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## Revisions to Payment Services Act Provisions, etc. on Crypto Assets<sup>1</sup>

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On March 15, 2019, the Financial Services Agency (the “**FSA**”) submitted a bill (the “**Bill**”) to the Diet for the revision of certain legislation governing virtual currencies, including the Payment Services Act (the “**PSA**”), the Financial Instruments and Exchange Act (the “**FIEA**”), and the Act on Sales, etc. of Financial Instruments (the “**ASFI**”). The following is a summary of the key revisions proposed.

### **PSA Revisions**

- (i) Revision of the term “virtual currency” to “crypto asset”
- (ii) Enhancement of regulation of crypto asset custody services
- (iii) Tightening of regulations governing crypto asset exchange services

### **FIEA Revisions**

- (i) Establishment of “electronically recorded transferable rights” (“**ERTRs**”) and regulations applicable thereto
- (ii) Introduction of regulations governing crypto asset derivative transactions
- (iii) Introduction of regulations governing unfair acts in crypto asset or crypto asset derivative transactions

### **ASFI Revisions**

- (i) Application of the ASFI to crypto asset sales and similar transactions

The Bill will come into force within a year of its introduction, upon its passage by both chambers of the Diet. Once passed into law, the Bill will significantly reshape the regulatory

<sup>1</sup> We have also issued a newsletter in Japanese on the same topic in April 2019, which can be found at the following link (although this newsletter is not a literal translation of the Japanese newsletter):  
[https://www.amt-law.com/asset/pdf/bulletins2\\_pdf/190409.pdf](https://www.amt-law.com/asset/pdf/bulletins2_pdf/190409.pdf)

landscape surrounding crypto assets in Japan. This newsletter provides an outline of the Bill.

## 1 General

The sale, exchange and similar transactions in respect of virtual currencies were first regulated in Japan when revisions to the PSA and the Act on Prevention of Transfer of Criminal Proceeds (the “**APTCP**”) came into effect in April 2017. These regulations provided a regulatory framework that focused primarily on the protection of users through various requirements including minimum capital, information disclosure, separation of assets under management, and system security, achieved via a system requiring the registration of virtual currency exchange service providers. Provisions such as those requiring personal identification were also introduced to the PSA and APTCP, to prevent money laundering and terrorist financing. However, several incidents involving leakage of users’ virtual currency information exposed the inadequacy of the security systems maintained by virtual currency service providers. Moreover, virtual currencies are being increasingly used for speculative reasons, rather than as a means of settlement.

In light of this situation, the FSA in March 2018 established a “Study Group on Virtual Currency Exchange Business, etc.” (the “**Study Group**”) to assess the adequacy of regulatory measures in addressing issues surrounding virtual currency exchange services. This was followed by the publication of the Study Group’s report (the “**Report**”) on December 21, 2018. Besides summarizing the results of the Study Group’s deliberations, the Report also proposed a new legal framework to govern virtual currencies<sup>2</sup>, which led to the introduction of the Bill. Tabled before the Diet on March 15, 2019, the Bill contains proposed revisions to the PSA (the “**PSA Revisions**”), based mainly on the proposals in the Report. At the same time, the Bill proposes revisions to the FIEA (the “**FIEA Revisions**”) and to the Act on Sales, etc. of Financial Instruments (the “**ASFI Revisions**”), primarily for purposes of strengthening the regulatory framework surrounding cryptocurrencies.

The following is a summary of the key revisions proposed under the Bill.

### PSA Revisions

- (i) Revision of the term “virtual currency” to “crypto asset”
- (ii) Enhancement of regulation of crypto asset custody services
- (iii) Tightening of regulations governing crypto asset exchange services (“**Crypto Asset Exchange Services**”)

### FIEA Revisions

- (i) Establishment of ETRRs and regulations applicable thereto
- (ii) Introduction of regulations governing crypto asset derivative transactions

<sup>2</sup> For more details, please refer to our firm’s newsletter entitled “Outline of the Report from the “Study Group on the Virtual Currency Exchange Services”, published in February 2019.

- (iii) Introduction of regulations governing unfair acts in crypto asset or crypto asset derivative transactions

### **ASFI Revisions**

- (i) Application of the ASFI to crypto asset sales and similar transactions

The key points of the respective revisions are discussed below.<sup>3</sup>

## **2 PSA Revisions**

The PSA Revisions proposes the following changes to the current regulatory system governing crypto asset exchange service providers (“**Crypto Asset Exchange Service Providers**”), both to enhance protection of users and to clarify the rules relating to Crypto Asset Exchange Service Providers:

- (i) revision of the term “virtual currency” to “crypto asset”;
- (ii) enhancement of regulation of crypto asset custody services;
- (iii) expansion of grounds on which applications for registration as Crypto Asset Exchange Service Provider may be rejected;
- (iv) introduction of a system of advance notification for any proposed amendment to certain matters in respect of the relevant crypto asset, such as the name thereof;
- (v) introduction of regulations governing advertisement and solicitation in respect of Crypto Asset Exchange Services;
- (vi) introduction of disclosure requirements where crypto assets are exchanged (or where certain similar transactions are undertaken) via the grant of credit to users;
- (vii) enhancement of the obligation on Crypto Asset Exchange Service Providers to preserve users’ assets; and
- (viii) grant of rights to users to enable their receipt of preferential payment when claiming for the return of crypto assets.

Each of these items is explained in more detail below.

### **2-1 Revision of the Term “Virtual Currency” to “Crypto Asset”**

The term “*kaso tsuka*” (virtual currency) under the PSA is a direct Japanese translation of the term “virtual currency”. This term has been used by the Financial Action Task Force and can also be found in many cryptocurrency-related laws across multiple jurisdictions, including Japan. As the expression “crypto asset” has seen increased usage in recent international discussions, however, and because the term “virtual currency” could mislead the public into thinking that a legal currency is involved, it has been proposed under Article 2, Paragraph 5 of the revised PSA to amend the term “virtual currency” to “crypto asset”.

We note, however, that the existing definition of “virtual currency” will remain unchanged.

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<sup>3</sup> This newsletter does not discuss those parts of the Bill that are not directly related to crypto assets.

Accordingly, it is generally understood that the change in reference from “virtual currency” to “crypto asset” will result in no substantive change to the legal interpretation of the term. (Hereafter, for purposes of this newsletter, the term “crypto asset” will be used.) With that said, Article 2, Paragraph 5 of the revised PSA clarifies that the definition of “crypto asset” does not include assets that confer ETRs (or so-called security tokens), referred to in Article 2, Paragraph 3 of the revised FIEA. This clarification seeks to prevent any redundant application of the PSA to such assets.

## 2-2 Regulations on Crypto Asset Custody Services

The PSA currently provides that management of users' money or crypto asset in connection with (i) any sale or purchase of a crypto asset or exchange of a crypto asset for another crypto asset, or (ii) any intermediary, brokerage or agency service for the acts listed in item (i), constitutes provision of a Crypto Asset Exchange Service.<sup>4</sup> Based on this, it is generally understood that the mere act of managing users' crypto asset and transferring such crypto asset to an address designated by users (“**Crypto Asset Custody Service**”) does not constitute a Crypto Asset Exchange Service, provided none of the acts listed in items (i) and (ii) above is performed.

It was highlighted in the Report, however, that Crypto Asset Custody Services (“**Crypto Asset Custody Service**”) share common risks with Crypto Asset Exchange Services (“**Crypto Asset Exchange Services**”). These risks include leakage of users' crypto assets (“**User Crypto Assets**”), bankruptcy of service providers, and risks associated with money-laundering and terrorism-financing.

To address this, the PSA Revisions provides that managing crypto assets for the benefit of another person constitutes a Crypto Asset Exchange Service, “unless otherwise specifically stipulated under any other law in cases where the relevant management activity is performed in the course of a business”. As a result of this provision, a Crypto Asset Custody Service would also constitute a Crypto Asset Exchange Service, even if the Crypto Asset Custody Service does not involve any acts listed in items (i) and (ii) above.<sup>5</sup>

Regarding the carve out encapsulated by the language “unless otherwise specifically stipulated under any other law in cases where the relevant management activity is performed in the course of a business”, it would seem, for example, that a trust company operating under the Trust Business Act, or a trust bank operating under the Act on Engagement in Trust Business Activities by Financial Institutions would not be required to undergo registration as a Crypto Asset Exchange Service Provider.

