THE VIRTUAL CURRENCY REGULATION REVIEW

Editors
Michael S Sackheim and Nathan A Howell

THE LAWREVIEWS

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PREFACE

On 31 October 2008, Satoshi Nakamoto published a white paper describing what he referred to as a system for peer-to-peer payments, using a public decentralised ledger known as a blockchain and cryptography as a source of trust to verify transactions. That paper, released in the dark days of a growing global financial market crisis, laid the foundations for Bitcoin, which would become operational in early 2009. Satoshi has never been identified, but his white paper represented a watershed moment in the evolution of virtual currency. Bitcoin was an obscure asset in 2009, but it is far from obscure today, and there are now many other virtual currencies and related assets. In 2013, a new type of blockchain that came to be known as Ethereum was proposed. Ethereum's native virtual currency, Ether, went live in 2015 and opened up a new phase in the evolution of virtual currency. Ethereum provided a broader platform, or protocol, for the development of all sorts of other virtual currencies and related assets.

Whether Bitcoin, Ether or any other virtual currency will one day be widely and consistently in use remains uncertain. However, the virtual currency revolution has now come far enough and has endured a sufficient number of potentially fatal events that we are confident virtual currency in some form is here to stay. Virtual currencies and the blockchain and other distributed ledger technology on which they are based are real, and are being deployed right now in many markets and for many purposes. The technology has matured beyond hypothetical use cases and beta testing. These technologies are being put in place in the real world, and we as lawyers must now endeavour to understand what that means for our clients.

Virtual currencies are essentially borderless: they exist on global and interconnected computer systems. They are generally decentralised, meaning that the records relating to a virtual currency and transactions therein may be maintained in a number of separate jurisdictions simultaneously. The borderless nature of this technology was the core inspiration for *The Virtual Currency Regulation Review* (*Review*). As practitioners, we cannot afford to focus solely on our own regulatory silos. For example, a US banking lawyer advising clients on matters related to virtual currency must not only have a working understanding of US securities and commodities regulation; he or she must also have a broad view of the regulatory treatment of virtual currency in other major commercial jurisdictions.

Global regulators have taken a range of approaches to responding to virtual currencies. Some regulators have attempted to stamp out the use of virtual currencies out of a fear that virtual currencies such as Bitcoin allow capital to flow freely and without the usual checks that are designed to prevent money laundering and the illicit use of funds. Others have attempted to write specific laws and regulations tailored to virtual currencies. Still others – the United States included – have attempted to apply legacy regulatory structures to virtual

currencies. Those regulatory structures attempt what is essentially 'regulation by analogy'. For example, a virtual currency may be regulated in the same manner as money, or in the same manner as a security or commodity. The editors make one general observation at the outset: there is no consistency across jurisdictions in their approach to regulating virtual currencies. That is, there is currently no widely accepted global regulatory standard. That is what makes a publication such as *The Review* both so interesting and so challenging to assemble.

The lack of global standards has led to a great deal of regulatory arbitrage, as virtual currency innovators shop for jurisdictions with optimally calibrated regulatory structures that provide an acceptable amount of legal certainty. While some market participants are interested in finding the jurisdiction with the lightest touch (or no touch), most of our clients are not attempting to flee from regulation entirely. They appreciate that regulation is necessary to allow virtual currencies to achieve their potential, but they do need regulatory systems with an appropriate balance and a high degree of clarity. The technology underlying virtual currencies is complex enough without adding layers of regulatory complexity into the mix.

It is perhaps ironic that the sources of strength of virtual currencies – decentralisation and the lack of trusted intermediaries necessary to create a shared truth – are the same characteristics that the regulators themselves seem to be displaying. There is no central authority over virtual currencies, either within and across jurisdictions, and each regulator takes an approach that seems appropriate to that regulator based on its own narrow view of the markets and legacy regulations. We believe optimal regulatory structures will emerge and converge over time. Ultimately, the borderless nature of these markets allows market participants to 'vote with their feet', and they will gravitate toward jurisdictions that achieve the right regulatory balance. It is much easier to do this in a virtual business than it would be in a brick and mortar business. Computer servers are relatively easy to relocate. Factories and workers are less so.

