alone; the same applies hereinafter), which can be used for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services from the issuer or the person designated by the issuer (“Issuer, etc.”) by way of presentation, delivery, notification, or other means;

ii. Certificates, or numbers, markings, or other signs issued in exchange for the receipt of consideration corresponding to the quantity of goods or services recorded in the Certificate, etc. or recorded using electronic or magnetic means (including additions to the quantity of goods or services recorded in the Certificate, etc. by electronic or magnetic means in exchange for the receipt of consideration corresponding to the additional quantity recorded), which can be used for the purpose of claiming the delivery or provision of those goods or services from the Issuer, etc. by way of presentation, delivery, notification, or other means.

The above definitions are analyzed into the following three (3) elements: (a) property value typically in pecuniary amount is being recorded; (b) issued in exchange for the receipt of consideration corresponding to the amount; and (c) can be used for the purpose of paying consideration for the

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purchase or leasing of goods or the receipt of provision of services. Examples of Prepaid Payment Instruments include Suica, Web Money, and BitCash.

A. REGULATION OF PREPAID PAYMENT INSTRUMENTS

Prepaid Payment Instruments are divided into two categories: a) Prepaid Payment Instruments for Own Business and b) Prepaid Payment Instruments for Third-Party Business.

“Prepaid Payment Instruments for Own Business” means Prepaid Payment Instruments that can be used for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services solely from the issuer of Prepaid Payment Instruments (including persons who have a close relationship specified by Cabinet Office Order with that issuer (“Closely Related Persons”)) or those Prepaid Payment Instruments that can be used for the purpose of claiming the delivery or provision of those goods or services only from the issuer of Prepaid Payment Instruments.

“Prepaid Payment Instruments for Third-Party Business” means Prepaid Payment Instruments other than Prepaid Payment Instruments for Own Business.

Any person may issue Prepaid Payment Instruments for their Own Business. When the unused/outstanding balance as of March 31 and September 30 (such semi-annual dates are base dates) has exceeded the standard amount of JPY 10 million, the issuer must submit a written notice to the director-general of the relevant local finance bureau or local finance branch bureau. In contrast, no person may engage in the business of issuing Prepaid Payment Instruments for a Third-Party Business unless the person is a corporation registered with the director-general of the relevant local finance bureau or local finance branch bureau.

Those who are registered with respect to the Prepaid Payment Instruments for their Own Business and those who are registered in respect of the Prepaid Payment Instruments for a Third-Party Business are subject to the code of conduct rules for the Prepaid Payment Instruments (e.g., Provision of Information on the issuer and the “Prepaid Payment Instruments”, Making of Security Deposits for Issuance, Prohibition in principle of refunds to the holders of Prepaid Payment Instruments, Complaint Processing Measures, Information Security Management).

VII. OUTLOOK FOR VIRTUAL CURRENCY REGULATION IN JAPAN

The regulation of “virtual currency” in Japan was perceived as advanced and forward-looking when regulations were first published in 2016. However, a lot has happened since then, and regulatory framework has thus started to lag behind the fast-paced technological development.

As stated above, amendments to the PSA and FIEA regarding crypto assets will be tighter than those currently imposed. Further regulation, however, is not all bad. Some of the advantages include, amongst
others, increased market transparency due to clarity around consumer/investor protection requirements, the possibility of using ICOs and STOs for capital raising, and structuring and promoting the use of financial derivatives products utilizing crypto assets (e.g., crypto assets derivatives transactions).

In this way, the tightening of regulations may not necessarily hinder innovation; however, additional work remains to be done before the updates are completed.
Legal Landscapes Governing Digital Tokens in Japan