## 2-3 Addition of the Reasons for Refusal of the Registration as Crypto Asset Exchange Service Provider

Under the existing provisions of the PSA, membership in the Certified Association for Payment Service Providers (the “**PSP Association**”) is not a prerequisite for registration as a Crypto Asset

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<sup>4</sup> Article 2, Paragraph 7, Item 3 of the PSA.

<sup>5</sup> Article 2, Paragraph 7, Item 4 of the revised PSA.

Exchange Service Provider.

The PSA Revisions, however, effectively reverses this by stipulating that an application for registration as a Crypto Asset Exchange Service Provider may be rejected on the grounds that the applicant is not a member of the PSP Association and has failed to establish (i) internal regulations equivalent to the self-regulatory rules adopted by the PSP Association or (ii) comparable compliance systems.<sup>6</sup>

## **2-4 Advance Notification for Proposed Amendment of Certain Matters (e.g., Name of the Relevant Crypto Asset)**

The current provisions of the PSA requires a Crypto Asset Exchange Service Provider to provide a post-factum notification to the FSA<sup>7</sup> if there has been any change in the information described in its registration application.<sup>8</sup>

By contrast, the PSA Revisions require a Crypto Asset Exchange Service Provider to notify the FSA in advance before changing any of the following information set forth in its registration application: (i) the proposed name of the relevant crypto asset, (ii) the terms of its crypto asset exchange services and (iii) the means by which such services will be provided.<sup>9</sup>

## **2-5 Introduction of Regulations Governing Advertisement and Solicitation in respect of Crypto Asset Exchange Services**

### **2-5-1 Disclosure Obligations in respect of Advertisements**

Currently, advertisements and solicitation in respect of Crypto Asset Exchange Services are not regulated by the PSA. To address the potential risks to users that may arise from such lack of regulation, the PSA Revisions require the following items to be disclosed in advertisements of Crypto Asset Exchange Services by Crypto Asset Exchange Service Providers, in accordance with the provisions of the relevant Cabinet Office Ordinance:<sup>10</sup>

- (i) the trade name of a Crypto Asset Exchange Service Provider;
- (ii) the fact that the service provider is a Crypto Asset Exchange Service Provider, together with its registration number;
- (iii) the fact that the crypto asset does not constitute Japanese Yen or any other foreign currency; and
- (iv) the nature of the relevant crypto asset or such other information (as specified in the relevant Cabinet Office Ordinance) necessary to enable users to form appropriate judgments on the crypto asset.

<sup>6</sup> Article 63-5, Item 6 of the revised PSA.

<sup>7</sup> Such notifications are submitted to the FSA, as proxy for the Prime Minister.

<sup>8</sup> Article 63-6, Paragraph 1 of the PSA.

<sup>9</sup> Article 63-6, Paragraph 1 of the revised PSA.

<sup>10</sup> Article 63-9-2 of the revise PSA.

The PSA Revisions further subject the relevant person at the Crypto Asset Exchange Service Provider responsible for any failure to make the required disclosure to punishment by imprisonment for a term not exceeding six (6) months or a fine not exceeding JPY500,000, or both.<sup>11</sup> Additionally, juridical persons (including corporations) are also subject to dual liability for such failure and are punishable by a fine not exceeding JPY500,000.<sup>12</sup>

## 2-5-2 Prohibited Acts in respect of Advertisements/Solicitation

As part of the new regulations on advertisements and solicitation, the PSA Revisions also prohibit a Crypto Asset Exchange Service Provider or any of its officers from engaging in any of the following:<sup>13</sup>

- (i) making any misrepresentation or representation under a Crypto Asset Exchange Agreement<sup>14</sup> that is likely to lead to an inaccurate understanding of the nature or any other aspects of a crypto asset;<sup>15</sup>
- (ii) making any misrepresentation or representation in an advertisement concerning a Crypto Asset Exchange Service that is likely to lead to an inaccurate understanding of the nature or any other aspects of a crypto asset;
- (iii) making a representation under a Crypto Asset Exchange Agreement or in an advertisement concerning a Crypto Asset Exchange Service, to induce the sale or purchase of a crypto asset or the exchange of a crypto asset for another crypto asset that is (i) not for the purpose of using the relevant crypto asset as a means of payment, but (ii) for the exclusive purpose of promoting the interests in a particular crypto assets;
- (iv) Such other acts specified in the relevant Cabinet Office Ordinance as being likely to result in (i) insufficient protection of Crypto Asset Exchange Service users or (ii) inappropriate performance or inadequate security in the performance of any Crypto Asset Exchange Service.

Any person at a Crypto Asset Exchange Service Provider who engages in the act referred to in item (i) above is punishable by imprisonment for a term not exceeding one (1) year or a fine not exceeding JPY 3.0 million, or both.<sup>16</sup> Additionally, juridical persons (including corporations) are also subject to dual liability for such act and are punishable by a fine not exceeding JPY 200 million.<sup>17</sup>

Any person at a Crypto Asset Exchange Service Provider who engages the act referred to in item (ii) or (iii) above is punishable by imprisonment for a term not exceeding six (6) months or a fine not

<sup>11</sup> Article 112, Item 9 of the revised PSA.

<sup>12</sup> Article 115, Paragraph 1, Item 4 of the revised PSA.

<sup>13</sup> Article 63-9-3 of the revised PSA.

<sup>14</sup> A "Crypto Asset Exchange Agreement" means an agreement between a Crypto Asset Exchange Service Provider and a user of Crypto Asset Exchange Services under which Crypto Asset Exchange Services are provided to, or interest in such services are solicited from, the user (Article 63-9-3, Item 1 of the revised PSA).

<sup>15</sup> "Nature or any other similar items of a crypto asset" means nature or any other items of a crypto asset specified by Cabinet Office Ordinance (Article 63-9-3, Item 1 of the revised PSA).

<sup>16</sup> Article 109, Item 8 of the revised PSA.

<sup>17</sup> Article 115, Paragraph 1, Item 2 of the revised PSA.

exceeding JPY500,000, or both.<sup>18</sup> Additionally, juridical persons (including corporations) are also subject to dual liability for such acts and are punishable by a fine not exceeding JPY500,000.<sup>19</sup>

## **2-6 Introduction of Disclosure Requirements where Crypto Assets are Exchanged (or where Certain Similar Transactions are Undertaken) via the Grant of Credit to Users**

To enhance the protection of users, the PSA Revisions require a Crypto Asset Exchange Service Provider, when exchanging a crypto asset or when engaging in a similar act through the grant of credit to users, to take appropriate measures for the protection of users, such as disclosing certain information regarding the relevant crypto asset exchange agreement or similar measures, pursuant to the provisions of the relevant Cabinet Office Ordinance.<sup>20</sup>

Such “grant of credit” is understood to include the lending of crypto assets in addition to the lending of money. Based on this, a Crypto Asset Exchange Service Provider that lends money or crypto assets to users for purposes of enabling such users to buy or sell crypto assets is required to make information disclosures pursuant to the PSA Revisions. (As a side note, any entity that wishes to lend money in the course of a business is also required to undergo registration as a moneylending business.)

## **2-7 Enhancement of Obligation on Crypto Asset Exchange Service Providers to Preserve Users’ Assets**

### **2-7-1 Obligation to Entrust Users’ Money**

The PSA currently requires a Crypto Asset Exchange Service Provider to manage users’ money separately from the Crypto Asset Exchange Service Provider’s own money.<sup>21</sup>

Under the PSA Revisions, however, a Crypto Asset Exchange Service Provider is required to both manage the money of users separately from its own money, and to entrust users’ money to a trust company or any other similar entity in accordance with the provisions of the relevant Cabinet Office Ordinance.<sup>22</sup> In other words, a Crypto Asset Exchange Service Provider is required not only to manage the money of users in bank accounts separate from its own, but also to entrust such money to a trust company or trust bank, acting as trustee.

### **2-7-2 Separate Management of Crypto Assets**

The PSA currently requires a Crypto Asset Exchange Service Provider to manage a user’s crypto assets separately from other User Crypto Assets, so as to enable identification of a user’s assets

<sup>18</sup> Article 112, Item 10 of the revised PSA.

<sup>19</sup> Article 115, Paragraph 1, Item 4 of the revised PSA.

<sup>20</sup> Article 63-10, Paragraph 2 of the revised PSA.

<sup>21</sup> Please refer to Article 63-11 of the PSA and each item of Article 20, Paragraph 1 of the Cabinet Office Ordinance regarding Crypto Asset Exchange Service Providers.

