

Newsletter

An abstract background graphic consisting of a grid of lines that curves and spirals, creating a tunnel-like effect. The colors transition from yellow-green at the top to blue and purple at the bottom.

2019 AMENDMENTS TO
THE PAYMENT SERVICES ACT, ETC.
New Legislation for Crypto-assets and More

2019 Amendments to the Payment Services Act, etc. **- New Legislation for Crypto-assets and More -**

On March 15, 2019, the Financial Services Agency of Japan (“FSA”) submitted to the Diet a bill¹ to amend the Payment Services Act, etc. in response to diversification of financial transactions associated with the development of information communication technology. The laws that are proposed to be amended include the Payment Services Act (“PSA”), the Financial Instruments and Exchange Act (“FIEA”) and other financial services laws. The main feature of the bill is the change of the defined legal term from “virtual currencies” to “crypto-assets”, additional restrictions on crypto-asset exchange and management services, the introduction of new regulatory framework for margin trading and Initial Coin Offering (“ICO”). In this newsletter, we outline the proposed amendments by the bill.

I. From “Virtual Currencies” to “Crypto-assets”

In light of usage of “crypto-assets” by the G20, the name of the defined legal term will be changed from “virtual currencies” to “crypto-assets”. The background of this change is that most of such assets do not function as money as the Basel Committee pointed out in its recent newsletter².

II. Proposed Amendment to the Payment Services Act regarding Crypto-assets

1. New requirement to administer customers’ crypto-assets

There were two theft cases where customers’ crypto-assets kept in a hot wallet (online) by crypto-assets exchange service providers were lost by hacking. To address the risks of crypto-assets leakages, additional requirements will be provided for exchange service providers:

- (i) A crypto-assets exchange service provider will be required to separately hold and manage users’ crypto-assets by a method less likely to lack user protection (e.g., in a cold wallet). In addition, it will be required to hold crypto-assets of the same type and amount (“Performance Bond Crypto-assets”) as those of users that are managed by other methods (e.g., in a hot wallet) and separately manage them by a method less likely to lack user protection; and
- (ii) A user who engages a crypto-assets exchange service provider to manage its crypto-assets will have the right to repayment of its crypto-assets and Performance Bond Crypto-assets managed by such crypto-assets exchange service provider in preference to other creditors.

2. New regulations of advertising / promotions against crypto-asset exchange service providers

Advertisements and promotions that encourage speculative trading can be often seen on the internet. The bill proposes that a crypto-assets exchange service provider will be prohibited

¹ <https://www.fsa.go.jp/common/diet/index.html> (only in Japanese)

² Statement on crypto-assets (https://www.bis.org/publ/bcbs_nl21.htm)

from making false statements in its advertisements and promotions and that regulations regarding advertising of crypto-assets exchange services will be established.

3. New Regulatory Framework of Custody Service Providers

Under the current PSA the administration of crypto-assets as a business in relation to a crypto-assets exchange is regulated, but custody service providers that exclusively manage crypto-assets are not regulated. The Financial Action Task Force (FATF) recommends countries to ensure that virtual asset service providers which includes a service provider of safekeeping and/or administration of virtual assets or instruments be regulated for AML/CFT purposes, and licensed or registered³. In response to the FATF's recommendation, custody service will be added to the definition of crypto-assets exchange services so that the custody service providers will be regulated by the AML/CFT regulations and required to be registered with the FSA.

III. Proposed Amendment to the Financial Instruments and Exchange Act regarding Crypto-assets

1. New regulatory framework of margin trading using crypto-assets

Even though 80 percent of crypto-assets transactions in Japan are margin trading, there are no regulations to restrict margin trading. As such, the bill proposes to establish regulations similar to those for foreign-exchange margin trading (Forex trading) by amending FIEA. Proposed amendments to FIEA include:

- (i) Crypto-assets will be added to the definition of financial instruments, and thus derivatives transactions using crypto-assets will become subject to regulations; and
- (ii) In terms of the services related to derivatives transactions using crypto-assets provided by financial instruments business operators, rules such as the obligation of accountability, etc. will be provided.

2. New regulatory framework of ICO tokens that grant rights to receive distribution of profits

To clarify the regulatory framework of ICOs, investment type ICOs will be regulated by the securities regulations (i.e., FIEA) and thus, as with stocks, a system of disclosure to investors and regulations of offering and solicitation will be established. Rights, etc. to receive distribution of profits that are indicated in property value (limited to those recorded on electronic devices or other objects by electronic means) that may be transferred using the electronic data processing system (the "Rights to Transfer Electronically-Recorded Claims") will be deemed to be Paragraph (1) Securities (e.g., stocks), which will be subject to the system of disclosure of corporate affairs, etc. In addition, selling and purchasing the Rights to Transfer Electronically-Recorded Claims as a business will become subject to the regulations pertaining to Type I Financial Instruments Business (e.g., securities companies).

³ The FATF Recommendations updated October 2018
(<http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>)

3. Prohibition of unfair price manipulation of crypto-assets, etc.

It was reported that unfair activities are sometimes seen in crypto-assets transactions. As such the bill proposes to add provisions to prohibit improper conduct, spreading rumors and price manipulation in relation to crypto-assets transactions and derivatives transactions using crypto-assets.

IV. Addition of the Services of Providing Customer Information to Third Parties to the Scope of Businesses of Financial Institutions

The scope of businesses that can be conducted by banks, financial instruments business operators and insurance companies, etc. are restricted by the Banking Act, FIEA and the Insurance Business Act, etc. For the purposes of utilizing the information and data, the provision of customer information to third parties with the consent of customers and provision of other information in possession to third parties that will contribute to the sophistication of the financial service businesses or improvement of convenience of users will be added to the incidental services of banks, financial instruments business operators and insurance companies, etc.

V. Proposed Amendment to the Insurance Business Act

Under the Insurance Business Act there are restrictions on the scope of businesses that can be conducted by subsidiaries of insurance companies. To enable the subsidiaries to conduct Fintech and Insurtech businesses fully, insurance companies will be allowed to acquire or hold, with authorization, in excess of the maximum threshold for voting rights held, the voting rights of companies providing services that contribute or are expected to contribute to the sophistication of the insurance business using information and communication technology and other technologies or improve the convenience of users.

Once the bill passes both Diet's chambers, these amendments will be effective one year after the promulgation of the legislation which is expected to be sometime next year.

For further information on these matters, please contact:

Yuri Suzuki

Attorney (*Bengoshi*), Japan
Partner, Atsumi & Sakai
E: yuri.suzuki@aplaw.jp

Takafumi Ochiai

Attorney (*Bengoshi*), Japan
Partner, Atsumi & Sakai
E: takafumi.ochiai@aplaw.jp

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Atsumi & Sakai

www.aplaw.jp/en/

Tokyo Office: Fukoku Seimei Bldg., 2-2-2 Uchisaiwaicho, Chiyoda-ku, Tokyo 100-0011, Japan

London Office: 4th Floor, 50 Mark Lane, London EC3R 7QR, United Kingdom

Frankfurt Office: Taunusanlage 21 60325 Frankfurt am Main Germany

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