The Review is intended to provide a practical, business-focused analysis of recent legal and regulatory changes and developments, and of their effects, and to look forward at expected trends in the area of virtual currencies on a country-by-country basis. It is not intended to be an exhaustive guide to the regulation of virtual currencies globally or in any of the included jurisdictions. Instead, for each jurisdiction, the authors have endeavoured to provide a sufficient overview for the reader to understand the current legal and regulatory environment.

Virtual currency is the broad term that is used in *The Review* to refer to Bitcoin, Ether, tethers and other stable coins, cryptocurrencies, altcoins, ERC20 tokens, digital, virtual and crypto assets, and other digital and virtual tokens and coins, including coins issued in initial coin offerings. The term is intended to provide rough justice to a complex and evolving area of law, and we recognise that in many instances the term virtual currency will not be appropriate. Other related terms, such as cryptocurrencies, digital currencies, digital assets, crypto assets and similar terms, are used throughout as needed. In the law, the words we use matter a great deal, so where necessary the authors of each chapter provide clarity around the terminology used in their jurisdiction, and the legal meaning given to that terminology.

We hope that you find *The Review* useful in your own practices and businesses, and we welcome your questions and feedback. We are still very much in the early days of the virtual currency revolution. No one can truthfully claim to know what the future holds for virtual currencies, but as it does not appear to be a passing fad, we have endeavoured to provide as

much useful information as practicable in *The Review* concerning the regulation of virtual currencies.

The editors would like to extend special thanks to Ivet Bell (New York) and Dan Applebaum (Chicago), both Sidley Austin LLP associates, without whom *The Review*, and particularly the US chapter, would not have come together.

Michael S Sackheim and Nathan A Howell
Sidley Austin LLP
New York and Chicago
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Chapter 16

JAPAN

Ken Kawai and Takeshi Nagase[1]

I INTRODUCTION TO LEGAL AND REGULATORY FRAMEWORK

The cryptocurrency market in Japan experienced exponential growth in 2017 on the coattails of a steep rise in the price of Bitcoin and growing enthusiasm for initial coin offerings (ICOs). Japan has emerged as one of the largest cryptocurrency markets globally, and the government has signalled its intention to support and encourage the continued and sustainable growth of the cryptocurrency market. Indeed, Japan was the first country to establish a regulatory framework for virtual currencies. Besides enabling the registration of virtual currency exchange service providers (exchange providers) wishing to provide virtual currency exchange services (exchange services) to residents in Japan, this framework seeks to protect cryptocurrency exchange customers and prevent cryptocurrency-related money laundering and terrorism financing.

The need for such regulatory framework can be traced to recent developments. One such development is the civil rehabilitation in February 2014 of MTGOX Co, Ltd (MTGOX), a Japanese company that provided convertible cryptocurrency exchange services between cryptocurrencies and fiat currencies and was the world's largest cryptocurrency exchange at that time. Through civil rehabilitation proceedings at the Tokyo District Court, it was discovered that the value of the legal tender (fiat currencies) and Bitcoins in the bankruptcy estate fell far short of the amount owed to MTGOX's customers. However, as these customer claims were deemed unsecured, a substantial amount could not be clawed back. This case highlighted the urgent need for regulatory protection of cryptocurrency exchange customers.

The *MTGOX* case was followed by the publication of the Guidance for a Risk-based Approach to virtual currencies by the Financial Action Task Force (FATF Guidance) in June 2015, pursuant to the Leaders' Declaration at the 2015 G7 Summit in Elmau. Among other proposals, the FATF Guidance recommended the registration or licensing, or both, of virtual currency exchanges, in addition to their compliance with anti-money laundering and anti-terrorism financing regulations, including customer identification requirements.