<sup>22</sup> Article 63-11, Paragraph 1 of the revised PSA.

from the assets of other users.<sup>23</sup>

In addition, the PSA Revisions require a Crypto Asset Exchange Service Provider to manage a user's crypto assets<sup>24</sup> separately from other User Crypto Assets in such manner specified in the relevant Cabinet Office Ordinance, in order to enhance the protection of users. Although the relevant Cabinet Office Ordinance has not yet been issued, we understand from the explanatory material prepared by the FSA<sup>25</sup> (the "**FSA Explanatory Paper**") that a Crypto Asset Exchange Service Provider will be required "to manage the crypto asset of users (other than crypto assets required for the smooth performance of crypto asset exchange services) through highly reliable methods, such as cold wallets."

### 2-7-3 Crypto Assets for Ensuring Performance

Pursuant to the PSA Revisions<sup>26</sup>, a Crypto Asset Exchange Service Provider is required to (i) hold for its own account crypto assets of the same kind and quantity as those User Crypto Assets that are subject to "requirements specified by the relevant Cabinet office Ordinance as being necessary for ensuring users' convenience and smooth performance of crypto asset exchange services"<sup>27</sup> (the "**Performance Assurance Crypto Assets**"), and (ii) manage Performance Assurance Crypto Assets separately from its own crypto assets (other than Performance Assurance Crypto Assets).

Based on the FSA Explanatory Paper, User Crypto Assets managed in hot wallets are anticipated to be subject to "requirements specified by the relevant Cabinet office Ordinance as being necessary for ensuring users' convenience and smooth performance of crypto asset exchange services". In other words, when a Crypto Asset Exchange Service Provider manages its User Crypto Assets in hot wallets, the Crypto Asset Exchange Service Provider would likely be required to (i) hold its own crypto assets of the same kind and quantity as the User Crypto Assets managed in hot wallets, and (ii) manage Performance Assurance Crypto Assets in cold wallets separately from its own crypto assets (other than Performance Assurance Crypto Assets). More details on this are expected to emerge from upcoming discussions on the provisions of the relevant Cabinet Office Ordinance.

## 2-8 Grant of Rights to Receive Preferential Payment with respect to Users' Claims for Return of Crypto Assets

As noted above, the PSA currently requires a Crypto Asset Exchange Service Provider to manage User Crypto Assets separately from its own crypto assets. However, User Crypto Assets are deemed under private law as nothing more than the Crypto Assets of the Crypto Asset Exchange Service Provider that it manages on behalf of users. Accordingly, if the Crypto Asset Exchange Service Provider goes into bankruptcy, users may not be able to claim the return of their crypto assets, because such claims would be treated as general unsecured claims.

<sup>23</sup> Article 63-11, Paragraph 1 of the PSA.

<sup>24</sup> Other than crypto assets subject to "requirements specified by the relevant Cabinet office Ordinance as being necessary for ensuring users' convenience and smooth performance of crypto asset exchange services".

<sup>25</sup> The FSA Explanatory Paper can be found at: <https://www.fsa.go.jp/common/diet/198/02/setsumei.pdf>

<sup>26</sup> Article 63-11-2 of the revised PSA.

<sup>27</sup> Article 63-11, Paragraph 2 of the revised PSA.

With this in mind, the PSA Revisions stipulate that users who have delegated the management of their crypto assets to a Crypto Asset Exchange Service Provider have the right, against the Crypto Asset Exchange Service Provider, to claim preferential payment of such User Crypto Assets that are managed separately from the service provider's own crypto assets and Performance Assurance Crypto Assets. Furthermore, users who have delegated the management of their crypto assets to a Crypto Asset Exchange Service Provider will be entitled under the PSA Revisions to receive payment in priority to general creditors, if the Crypto Asset Exchange Service Provider goes into bankruptcy, except that such preferential right will automatically be subordinated to any claim on the service provider's estate.<sup>28</sup>

The PSA Revisions also require any person to whom a Crypto Asset Exchange Service Provider sub-delegates the management of crypto assets, and any person affiliated with the Crypto Asset Exchange Service Provider, to endeavor to provide such cooperation as requested by the FSA, in connection with any exercise by users of the aforementioned preferential right.<sup>29</sup>

## 3-1 Electronically Recorded Transferable Rights

### 3-1-1 Introduction

Previously, Japanese regulators have been unclear on whether “initial coin offerings” (“**ICOs**”) and “security token offerings” (“**STOs**”), through which entrepreneurs issue electronic tokens and raise funds from the public, are governed by the PSA or FIEA, or both. For this reason, prospective issuers (including overseas issuers) of ICOs and STOs in Japan have faced significant uncertainty. This has resulted in a virtual curtailment of ICO and STO issuances in Japan. To make matters worse, a significant number of complaints (including complaints of fraud) have been filed in respect of white papers prepared by supposed ICO and STO issuers for investors in several jurisdictions, including Japan. Common complaints include issuers' failure to perform in accordance with the relevant white papers or to provide goods or services as promised.

To address this situation, the FIEA Revisions introduced the concept of ERTRs (electronically recorded transferable rights) to clarify the scope of tokens governed by the FIEA.<sup>30</sup> Consistent with this, the PSA Revisions also exclude from the definition of “Crypto Assets” tokens that represent ERTRs. It is therefore now clear that the PSA is inapplicable to tokens that are deemed ERTRs.<sup>31</sup> Additionally, as discussed in more detail below, there is now clarity that so-called “utility tokens” issued under ICOs will continue to be governed by the PSA.

### 3-1-2 What are “ERTRs”?

ERTRs refer to the rights set forth in Article 2, Paragraph 2 of the FIEA that are represented by proprietary value transferrable by means of an electronic data processing system (but limited only

<sup>28</sup> Article 63-19-2, Paragraph 1 of the revised PSA.

<sup>29</sup> Article 63-19-3 of the revised PSA.

<sup>30</sup> Article 2, Paragraph 3 of the revised FIEA.

<sup>31</sup> Article 2, Paragraph 5, of the revised PSA.

to proprietary values recorded in electronic devices or otherwise by electronic means), excluding those rights specified in the relevant Cabinet Office Ordinance in light of their negotiability and other factors.<sup>32</sup> Although the details of such Cabinet Office Ordinance have not been released, the FIEA Revisions expressly stipulate that ETRs will be treated as “Paragraph 1 Securities” (i.e., securities defined in Article 2, Paragraph 1 of the FIEA)<sup>33</sup>. To put it simply, rights treated as “Paragraph 2 Securities” (i.e., rights that are deemed securities pursuant to Article 2, Paragraph 2 of the FIEA) and represented by negotiable digital tokens will be treated as Paragraph 1 Securities unless they fall under an exemption. This suggests a focus on the generally high negotiability of ETRs, and the imposition of disclosure requirements in respect of ETRs that are comparable to those applicable to Paragraph 1 Securities, which are generally highly negotiable. On the other hand, as the rights specified in the relevant Cabinet Office Ordinance in light of their negotiability and other factors will continue to be treated as Paragraph 2 Securities, attention should be paid to the scope of exemption to be specified in the relevant Cabinet Office Ordinance.

No special provision is stipulated in respect of Paragraph 1 Securities represented in digital tokens, such as shares of stock or bonds. However, given their nature as Paragraph 1 Securities, they will likely be subject to the relevant FIEA disclosure requirements, even if they are represented in digital tokens.

### 3-1-2-1 ETRs as Interests in Collective Investment Schemes

Although Article 2, Paragraph 2 of the FIEA refers to rights of various kinds, tokens issued in STOs are expected to constitute, in principle, “collective investment scheme interests” (“**CISIs**”) under the FIEA.<sup>34</sup> CISIs are deemed to be formed when the following three requirements are met: (i) investors (i.e., right holders) invest or contribute cash or other assets to a business, (ii) the cash or other assets contributed by investors are invested in the business, and (iii) investors have the right to receive dividends of profits or assets generated from investments in the business. Tokens issued under STOs would constitute ETRs if the three requirements above are satisfied.

