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TLAC'S TOLL

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Managing the groundswell

Atsumi & Sakai's Yuri Suzuki and Takafumi Ochiai identify Japan's legal and regulatory hurdles to be overcome in the world of fintech business

Interest in financial technology (fintech) has intensified globally in recent years, and Japan is no exception. With Japan's Financial Services Agency (FSA) driving forward new regulatory changes, the country appears poised to experience a surge in fintech activity, and overseas fintech startups, vendors and financial institutions are showing an interest in doing business in Japan.

Banking and related services

Banking in Japan covers acceptance of deposits, lending and exchange transactions (*kawase torihiki*), and requires a licence under the Banking Act. Obtaining the licence is quite onerous and it is unlikely that a fintech company would be eligible for one. In order to protect depositors, the Banking Act also restricts the types of businesses that banks may conduct to certain specific services. As these restrictions may restrain the development of fintech in Japan, in March 2016 the FSA submitted to the Diet draft revisions aimed at relaxing the Banking Act and related laws (Proposed Amendments).

The Act Regulating the Receipt of Contributions, Receipt of Deposits, and Interest Rates (Contributions Act) prohibits any person or entity from conducting the business of accepting deposits unless they are permitted to do so under another law (for example, the Banking Act). The acceptance of deposits, therefore, is effectively limited to banks and deposit-taking institutions.

Exchange transactions are not defined in the Banking Act, but according to a Supreme Court decision, 'conducting an exchange transaction' means accepting a request from a customer to transfer funds using the mechanism of transferring funds between parties at a distance without actually transporting cash, or accepting and actually carrying out the request. If this definition is applied to a payments service, something that many fintech businesses are involved in, the operator could be required to obtain a banking licence or register under the Payment Services Act (PSA). Various payment services are affected by the Supreme Court's interpretation of the term 'exchange transactions'.

Payments (fund transfer services)

While the Banking Act regulates exchange transactions, the PSA allows non-banks registered under the PSA to engage in exchange transactions in the course of their business even if not permitted under the Banking Act, provided that the amount of each exchange transaction is not greater than one million yen (\$9,200). However, as this threshold is quite low, PSA registration is not really of much help to growing fintech startups that provide funds transfer services. Those with operations overseas should also note that the PSA is applied extraterritorially, in that a foreign funds transfer service provider not registered under the PSA cannot solicit its exchange transaction services to persons in Japan.

Electronic money

Electronic money (such as stored-value cards and mobile phones) is more prevalent in Japan than debit cards. The PSA regulates the issuance of prepaid payment instruments, including electronic money. A company that wishes to engage in the business of issuing prepaid payment instruments for a third party's business is required to be registered under the PSA. Persons engaging in the business of issuing prepaid payment instruments outside of Japan must not solicit people in Japan for that business.

Lending to EC operators

As elsewhere, electronic commerce (EC) mall operators have begun offering online lending in Japan. A typical process would, for example, involve screening EC operators (online sellers) by analysing settlement information, performance, seasonal variations and industry trends, then calculating a loan limit and interest rate, and remitting the funds, often all within one day. In such a case, the EC mall operator needs to be registered as a moneylender under the Money Lending Business Act (MLBA) in order to be able to provide the loans. The MLBA does not distinguish between lending to corporations and lending to individuals, so the strict operational and supervisory provisions (including delivery of certain documents to borrowers) apply even when providing loans to companies. Overseas moneylenders should note that while the MLBA could be applied to cross-border lending by them to persons or entities in Japan (though this is not certain), they cannot be registered under the MLBA without having a place of business in Japan.

Peer-to-peer lending

For a business operator to intermediate bilateral loans, both the operator and the lender must be registered as moneylenders under the MLBA. This effectively restricts the operation of peer-to-peer lending (P2P lending) in Japan. Instead, social lending or crowdfunding-type lending generally takes the form of a *tokumei kumiai* (TK) partnership, under which an operator collects funds from TK partnership investors, then advances the funds to enterprises as loans. The operator then receives the principal and interest payments from the enterprises and distributes them as dividends and repayment of capital to the investors. In this structure, the operator is required to be registered both as a moneylender under the MLBA (in order to provide the loans), and as a financial services provider under the Financial Instruments and Exchange Act (FIEA) in order to solicit TK partnership investors.