In light of these circumstances, a bill to amend the Payment Services Act (PSA) and the Act on Prevention of Transfer of Criminal Proceeds (APTCP) was submitted to the Japanese Diet on 4 March 2016. This bill was subsequently passed on 25 May 2016, and the proposed legislative amendments (amendments) came into force on 1 April 2017. As of the end of 2017, 16 cryptocurrency exchanges were registered with the Financial Services Agency of Japan (FSA) as exchange providers under the amendments, with over 100 more (including overseas entities) awaiting or applying for such registration. These developments

1 Ken Kawai is a partner and Takeshi Nagase is a senior associate at Anderson Mori & Tomotsune.

in the cryptocurrency market were buoyed by the conclusion of several large-scale ICOs in Japan. As cryptocurrency-based businesses such as cryptocurrency or ICO investment funds, and mining businesses, grew in popularity, several Japanese companies, including financial institutions, also established ICO platforms.

However, the upsurge of the Japanese cryptocurrency market was arrested in January 2018, when Coincheck, Inc (Coincheck), one of the largest cryptocurrency exchanges in Japan, announced losses of approximately US$530 million from a cyberattack on its network. As a result, the FSA conducted sweeping on-site inspections on registered and provisional exchanges,[2] including Coincheck. This was followed by the FSA's announcement, on 8 March, of the imposition of business suspension orders on two provisional exchanges, and business improvement orders on two registered exchanges and three provisional exchanges. After further review, on 22 June the FSA also imposed business improvement orders on six additional major registered exchanges. Because of this turn of events, the regulatory environment in Japan has become uncertain.

II SECURITIES AND INVESTMENT LAWS

A token may be deemed to constitute equity interest in an investment fund (i.e., a collective investment scheme) under the Financial Instruments and Exchange Act of Japan (FIEA) if distributions are paid to holders of such tokens on the profits of the token issuer in accordance with the ratio of each holder's ownership of tokens. Issuers of tokens constituting equity interest in an investment fund will be regulated by the FIEA.

However, tokens (including virtual currencies) that do not have such characteristics in most cases will not fall within the definition of securities under the FIEA. Accordingly, token sales (including ICOs) are not specifically regulated by the FIEA, which primarily regulates securities. (For further details, see Section VII.)

III BANKING AND MONEY TRANSMISSION

i Approach of the central bank

Under Japanese law, cryptocurrencies are neither deemed money nor equated with fiat currency. No cryptocurrency is backed by the government or the Bank of Japan, the Japanese central bank.

ii Money transmission

Under Japanese law, only licensed banks or registered fund transfer business operators are permitted to engage in money remittance transactions as a business. For this purpose, the Supreme Court, in a case precedent, has defined money remittance transactions to mean 'the planned or actual transfer of funds, as requested by customers, through utilisation of a fund transfer system without physical transportation of cash between physically distant parties'. As funds does not include virtual currencies, however, a virtual currency remittance transaction is unlikely to be deemed a money remittance transaction. For instance, a transfer of Bitcoins by a wallet service provider to an address designated by the relevant customer is unlikely to be deemed a money remittance transaction.

2 Provision exchanges are those exchanges that have received temporary business permits.

IV ANTI-MONEY LAUNDERING

As noted above, to prevent cryptocurrency-related money laundering and terrorism financing, the APTCP was amended to require exchange providers to implement know your customer (KYC) and other preventative measures. The APTCP applies to registered exchange providers, and generally requires financial institutions to:

a verify and record the identity of customers when conducting certain transactions (that is, to implement a KYC process);[3]

b record transactions with customers;[4]

c report suspicious transactions to the FSA;[5] and

d take measures to keep information regarding customer verification up to date, provide education and training for employees, and develop other systems necessary for the proper conduct of the processes described in (a) to (c).[6]

Under the APTCP, exchange providers must conduct a KYC process[7] when undertaking any of the following:

a executing a master agreement with a customer for providing such customer with regular virtual currency exchange, management and similar services in respect of the customer's money or virtual currency;

b exchanging (and similar) of a virtual currency involving the receipt and payment of virtual currency exceeding ¥2 million in value; or

c transferring the virtual currency of a customer that is managed by the exchange provider, at the request of the customer, where the virtual currency to be transferred exceeds ¥100,000 in value.