Notably, “investment contracts,” which are deemed “securities” under the U.S. Securities Act, are generally understood as being equivalent to CISIs under the laws of Japan, although the scope of the respective rights in respect of the two is not exactly the same. Specifically, investment contracts for purposes of the U.S. Securities Act are deemed to be formed when the following three requirements are met: (i) investors invest in a common enterprise, (ii) a reasonable expectation of profits arises, and (iii) profits are generated solely from the efforts of others (the so-called “Howey test”). For this purpose, “profits” include not only profits arising from a common enterprise (such as dividends), but also profits from capital appreciation. Accordingly, so-called “utility tokens” that are used solely to access an online platform or as a means of payment for goods or services on the platform, but do not involve any payment of dividends of profits arising from a common enterprise, may constitute investment contracts for purposes of the U.S. Securities Act. Under the FIEA, by contrast, “profits” from CISIs are deemed to exclude profits from capital appreciation. Accordingly, the aforementioned utility tokens, even if negotiable on exchanges, do

<sup>32</sup> Article 2, Paragraph 3, of the revised FIEA.

<sup>33</sup> Article 2, Paragraph 3 of the revised FIEA.

<sup>34</sup> Article 2, Paragraph 2, Items 5 and 6 of the FIEA.

not constitute ERTRs to which the FIEA is applicable (although such utility tokens may be deemed Crypto Assets, to which the PSA is applicable).

On a related note, there had been discussions on whether tokens, issued under STOs that involve the investment of Crypto Assets (such as bitcoins) in a business, constitute CISIs. This question has arisen because Crypto Assets do not constitute “cash or other assets”, but has been resolved by the FIEA Revisions, which provide that such “cash or other assets” include Crypto Assets.<sup>35</sup>

### 3-1-2-2 ERTR Represented by Proprietary Value Transferrable via Electronic Data Processing Systems

An ERTR is required to be “represented by proprietary value transferrable by means of an electronic data processing system (but limited only to proprietary values recorded in electronic devices or otherwise by electronic means).” Since this language is consistent with the definition of Crypto Assets (see Article 2, Paragraph 5 of the PSA), Crypto Assets that are transferrable on blockchain (as is the case with bitcoins) may constitute ERTRs.

Incidentally, as stated above, ERTRs are expected to consist mainly of CISIs of some kind. It should be noted, however, that CISIs as exemplified in Article 2, Paragraph 2, Item 5 of the FIEA (other than for membership interests in incorporated associations) are stipulated as contractual rights under applicable laws and regulations. To transfer contractual status, the consent of the counterparty to the contract is required.<sup>36</sup> For example, where ERTRs represent the status of silent partners (*tokumei kumiai-in*) under silent partnership agreements (*tokumei kumiai keiyaku*) as set forth in the Commercial Code, then even if such ERTRs are recorded on blockchain as being transferred from the assignor to the assignee, the status of the silent partners would not be deemed to have been transferred as a matter of course to the assignee if the consent of the operator (*eigyo-sha*), who is the counterparty to the contract, has not been obtained. This issue needs to be resolved. A possible resolution is to provide in the relevant silent partnership agreement that the operator will be deemed to have provided its consent to a transfer of contractual status, if a silent partner transfers its contractual status on blockchain.

## 3-1-3 Disclosure Requirements

### 3-1-3-1 Public Offerings and Private Placements

As a result of the application of disclosure requirements to ERTRs<sup>37</sup>, issuers of ERTRs are in principle required, upon making a public offering or secondary distribution, to file a securities registration statement<sup>38</sup> and issue a prospectus<sup>39</sup>. Any person who causes other persons to acquire ERTRs or who sells ERTRs to other persons through a public offering or secondary

<sup>35</sup> Article 2-2 of the revised FIEA.

<sup>36</sup> Supreme Court Judgment of September 29, 1955, *Minshu*, Vol. 9, No. 10, p.1472, and Article 539-2 of the Amended Civil Code.

<sup>37</sup> Article 3, Item 3(b) of the revised FIEA.

<sup>38</sup> Article 4, Paragraph 1 and Article 5, Paragraph 1 of the FIEA.

<sup>39</sup> Article 13, Paragraph 1 of the FIEA.

distribution must deliver a prospectus to such other persons in advance or at the same time.<sup>40</sup> Although details of the relevant Cabinet Office Ordinance stipulating the matters to be stated in securities registration statements and prospectuses for public offerings or secondary distributions of ETRs have not been released, such disclosure requirements are anticipated to be at a level that is higher, both qualitatively and quantitatively, than described in the relevant white papers in respect of past ICO practice.

As these disclosure obligations will impose significant practical burdens, solicitation of buyers for ETRs under STOs that are launched after the coming into effect of the FIEA Revisions may largely be conducted by means of so-called private placements to qualified institutional investors<sup>41</sup> or private placements to less than 50 investors<sup>42</sup>, to avoid triggering such disclosure requirements. Moreover, as solicitation of buyers for ETRs is expected to be largely conducted via the Internet, the issue of how to ensure that persons solicited on the Internet will be restricted to qualified institutional investors or limited to 49 persons will have to be further considered.

### 3-1-3-2 Annual Securities Report and Semi-Annual Securities Report

An issuer who files a securities registration statement for a public offering or secondary distribution of ETRs will in principle be required to file annual securities reports and semi-annual securities reports.<sup>43</sup> Although details of the relevant Cabinet Office Ordinance stipulating the matters to be stated in the annual securities reports and semi-annual securities reports by ETR issuers have not been released, regular disclosure are expected to be required at a significant level, both qualitatively and quantitatively, after the completion of an STO.

It should be noted that even if an issuer does not have to file a securities registration statement for a public offering or secondary distribution of ETRs because it has implemented an STO through a private placement or before the coming into effect of the FIEA Revisions (or for any other reason), if subsequently the number of ETR owners as of the last day of any fiscal year is equal to or higher than the number prescribed by the relevant Cabinet Order, the issuer will be required to file annual securities reports and semi-annual securities reports for at least the next five consecutive years, including the fiscal year in which the number of ETR owners reach or exceed the relevant threshold.<sup>44</sup> The threshold prescribed by the relevant Cabinet Order is currently 1,000 ETR owners.<sup>45</sup> To avoid triggering such filing requirements, continuous monitoring of the number of right holders will be crucial after the completion of an STO.

### 3-1-4 Licensing (Registration) Requirements

As ETRs are expected to constitute Paragraph 1 Securities<sup>46</sup>, registration as a Type I Financial Instruments Business Operator will be required for purposes of selling, purchasing or handling the

<sup>40</sup> Article 15, Paragraph 2 of the FIEA.

<sup>41</sup> Article 2, Paragraph 3, Item 2(a) of the FIEA.

<sup>42</sup> Article 2, Paragraph 3, Item 2(c) of the FIEA.

<sup>43</sup> Article 24, Paragraph 1, Item 3 and Article 24-5, Paragraph 1 of the FIEA.

<sup>44</sup> Article 24, Paragraph 1, Item 4 of the FIEA.

<sup>45</sup> Article 3-6, Paragraph 4 of the FIEA Enforcement Order.

<sup>46</sup> Article 2, Paragraph 3, of the revised FIEA.

public offering of ETRs in the course of a business.<sup>47</sup> However, a Type I Small Amount Electronic Public Offering Business Operator may conduct a public offering or private placement of ETRs by means of so-called “crowdfunding” under less stringent registration requirements.<sup>48</sup> The relevant Cabinet Order currently provides less stringent registration requirements for STOs conducted by means of crowdfunding, where the total value of ETRs issued is less than JPY100 million, and where the paid-in amount per buyer of ETRs does not exceed JPY500,000.<sup>49</sup>

The FIEA Revisions prohibit Registered Financial Institutions (such as banks) that may engage in certain securities businesses from purchasing, selling or conducting any public offer of certain ETRs as prescribed by the relevant Cabinet Order.<sup>50</sup> The degree of such prohibition will have to be examined in detail when the relevant Cabinet Order is issued.

In connection with the above, we note that the FIEA Revisions do not amend the language in Article 2, Paragraph 8, Item 7 of the FIEA, which provides the definition of “public offering” and “private placement”. Accordingly, any ETR issuer who solicits acquisition of such ETR (i.e., undertaking an STO), will be required to undergo registration as a Type II Financial Instruments Business Operator<sup>51</sup>, unless such issuer qualifies as a specially permitted business for qualified institutional investors.