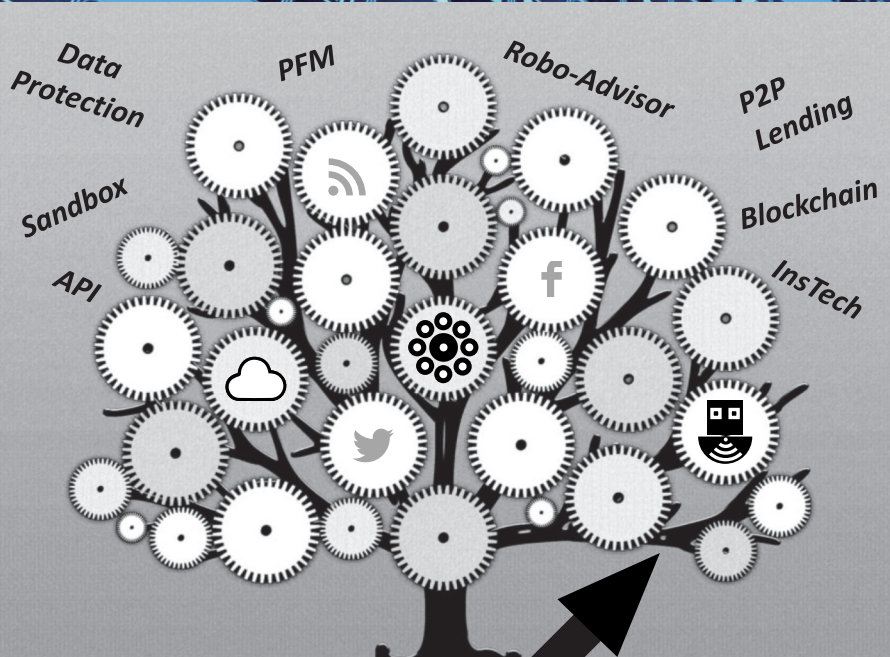
Investment advising

The FIEA defines 'investment advisory and agency services' as:

'the conclusion of a contract in which one of the parties promises to provide the other party advice about the value of securities or investment decisions based on an analysis of the value of financial instruments, and the other party promises to pay consideration for this, and providing advice under that contract.'

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It requires any person or entity providing such services to be registered.

Robo-advisor-type portfolio management services could be viewed as requiring such registration, but the position is not clear.

Credit cards

The credit card business in Japan primarily involves cash advances and purchasing on credit. A credit card company that provides cash advances and credit purchases must, with certain exceptions, register as a moneylender under the MLBA and as a 'card provider of credit for comprehensive purchase transactions' under the Installment Sales Act (ISA). The ISA is important in a fintech context in that it regulates credit cards which are commonly used by consumers for payments in e-commerce. In response to recent trends in the credit card market where 'off-us' transactions are becoming more popular than 'on-us' transactions, there is discussion now about the introduction under the ISA of a mandatory registration system for acquirers and a voluntary registration system for payment service providers.

Virtual currencies

The Mt Gox bankruptcy in Japan in 2014 sent ripples across the virtual currency market. Some customers filed a lawsuit demanding the bankruptcy trustee return their bitcoins. This case attracted a great deal of public attention, particularly when the Tokyo District Court ruled that bitcoins were not subject to ownership (a decision that has prompted debate among lawyers and scholars). The Proposed Amendments include measures against money laundering and proposed provisions on virtual currencies, such as bitcoin, for the purpose of protecting their users. 'Virtual currency' as referred to in the Proposed Amendments means a currency that may be used for settlement and which is exchangeable with statutory currencies. This

Financial services and primary legislation applicable to fintech

Acceptance of deposits	Banking Act, Contributions Act
Exchange transactions	Banking Act
Fund transfer services	PSA
Electronic money	PSA
Lending	Banking Act, MLBA
Crowdfunding lending	MLBA, FIEA
Investment advising	FIEA
Credit cards	ISA, MLBA
Virtual currency	PSA*

* Subject to the enactment of the Proposed Amendments.

would recognise a virtual currency as having the function of currency, though does not conflict with the previous view of the Japanese government that bitcoin has no legal force and is not considered a currency.

The Proposed Amendments to the PSA define engaging in the business of the sale and purchase of virtual currencies, or the exchange of a virtual currency with another virtual currency, as 'virtual currency exchange business' and would prohibit virtual currency exchange business by any person other than corporations registered under the PSA for that purpose. Only foreign companies with a place of business in Japan would be permitted to register as foreign virtual currency exchange business operators.

The Proposed Amendments would also apply the Act on Prevention of Transfer of Criminal Proceeds to virtual currency exchange business operators, requiring them to verify the identity of users at the time of opening accounts, and to report any suspicious transactions to the authorities, in order to help prevent money laundering and the financing of terrorism



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Yuri Suzuki specialises in banking & finance, structured finance, IT, M&A, international transactions, and international trade. She is the head of the firm's fintech team and a member of the administrative board of Fintech Association Japan. She is also co-author of 'Innovation by Banks and Fintech Companies A Summary of FinTech Issues from the Perspective of Financial and IT Law' Financial Law Journal, Kinzai Institute for Financial Affairs (February, 2016).

Suzuki is qualified as an attorney (*Bengoshi*) in Japan (2001) and holds a law degree from Waseda University (1997) and an LLM from New York University (2005). She has been a partner at Atsumi & Sakai since 2008 and a trustee of the Japan Institute of Life Insurance since 2015. She worked in the Chicago office of Kirkland & Ellis in 2005/6.



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