V REGULATION OF EXCHANGES

i Regulation of exchange services

As noted above, the amendments were mainly intended to regulate exchange services, with a particular focus on protecting customers, and preventing cryptocurrency-related money laundering and terrorism financing. As a result of the amendments, those wishing to provide exchange services have to be registered with the Prime Minister[8] as exchange providers.[9, 10] To qualify, applicants must be either a stock company, or a foreign exchange provider with

3 Articles 4 and 6 of the APTCP.

4 Article 7 of the APTCP.

5 Article 8 of the APTCP.

6 Article 11 of the APTCP.

7 Order for Enforcement of the APTCP, Article 7, Paragraph 1, Item (i).

8 Article 63-2 of the PSA. Such registration will be carried out through the FSA and the relevant local finance bureau (both of which are administrative agencies in Japan), which act as the Prime Minister's delegates (Article 104, Paragraph 1 and 2 of PSA and Article 30, Paragraph 1 of Order for Enforcement of the PSA).

9 Article 2 Paragraph 8 of the PSA.

10 It should also be noted that the PSA does not restrict exchange providers from engaging in other kinds of businesses or officers of exchange providers from being officers in other companies. This would have the effect of facilitating alliances between businesses of different kinds.

an office and representative in Japan. Accordingly, a foreign applicant is required to establish either a subsidiary (in the form of a stock company) or a branch in Japan as a prerequisite to registration. In addition, applicants are required to have:

a a sufficient financial base of at least ¥10 million in capital as well as net assets with a positive value;

b a satisfactory organisational structure and appropriate operational systems to enable the proper provision of exchange services; and

c appropriate systems to ensure compliance with the applicable laws and regulations.

The amendments have also provided legislative definitions of exchange services and virtual currency.

Article 2(7) of the PSA defines exchange services as engagement in any of the following activities as a business:

a the sale or purchase of virtual currencies, or the exchange of a virtual currency for another virtual currency;

b intermediating, brokering or acting as an agent in respect of the activities listed in (a) ; or

c the management of customers' money or virtual currency in connection with the activities listed in (a) and (b).

Virtual currency is defined in Article 2(5) of the PSA as:

a a proprietary value[11] that may be used to pay an unspecified person the price of any goods purchased or borrowed or any services provided, where such proprietary value may be:
- sold to or purchased from an unspecified person, provided such sale and purchase is recorded on electronic or other devices through electronic means; and
- transferred through an electronic data processing system; or

b a proprietary value that may be exchanged reciprocally for such proprietary value specified in (a) with an unspecified person, where such proprietary value may be transferred through an electronic data processing system.

Notwithstanding the above, it should be noted that the amendments are not intended to constitute a comprehensive legal framework for the regulation of virtual currencies. For example, the amendments do not address the treatment of consumption tax and other taxes on virtual currency transactions.

ii Process of registration as an exchange provider

A registration application is required to contain, *inter alia*:

a the applicant's trading name and address;

b the applicant's capital amount;

11 For the purposes of the definition of virtual currency, this excludes the proprietary value comprising Japanese and other foreign currencies and currency-denominated assets. Currency-denominated assets, in turn, are assets denominated in yen or a foreign currency, or with respect to which the performance, repayment or other activities equivalent thereto will be carried out in yen or a foreign currency. Accordingly, a digital coin would fall outside the definition of virtual currency if its price is pegged to the yen (such as a situation where the price of a digital coin is invariably fixed at ¥1).

c the names of the applicant's director or directors;
d the name of the virtual currencies to be handled;
e the nature and content of the exchange services to be provided, and the means by which such services will be provided;
f the name of the applicant's outsourcees (if any) and the address thereof; and
g the method by which the applicant will segregate its management of customers' virtual currencies from the management of its own properties.

A registration application must also be accompanied by certain supporting documents, including:

a a document certifying the non-existence of any circumstance that would constitute grounds for rejection of the application;
b extracts of documents certifying the place of residence of its directors and the like;
c résumés (and the like) of an applicant's directors;
d a list of the applicant's shareholders;
e the applicant's financial information;
f documents showing that the applicant has systems in place for ensuring the proper provision of exchange services;
g an organisation chart;
h internal rules; and
i the proposed form of the contract to be entered into between the applicant and its customers.