The provisions in the revised FIEA specifying that ETRs constitute securities also expressly provide that (i) a license for a Financial Instrument Market will be required for the establishment of a trade market for ETRs<sup>52</sup>, and (ii) registration as and authorization to conduct a Type I Financial Instruments Business will be required for engaging in a “proprietary trading system (PTS) business” involving ETRs.<sup>53</sup>

## 3-2 Crypto Asset Derivatives Transactions

### 3-2-1 Introduction

Currently, crypto asset margin trading services are offered by many Crypto Asset Exchange Service Providers. According to the Report, crypto asset derivatives transactions accounted for approximately 80% of the total domestic crypto asset transactions conducted through Crypto Asset Exchange Service Providers in fiscal year 2017. However, the FSA has received a significant number of user complaints. These complaints relate mainly to defective systems and ambiguity in the services of Crypto Asset Exchange Service Providers. Moreover, even though crypto asset derivatives transactions are regulated in many major countries, they are not regulated in Japan.

Under these circumstances, it has been proposed in the FIEA Revisions to subject crypto asset derivatives transactions to the FIEA in order to protect users and ensure that such transactions are

<sup>47</sup> Article 28, Paragraph 1, Item 1 and Article 29 of the FIEA.

<sup>48</sup> Article 29-4-2 of the FIEA.

<sup>49</sup> Article 29-4-2, Paragraph 10 of the FIEA, and Article 15-10-3 of the FIEA Enforcement Order.

<sup>50</sup> Article 33-1, Paragraph 1 and Article 33-1, Paragraph 2, Item 1 of the revised FIEA.

<sup>51</sup> Article 28, Paragraph 2, Item 1 and Article 29 of the FIEA.

<sup>52</sup> Article 2, Paragraph 14 and Article 80, Paragraph 1 of the FIEA.

<sup>53</sup> Article 2, Paragraph 8, Item 10, Article 28, Paragraph 1, Item 4, and Article 29, Paragraph 30, Item 1 of the FIEA.

conducted appropriately, by establishing certain regulations of crypto asset derivatives transactions while, at the same time, requiring investors to take appropriate responsibility for such transactions. Specifically, for purposes of subjecting derivatives transactions involving "Financial Instruments" or "Financial Indicators" to certain entry regulations and rules of conduct issued under the FIEA, the FIEA Revisions has included "crypto assets (as defined in Article 2, Paragraph 5 of the PSA)" and "standardized instruments created by a Financial Instruments Exchange for purposes of facilitating Market Transactions of Derivatives by standardizing interest rates, maturity periods and/or other conditions of (crypto assets)" (as defined in Article 2, Paragraph 24, Item 3-2 of the revised FIEA) in the definition of "Financial Instruments," and incorporated the prices, interest rates, etc. of crypto assets into the definition of "Financial Indicators" (Article 2, Paragraph 25 of the FIEA).

### 3-2-2 Crypto Asset Derivatives Transactions

For purposes of the FIEA, "Derivatives Transactions" is a general term encompassing Market Derivatives Transactions, Over-the-Counter Derivatives Transactions and Foreign Market Derivatives Transactions (Article 2, Paragraph 20 of the FIEA). By adding "crypto assets" to the definition of "Financial Instruments," derivatives transactions related to crypto assets will be subject to the provisions of the FIEA, regardless of the type of derivatives transaction involved. The following section focuses on Over-the-Counter Derivatives Transactions (Article 2, Paragraph 22 of the FIEA).

The following transactions are examples of Over-the-Counter Derivatives Transactions related to crypto assets.<sup>54</sup>

- Forward transactions (Article 2, Paragraph 22, Item 1 of the FIEA): transactions in which the parties promise to transfer crypto assets and the consideration therefor at a fixed time in the future, and the parties may undertake cash settlement by transferring the difference in values by reselling or repurchasing the underlying crypto assets.
- Option transactions (Article 2, Paragraph 22, Item 3 of the FIEA): transactions in which the parties promise that one party would grant the other party an option to effect a transaction involving a certain amount of crypto assets at a certain price between them only by a unilateral manifestation of the other party's intention, and the other party pays the consideration for such option, or any other similar transactions.
- Swap transactions (Article 2, Paragraph 22, Item 5 of the FIEA): transactions in which the parties mutually promise that, using the amount they have agreed upon as the principal, one party will pay an amount of money calculated based on the agreed upon interest rate, etc. of the crypto assets, and the other party will pay an amount of money calculated based on the agreed upon interest rate, etc. of the currency, or any other similar transactions.

In addition, as mentioned above, since the prices or interest rates, etc. of crypto assets are included in the definition of "Financial Indicators" (Article 2, Paragraph 25 of the revised FIEA), the

<sup>54</sup> We note, however, that Over-the-Counter Derivatives Transactions related to crypto assets are not limited to these transactions; instead they can be any type of transactions that falls under Article 2, Paragraph 22 of the revised FIEA.

provisions of the FIEA will apply not only to derivatives transactions underlain by crypto assets, but also to futures transactions, option transactions and swap transactions that use crypto asset indices as reference indices.

### 3-2-3 Licensing (Registration) Requirements under the FIEA

Since crypto assets will be included in the definition of Financial Instruments, the conduct of Over-the-Counter Derivatives Transactions related to crypto assets or intermediary (*baikai*) or brokerage (*toritsugi*) activities in relation thereto will also constitute Type I Financial Instruments Business (Article 2, Paragraph 8, Item 4, and Article 28, Paragraph 1, Item 2 of the FIEA).<sup>55</sup> Accordingly, business operators engaging in these transactions will need to undergo registration as Financial Instruments Business Operators (Article 29 of the FIEA) in the same way as business operators engaging in foreign exchange margin trading (FX trading).

In addition, any person who intends to become a Financial Instruments Business Operator engaging in the Type I Financial Instruments Business is required to meet certain asset requirements, including having:

- a stated capital of at least JPY 50 million (Article 29-4, Paragraph 1, Item 4 of the FIEA, Article 15-7, Paragraph 1, Item 3 of the FIEA Enforcement Order);
- net assets of at least JPY 50 million (Article 29-4, Paragraph 1, Item 5 (b) of the FIEA, Article 15-9, Paragraph 1 of the FIEA Enforcement Order); and
- a capital-to-risk ratio of at least 120% (Article 29-4, Paragraph 1, Item 6 (i), and Article 46-6, Paragraph 2 of the FIEA).<sup>56</sup>

It bears noting that a business operator who intends to engage in any of the following businesses, at the time of its application for registration as a Financial Instruments Business Operator, will be required to state the following facts in the registration application form (Article 29-2, Paragraph 1, Items 8 and 9 of the revised FIEA):

- (i) if the business operator engages in the business of conducting an Act of Engaging in Financial Instruments Transactions with regard to derivatives transactions related to Paragraph 2 Securities (but limited to those provided by a Cabinet Office Order) or rights in the Paragraph 2 Securities or Financial Indicators (but limited to the prices and interest rates, etc. of rights in Paragraph 2 Securities and figures calculated based thereon), such fact; or
- (ii) if a business operator engages in the business of conducting an Act of Engaging in Financial Instruments Transactions with regard to derivatives transactions related to crypto assets or Financial Indicators (but limited to the prices and interest rates, etc. of crypto assets, and figures calculated based thereon), such fact.

<sup>55</sup> Market Derivatives Transactions and Foreign Market Derivatives Transactions, as well as all intermediary, brokerage, agency services in relation thereto (including intermediary, brokerage, or agency services in relation to the entrustment of such transactions) are deemed Type II Financial Instruments Business.

<sup>56</sup> In addition to the asset requirements above, requirements such as personnel requirements, corporate requirements, requirements for the establishment of domestic sales offices or business offices, requirements for establishment of internal regulations, requirements as to major shareholders, and requirements as to concurrent businesses also need to be satisfied.

There are certain exemptions to the application of the FIEA provisions. For example, certain Over-the-Counter Derivatives Transactions related to non-securities with certain derivatives professionals (as defined under the FIEA) are exempted from the regulations. Furthermore, foreign business operators may conduct certain limited activities in relation to Foreign Market Derivative Transactions without having to register as Financial Instruments Business Operators (which means such activities do not involve the conduct of Financial Instruments Business)

### **3-2-4 Rules of Conduct under the FIEA**

Under the FIEA Revisions, derivatives transactions related to crypto assets that are engaged in by Financial Instruments Business Operators will be deemed "Acts of Engaging in Financial Instruments Transactions" (Article 2, Paragraph 8 of the revised FIEA). Therefore, such transactions will be subject to various rules of conduct under the FIEA, including the following (which may be revised by future government orders):

- rules prohibiting the provision of false information (Article 38, Item 1 of the FIEA);
- rules prohibiting the provision of conclusive evaluations, etc. (Article 38, Item 2 of the FIEA);
- rules prohibiting uninvited solicitation (Article 38, Item 4 of the FIEA);
- rules requiring confirmation as to whether a customer is willing to be solicited (Article 38, Item 5 of the FIEA); and
- rules prohibiting continuing solicitation (Article 38, Item 6 of the FIEA).

In addition, when a Financial Instruments Business Operator engages in any crypto asset derivatives transaction with a General Investor (i.e., any person who is not a Professional Investor (Article 2, Paragraph 31 of the FIEA)), it will be required to deliver the following documents:

- a document delivered prior to the conclusion of a contract (Article 37-3 of the FIEA);
- a document delivered upon the conclusion of a contract and/or a report on the outstanding balance of the transactions (Article 37-4 of the FIEA); and
- a document delivered pertaining to the receipt of a security deposit (Article 37-5 of the FIEA).

#### **3-2-4-1 Loss-cutting Rules**

Loss-cutting rules generally refer to a mechanism through which a transaction will be compulsorily settled by a cross transaction to prevent any further losses if the appraised loss reaches a certain level.

The FIEA imposes an obligation on Financial Instruments Business Operators to establish and observe loss-cutting rules in connection with currency-related derivatives transactions with individual customers (Article 40, Item 2 of the FIEA, Article 123, Paragraph 1, Items 21-2 and 21-3 of the Cabinet Office Order on Financial Instruments Business, etc.).

It is expected that as a result of proposed amendments to the relevant government order, similar regulations will apply to crypto asset derivatives transactions as well, although the FIEA Revisions

do not address this point.

### 3-2-4-2 Leverage Regulations

Leverage regulations generally mean regulations obligating business operators to require their customers to deposit margins of an amount that exceeds a certain ratio of the transaction amount (i.e., the notional principal). Leverage regulations are considered regulations operating under the basic principle that Financial Instruments Business Operators should maintain margins at a level that will enable them to cope with daily market fluctuations in the relevant transactions. Such regulations are necessary because of the risk that loss-cutting rules may not work properly in the event of sudden market movements or other reasons, as a result of which customers exceeding their margins may incur damage, and business operators may face risk management issues. Moreover, highly-leveraged transactions could lead to excessive speculation, which would be problematic<sup>57</sup>.

According to the Report, some business operators currently employ a maximum margin rate of 25 times in crypto asset margin trading. According to the Report, considering that fluctuations in the price of a crypto asset are greater than fluctuations in a legal currency, it is appropriate to set a proper upper limit taking into consideration the actual conditions of transactions.

As for currency-related derivatives transactions with retail customers, the FIEA imposes an obligation on the Financial Instruments Business Operators to require such customers to deposit a margin in order to ensure that the ratio of the margin amount (i.e., the actual deposit amount) to the transaction amount (i.e., the notional principal) is more than 4% (which is less than 25 times if converted to a margin rate) (Article 38, Item 7 of the FIEA, Article 117, Paragraph 1, Items 27 and 28, and Article 117, Paragraphs 7 and 8 of the Cabinet Office Order on Financial Instruments Business, etc.).

It is expected that as a result of proposed amendments to the relevant government order, similar regulations will apply to crypto asset derivatives transactions as well, although the FIEA Revisions do not address this point. It should be borne in mind, however, that under the current margin trading regulations and guidelines of the Japan Virtual Currency Exchange Association (the "JVCEA"), the PSP Association in connection with crypto asset exchange business under the PSA, margin rates should in principle be four times or lower, and this may be taken into account when specific provisions are promulgated by the relevant Cabinet Office Order.

### 3-2-4-3 Separate Management

In currency-related derivatives transactions, as a method of separately managing money or other security deposit deposited by their customers, the FIEA imposes an obligation on Financial Instruments Business Operators to entrust money to a trust company or a trust bank in order to ensure that the money will be refunded to investors (Article 43-3, Paragraph 1 of the FIEA, and

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<sup>57</sup> Page 50 of the paper entitled "A summary of the entry regulations and rules of conduct for derivatives transactions - focusing on the Financial Instruments and Exchange Act and the Commodity Derivatives Act -" published by the Financial Law Board on January 28, 2015. This paper can be found at: <http://www.flb.gr.jp/jdoc/publication47-j.pdf>

Articles 143 to 143-3 of the Cabinet Office Order on Financial Instruments Business, etc.).

It is expected that as a result of proposed amendments to the relevant government order, similar regulations will also apply to the method by which deposit money will be separately managed in the case of crypto asset derivatives transactions, although the FIEA Revisions do not address this point.

### **3-2-5 Duty to Explain**

Since crypto asset derivatives transactions are transactions that could result in excessive speculation, it is appropriate for service providers handling such transactions to fully inform their customers of the risks inherent in such transactions to ensure that individuals with insufficient financial resources or knowledge do not suffer damage thereby.

In light of the foregoing, certain special provisions concerning the crypto asset-related business (i.e., business involving Acts of Engaging in Financial Instruments Transactions, as defined in the Cabinet Office Order related to crypto assets) will be added to Article 43-6 of the FIEA.

First, it is stipulated that when engaging in business related to crypto assets, Financial Instruments Business Operators, etc. must explain the nature of crypto assets in accordance with the provisions of the relevant Cabinet Office Order (Article 43-6, Paragraph 1 of the revised FIEA).

It is also stipulated that when executing an agreement or soliciting the execution of an agreement to engage in acts related to crypto assets with or for the benefit of their customers in connection with their business related to crypto assets, Financial Instruments Business Operators, etc. or their officers or employees must not make any representation that may mislead their customers about the nature of crypto assets or other matters set forth in the relevant Cabinet Office Order (Article 43-6, Paragraph 2 of the revised FIEA).

The specific scope of business related to crypto assets and matters to be explained will be stipulated in the relevant Cabinet Office Order.

### **3-2-6 Derivatives Transactions for Exchanging Crypto assets for Other Crypto assets**

Since crypto assets will be deemed a type of Financial Instruments, as noted above, derivatives transactions related to crypto assets will also fall under the definition of Over-the-Counter Derivatives Transactions (Article 2, Paragraph 22 of the FIEA). However, it is unclear at this juncture whether various types of crypto asset derivatives transactions involving the exchange of “crypto assets” for other “crypto assets” will be included in the definition of Over-the-Counter Derivatives Transactions (i.e., whether they will be subject to regulations under the FIEA as Over-the-Counter Derivatives Transactions). To include such derivatives transactions within the definition of Over-the-Counter Derivatives Transactions in the FIEA, it would be necessary to stipulate, in the relevant Cabinet Order in accordance with Article 2-2 of the revised FIEA, which contains the wording “money referred to in the provisions of the relevant Cabinet Order or money

related to transactions under such provisions,” that crypto assets will be deemed money as referred to in each item of Article 2, Paragraph 22 of the FIEA. Attention should be paid to whether any measures will be considered to clarify this point in the relevant Cabinet Order.

### **3-2-7 Capital-to-Risk Ratio**

Financial Instruments Business Operators engaging in the Type I Financial Instruments Business are required to calculate their capital-to-risk ratio, and report such ratio at the end of each month as well as when such ratio falls below 140% (Article 46-6, Paragraph 1 of the FIEA, and Article 179 of the Cabinet Office Order on Financial Instruments Business, etc.). Additionally, such Financial Instruments Business Operators must also maintain their capital-to-risk ratio at 120% or higher (Article 46-6, Paragraph 2 of the FIEA). Furthermore, Type I Financial Instruments Business Operators are required, in a reasonable manner according to the type of business being operated, to monitor their market risk equivalent amount and counterparty risk equivalent amount every business day, because information on such amounts is necessary for purposes of calculating their capital-to-risk ratio (Article 178 of the Cabinet Office Order on Financial Instruments Business, etc.).

Although the method for determining the risk equivalent amounts necessary to calculate the capital-to-risk ratio is stated in the public notice entitled “Establishment of Standards, etc. for Calculation of Market Risk Equivalent Amount, Counterparty Risk Equivalent Amount and Basic Risk Equivalent Amount of Financial Instruments Business Operators” in accordance with Article 178 of the Cabinet Office Order on Financial Instruments Business, etc., attention should be paid to how the method of calculating risk equivalent amounts in connection with crypto asset derivatives transactions will be stipulated in the amendment to the aforementioned public notice.