To enable applicants to monitor their applications, the FSA has prepared a detailed progress chart through which applicants may track the status of their applications. The registration process in effect constitutes due diligence on the part of the FSA, and the FSA accordingly conducts a comprehensive review of applications. As a practical matter, therefore, the registration process is similar to a licence application.

Once an application is approved, the name of the applicant will appear on a publicly available list of exchange providers.

iii Principal regulations applicable to the operation of exchange providers

Exchange providers are required to:

a take such measures necessary to ensure the safe management of information available to them;
b provide sufficient information[12] to customers;
c take such measures necessary for the protection of customers and the proper provision of services;
d segregate the property of customers from its own property,[13] and subject such segregation to regular audits by a certified public accountant or audit firm; and

12 Such as details of transactions; an outline of each virtual currency handled by the provider; fee information; information on the amount of cash or virtual currency that the provider has received from the customer and the date of receipt thereof; and transaction records.

13 Such as maintaining segregated bank deposits or trust assets with respect to cash; and maintaining such a degree of distinction as to enable customers' virtual currency to be immediately identifiable; with respect to virtual currency.

e establish internal management systems to enable the provision of fair and appropriate responses to customer complaints, and implement measures for the resolution of disputes through financial ADR proceedings.

iv Other regulations applicable to exchange providers

Additionally, exchange providers must:

a prepare and maintain books and documents relating to their exchange services;

b prepare and submit to the FSA a report on their exchange services for every business year of operation, together with related financial documents and an audit report on such financial documents prepared by a certified public accountant or audit firm; and

c prepare and submit to the FSA a report on the amount or quantity of customers' funds or virtual currency managed by them.

Where it deems necessary for the proper and secure provision of exchange services, the FSA may also order an exchange provider to submit additional reports or materials; inspect the office or other facilities of an exchange provider; and enquire about the status of an exchange provider's business or properties, or inspect its books and other documents. Furthermore, the FSA may order an exchange provider to take such measures necessary for the improvement of its business operations or financial condition, or to facilitate the FSA's supervision of the exchange provider.

The FSA may revoke the registration of an exchange provider, or order it to suspend all or part of its services for a period not exceeding six months, if any ground is found for the revocation of the exchange provider's registration; the exchange provider has obtained the registration through fraudulent means; or the exchange provider has violated the PSA, an order issued under the PSA or a disposition rendered pursuant to the PSA. The FSA, when revoking the registration of an exchange provider, will issue a public notice to that effect.

VI REGULATION OF MINERS

As the mining of virtual currencies does not fall within the definition of exchange service, mining activities are not regulated under current Japanese law. It is important to note, however, that interests in mining schemes formulated as collective investment schemes or in cloud mining schemes[14] could be deemed securities under the FIEA, and could therefore be subject to provisions under the FIEA.

VII REGULATION OF ISSUERS AND SPONSORS

i Regulation of ICO tokens and ICO token issuers

Tokens issued by way of ICOs take many forms, and the Japanese regulations applicable to a token vary depending on the ICO scheme involved.

14 That is, schemes where money or cryptocurrencies are collected from investors who do not themselves deploy actual mining machines (but instead take up stakes in the mining capacities of remote facilities under contract); and operators of the actual mining machines distribute cryptocurrencies as returns of the mining business to investors on a *pro rata* basis.

Virtual currency-type tokens

Where a token falls within the definition of virtual currency, virtual currency-related regulations under the PSA will apply. Where a token is subject to the PSA, it must be sold by or through an exchange provider.

Based on the prevailing view as well as current practices, where a token issued via an ICO is already in circulation on a Japanese or foreign cryptocurrency exchange, such token would be deemed a virtual currency under the PSA, since a market of exchange for that token is already in existence. It bears noting that a token that is not already in circulation would also likely be considered a virtual currency under the PSA if it is readily exchangeable for Japanese or foreign fiat currencies or virtual currencies, owing to a lack of exchange restrictions applicable to such token.

By extension of this reasoning, virtual currency-type tokens issued via an ICO would be deemed virtual currencies upon their issuance. Similarly, the sale of such tokens would constitute the sale of virtual currencies. Hence, a token issuer must, as a general rule, be registered as an exchange provider if the token sale (i.e., the ICO) is targeted at residents in Japan. Notwithstanding the foregoing, it has been argued that a token issuer does not need to undergo registration as an exchange provider if the issuer has completely outsourced its token issuance to a reliable ICO platform provider that is registered as an exchange provider.