## **3-3 Regulations on Unfair Transactions Using Crypto Asset**

### **3-3-1 Introduction**

Under the FIEA, certain unfair acts related to securities transactions are prohibited and punishable by penalties. However, crypto asset transactions are not subject to any such prohibition under the existing provisions of the FIEA or PSA.

Nevertheless, according to the Report, cases of market manipulation by speculative groups in crypto asset transactions have been reported, and the Report suggested that certain restrictions on unfair transactions equivalent to those applicable to securities transactions are also necessary.

Accordingly, the FIEA Revisions contains prohibitions against certain unfair acts (the conduct of which is punishable by penalties) in respect of crypto asset spot transactions and crypto asset derivative transactions, without limits as to the violating party. These prohibitions are intended to enhance protection of users and to prevent obtainment of unjust benefits.

However, insider trading is not regulated under the FIEA Revisions, due to difficulties with

formulating a clear concept of crypto asset issuers and with the identification of undisclosed material facts.

### 3-3-2 Prohibition of Wrongful Acts

Article 185-22 of the revised FIEA provides that “no person”<sup>58</sup> shall conduct any of the following acts in the sale or purchase of, or in any other transaction concerning, crypto assets (in-kind)<sup>59</sup>, or in any crypto asset-related derivative transactions, etc.<sup>60</sup>:

- (i) engage in wrongful means, schemes or techniques;
- (ii) acquire money or other property using a document or other means of communication that contains misrepresentations on important matters, or lacks representation on material matters necessary for the avoidance of misunderstanding; or
- (iii) use false quotations in order to induce transactions.

Any person who engages in such prohibited acts is punishable by imprisonment for a term not exceeding ten (10) years or a fine not exceeding JPY 10 million, or both<sup>61</sup>. Such penalties will be compounded for any violation committed for the purpose of gaining property benefit, such that the violating person will be punishable by imprisonment for a term not exceeding ten (10) years and a fine not exceeding JPY 30 million<sup>62</sup>. Furthermore, juridical persons (including corporations) are also subject to dual liability, and are punishable by a fine not exceeding JPY 700 million.<sup>63</sup>

### 3-3-3 Prohibition against Dissemination of Rumors, Usage of Fraudulent Means, Assault or Intimidation

Article 185-23 of the revised FIEA provides that “no person”<sup>64</sup> shall (i) disseminate rumors, use fraudulent means, or commit assault or intimidation for purposes of selling or purchasing, or engagement in any transaction in respect of crypto assets or for purposes of engagement in any crypto asset derivative transactions and the like, or (ii) causing any fluctuation in the quotations of any crypto asset, or in any option or index based on crypto assets.<sup>65</sup>

Any person who violates the above prohibition is punishable by imprisonment for a term not exceeding ten (10) years or a fine not exceeding JPY 10 million, or both.<sup>66</sup> Such penalties will be compounded for any violation committed for purposes of gaining property benefit, such that the violating person will be punishable by imprisonment for a term not exceeding ten (10) years and a

<sup>58</sup> This indicates that all persons (without limit as to whether the violating party is a natural person or otherwise) are covered under the scope of Article 185-22 of the revised FIEA.

<sup>59</sup> “Other transactions” seem to assume not only exchange with other crypto asset, but also intermediary, brokerage or agency service for sales and purchase/exchange.

<sup>60</sup> “Crypto asset-related derivative transactions, etc.” mean derivative transactions which are only related to crypto asset or crypto asset-related financial indicators (only limited to crypto asset’s price and interest rates and any figures calculated that are based thereof) (Article 185-22, Paragraph 1, Item 1 of the revised FIEA).

<sup>61</sup> Article 197, Paragraph 1, Item 6 of the revised FIEA.

<sup>62</sup> Article 197, Paragraph 2, Item 2 of the revised FIEA.

<sup>63</sup> Article 207, Paragraph 1, Item 1 of the FIEA.

<sup>64</sup> This indicates that all persons (without limit as to whether the violating party is a natural person or otherwise) are covered under the scope of Article 185-23 of the FIEA Revisions.

<sup>65</sup> Article 185-23 of the revised FIEA.

<sup>66</sup> Article 197, Paragraph 1, Item 6 of the revised FIEA.

fine not exceeding JPY 30 million.<sup>67</sup> Furthermore, juridical persons (including corporations) are also subject to dual liability, and are punishable by a fine not exceeding JPY 700 million.<sup>68</sup>

### 3-3-4 Prohibition against Market Manipulation

Article 185-24 of the revised FIEA provides that “no person”<sup>69</sup> shall commit any of the following acts for purposes of misleading other persons into believing that the sale and purchase of crypto assets, crypto asset-related market derivative transactions or crypto asset-related over-the-counter derivative transactions are thriving or otherwise misleading other persons about the state of such transactions:

- (i) engage in fake sales and purchases;<sup>70</sup>
- (ii) engage in collusive sales and purchases;<sup>71</sup>
- (iii) entrust or accept any entrustment of fake sales and purchases or collusive sales and purchases;<sup>72</sup>
- (iv) engage in market manipulation through actual sales and purchases;<sup>73</sup> or
- (v) engage in market manipulation through representations and certain similar acts.<sup>74</sup>

Any person who violates the above prohibitions is punishable by imprisonment for a term not exceeding ten (10) years or a fine not exceeding JPY 10 million, or both.<sup>75</sup> Such penalties will be compounded for any violation committed for the purpose of gaining property benefit, such that the violating person will be punishable by imprisonment for a term not exceeding ten (10) years and a fine not exceeding JPY 30 million.<sup>76</sup> Furthermore, juridical persons (including corporations) are also subject to dual liability, and are punishable by a fine not exceeding JPY 700 million.<sup>77</sup>

\*See below (page 26) for the list of wrongful acts and penalties.

## 4 Act on Sales, etc. of Financial Instruments

### 4-1 Introduction

As a result of the PSA and FIEA Revisions, the ASFI is also proposed to be amended to apply to acts that result in the acquisition of crypto assets. Without amendment of the ASFI, customers wishing to claim against Crypto Asset Exchange Service Providers will be required to prove that

<sup>67</sup> Article 197, Paragraph 2, Item 2 of the revised FIEA.

<sup>68</sup> Article 207, Paragraph 1, Item 1 of the FIEA.

<sup>69</sup> This indicates that all persons (without limit as to whether the violating party is a natural person or otherwise) are covered under the scope of Article 185-24 of the revised FIEA.

<sup>70</sup> Article 185-24, Paragraph 1, Items 1 to 3 of the revised FIEA.

<sup>71</sup> Article 185-24, Paragraph 1, Items 4 to 8 of the revised FIEA.

<sup>72</sup> Article 185-24, Paragraph 1, Item 9 of the revised FIEA.

<sup>73</sup> Article 185-24, Paragraph 2, Item 1 of the revised FIEA

<sup>74</sup> Article 185-24, Paragraph 2, Items 2 and 3 of the revised FIEA.

<sup>75</sup> Article 197, Paragraph 1, Item 6 of the revised FIEA.

<sup>76</sup> Article 197, Paragraph 2, Item 2 of the revised FIEA.

<sup>77</sup> Article 207, Paragraph 1, Item 1 of the FIEA.

the latter owe the relevant legal obligations under tort.<sup>78</sup> To address this unsatisfactory situation, the ASFI Revisions expressly imposes accountability on Crypto Asset Exchange Service Providers, including presuming the amount of damages that such service providers would owe, in order to reduce the burden of proof on the part of service users.

Article 2, Paragraph 1, Item 6(c) of the revised ASFI provides that an act that results in the acquisition of “the crypto assets prescribed in Article 2, Paragraph 5 ... of the Payment Services Act” constitutes a “Sale(s) of Financial Instruments”. In addition, Article 2, Paragraph 2 of the revised ASFI provides that the ASFI applies to agency or intermediary services for acts that result in the acquisition of crypto assets. Although crypto assets as referred to in the ASFI do not include the ERTRs discussed in Section 3-1 above, they fall under Article 2, Paragraph 1, Item 5 or Item 6(a) of the ASFI because ERTRs are caught under all the items in Article 2, Paragraph 2 of the FIEA and are in any case subject to the ASFI.

An outline of the provisions in the revised ASFI that relate specifically to the sale of crypto assets is set forth below.

## 4-2 Accountability

### 4-2-1 Matters to be Explained

Article 3 of the ASFI imposes on financial instrument providers (including any person selling crypto assets, and any person providing agency or intermediary service therefor, in the ordinary course of business) the obligation to explain to users of Crypto Asset Exchange Services “Important Matters”. Paragraph (1) of the said article prescribes the following as constituting “Important Matters”:

- (i) where the relevant Sales of Financial Instruments involves the risk of loss of principal or loss exceeding the initial principal, due directly to fluctuations in interest rates, currency values, quotations on a Financial Instruments Market, or any other indicator, (A) the fact of such risk, (B) information on the relevant indicators, and (C) important aspects of the transaction structure; and
- (ii) if the relevant sale of financial instruments involve the risk of loss of principal due directly to changes in the condition of the business or property of the person carrying out the relevant sale of financial instruments or changes in the condition of any other person, (A) the fact of such risk, (B) information on the relevant person(s), and (C) important aspects of the transaction structure.

Although item (i) above addresses the risk of price fluctuations in respect of financial instruments, the details set forth of sub-items (A) through (C) above are necessary because crypto assets

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<sup>78</sup> Article 709 of the Civil Code.

involve the risk of loss of principal directly as a result of fluctuations pertaining to “other indicators” (such as the price of Bitcoin in spot transactions), and loss exceeding the initial principal in crypto asset-related margin transactions.

Although item (ii) above addresses the credit risk in respect of financial instrument providers, if a loss of principal or loss exceeding the initial principal will likely be incurred with respect to crypto assets due to the bankruptcy (and similar events) of crypto asset providers, explanation of the relevant fact is required.

On the other hand, Article 3, Paragraph 5, Item 5 of the revised ASFI provides that the “important aspects of the transaction structure” stated in (i)(C) above refers to “details of the rights indicated in respect of crypto assets (or, if the relevant rights do not exist, such fact) and ... details of the obligations to be assumed by the Customer as a result of Sales of Financial Instruments”. Although the meaning of “details of the rights indicated on crypto assets” is not clear. In the case of Bitcoin, for example, “such rights do not exist” since Bitcoin holders do not acquire any specific rights. Turning to the reference “details of the obligations to be assumed by the Customer” it would seem to mean both the obligation to pay fees (if any) and the obligation to provide additional security deposit in the event of fluctuations in quotations.

#### 4-2-2 Manner and Extent of Explanation

Article 3, Paragraph 2 of the ASFI requires explanations of any sale of financial instruments to be provided in such manner and to such extent necessary to facilitate the understanding of a crypto asset user, in light of his or her knowledge and experience, the condition of his or her property, or the purpose for which he or she has concluded a contract for the purchase of financial instruments. In this connection, Chapter II of the “Rules on Solicitation and Advertising, etc.” issued by the JVCEA sets forth the relevant rules applicable to solicitation.

## 5 Transitional Measures

### 5-1 Crypto Asset Exchange Service

The transitional measures for Crypto Asset Exchange Services are stipulated in Articles 2 and 3 of the Supplementary Provisions of the Bill (the “**Supplementary Provisions**”), which are summarized below.

First, any person who actually engages in the business of managing crypto assets when the amendment act comes into force (except for businesses that are already regulated as crypto asset exchange businesses) may engage in such business (but limited to businesses for the benefit of users within the scope of operations actually conducted when the amendment act becomes effective) for 6 months from the effective date of the PSA Revisions (Article 2, Paragraph 1 of the

Supplementary Provisions). A person who files an application for registration within 6 months of the effective date may engage in the business of managing crypto assets within the existing scope until the relevant authorities decide whether to approve the registration. However, a person who is not registered within 18 months of the effective date would be prohibited from engaging in such business (Article 2, Paragraph 2 of the Supplementary Provisions). This only applies to business operators who (i) actually engage in the business of managing crypto assets and (ii) do not engage in the crypto asset exchange business under current laws (i.e., those who only engage in Crypto Asset Custody Services) when the amendment act takes effect. In addition, it should be noted that since the scope of business will be "limited to businesses for the benefit of users within the scope of operations actually conducted when the amendment act becomes effective," activities such as taking on new customers or handling new types of crypto assets after the effective date are not allowed, until such person is registered as a Crypto Asset Exchange Service Provider.

It is also worth noting that any person who engages in the business of managing crypto assets in this way will be deemed a Crypto Asset Exchange Service Provider, and will be subject to the amended PSA and the APTCP (Article 2, Paragraph 3 of the Supplementary Provisions).

In addition, any person who engages in the business of managing crypto assets in the manner stated above is required to report its trade name and address within 2 weeks of the effective date of the Bill (Article 3, Paragraph 1 of the Supplementary Provisions). The transitional measures mentioned above will not apply to any person who fails to make such report or who makes a false report (Article 3, Paragraph 2 of the Supplementary Provisions).

## **5-2 Financial Instruments Business**

The transitional measures for the Financial Instruments Business, stipulated in Articles 10 to 13 of the Supplementary Provisions, are summarized below.

First, in respect of public offerings (primary or secondary) of securities related to ERTRs that are commenced before the effective date of the Bill, the provisions in force will remain applicable (Article 10 of the Supplementary Provisions).

Second, any person who actually engages in the Financial Instruments Business (except for businesses that already fall under Financial Instrument Business) when the FIEA Revisions come into force may engage in such business (but limited to businesses for the benefit of users within the scope of operations related to the Financial Instruments Business actually conducted when the amendment act becomes effective) for 6 months from the effective date (Article 11, Paragraph 1 of the Supplementary Provisions). A person who files an application for registration within 6 months of the effective date may engage in the Financial Instruments Business within the existing scope until the relevant authorities decide whether to approve the registration. However, a person that is not registered within 18 months of the effective date would be prohibited from engaging in the Financial Instruments Business (Article 11, Paragraph 2 of the Supplementary Provisions).

Moreover, it should be noted that, as with the transitional measures for crypto asset exchange business, activities such as taking on new customers or handling new types of crypto assets after the effective date are not allowed until registration for the relevant Financial Instruments Business Operator is approved.

It should be noted that a person who engages in the Financial Instruments Business in this manner will be deemed a Financial Instruments Business Operator, and will be subject to the revised FIEA and the APTCP (Article 11, Paragraph 3 of the Supplementary Provisions).

In addition, any person who engages in the Financial Instruments Business in the manner described above will be required to report its trade name and address within 2 weeks of the effective date of the Bill (Article 12, Paragraph 1 of the Supplementary Provisions). The transitional measures mentioned above will not apply to any person who fails to make such report or who makes a false report (Article 12, Paragraph 2 of the Supplementary Provisions).

Furthermore, transitional measures for the registration of changes under Article 31, Paragraph 4 of the FIEA will also apply to Financial Instruments Business Operators who engage in the business referred to in Article 29-2, Paragraph 1, Items 8 and 9 of the revised FIEA, when the amendment act comes into force (see 3-2-3 above) (Articles 13 and 14 of the Supplementary Provisions).

\* \* \* \* \*

**[List of wrongful acts and penalties]**  
(See sub-sections 3-3-2, 3-3-3 and 3-3-4)

Type of acts	Provision under the relevant revisions	Specific prohibited acts	Penalties
Prohibited wrongful acts	Article 185-22 of the revised FIEA	(i) Using wrongful means, schemes or techniques; (ii) acquiring money or other property using a document or other means of communication containing misrepresentations on material matters, or omissions of material matters necessary for avoidance of misunderstanding; or (iii) using false quotations to induce transactions.	<ul style="list-style-type: none"> <li>• Imprisonment for term not exceeding ten (10) years or a fine not exceeding JPY 10 million, or both</li> <li>• If violation is committed for purposes of gaining property benefit, imprisonment for term not exceeding ten (10) years and a fine not exceeding JPY 30 million.</li> <li>• Fine not exceeding JPY 700 million for judicial persons (dual liability)</li> </ul>
Dissemination of rumors, fraudulence, commitment of assault or intimidation	Article 185-23 of the revised FIEA	Spreading of rumors, engagement in fraudulence, commitment of assault or intimidation	
Market manipulation and certain similar acts	Article 185-24 of the revised FIEA	(i) Engaging in fake sales and purchases; (ii) engaging in collusive sales and purchases; (iii) entrusting or accepting entrustment of fake sales and purchases or engaging in collusive sales and purchases; (iv) engaging in market manipulation through actual sales and purchases; or (v) engaging in market manipulation through representations and certain similar acts.	

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