Securities-type tokens

As noted above, where distributions are paid to token holders on the profits of the business conducted by a token issuer, and calculated based on the ratio of the holder's token ownership, the token involved may constitute equity interest in an investment fund (i.e., a collective investment scheme) and subject the token issuer to the provisions of the FIEA. In such a case, the offering of tokens must be conducted by a duly registered Type II financial instruments business operator, unless the offer constitutes an exempt private placement to a qualified institutional investor and similar pursuant to Article 63 of the FIEA. To date, however, there have been no offerings of securities-type tokens in Japan. If a token also falls within the definition of virtual currency under the PSA, that token would be subject to regulation under the PSA. However, it is unclear in such a case whether the token issuer would be required to comply with the requirements of the PSA on top of those under the FIEA.

Prepaid card-type tokens

Tokens that are similar to prepaid cards, in the sense of being usable as consideration for goods or services provided by token issuers, may be regarded as prepaid payment instruments, and accordingly could be subject to the applicable regulations under the PSA. (It is noteworthy that a token subject to the prepaid payment instrument regulations under the PSA would not simultaneously be subject to the PSA regulations applicable to virtual currency (and vice versa).)

ii Regulation of sponsors

As one of the primary purposes of virtual currency regulations in Japan is the protection of cryptocurrency exchange customers, sponsors of ICO issuers are not regulated by the PSA or other laws in respect of virtual currencies.

VIII CRIMINAL AND CIVIL PENALTIES

i Penal provisions applicable to exchange providers

The existing penal provisions found in the PSA are applicable to virtual currency exchange service providers. The following is a summary of some of the major violations under the PSA, and the penalties for such violations.

a Imprisonment with penal labour for a term not exceeding three years or a fine not exceeding ¥3 million, or both, can be imposed for:[15]
- providing exchange services without registration;
- registration through fraudulent means; or
- name-lending.

b Imprisonment with penal labour for a term not exceeding two years or a fine not exceeding ¥3 million, or both, can be imposed for:[16]
- a violation of the obligation to segregate customers' funds and virtual currency from an exchange provider's funds and virtual currency; or
- a violation of any order for the suspension of exchange services.

c Imprisonment with penal labour for a term not exceeding one year or a fine not exceeding ¥3 million, or both, can be imposed for:[17]
- failure to give public notice of a business assignment, merger, demerger, company split or discontinuance of business, or dissolution with respect to an exchange provider, or giving false public notice thereof;
- a violation of the obligation to prepare and maintain books and documents, or the preparation of false books or documents;
- failure to submit the required report (and required attachments thereto) for each business year to the Prime Minister, or submission of a report containing false statements;
- failure to comply with an order of the Prime Minister to submit reports or materials, or the submission of false reports or materials; or
- refusing to respond to questions or giving false responses at an on-site inspection, or refusing to provide cooperation in respect of such inspection.

d Imprisonment with penal labour for a term not exceeding six months or a fine not exceeding ¥500,000, or both, can be imposed for providing false statements in a registration application or attachments thereto.[18]

e A fine not exceeding ¥1 million can be imposed for violating an order for the improvement of business operations.[19]

ii Civil fraud

The PSA contains no specific regulation for the prevention of unfair trading or sale of tokens. However, the Civil Code or Penal Code of Japan, and certain consumer protection laws and

15 Article 107 of the PSA.

16 Article 108, 63-11 (1), 63-17 (1) of the PSA.

17 Article 109, 63-20, 63-13, 63-14, 63-15 of the PSA.

18 Article 112, 63-3 (1) and (2) of the PSA.

19 Article 113, 63-16 of the PSA.

regulations,[20] are applicable to such activities, except where the relevant token is deemed a security under the FIEA, in which case the FIEA provisions regulating unfair trading of securities will apply.

IX TAX

The treatment of consumption tax in respect of cryptocurrencies has been a hot topic in Japan. In the past, sales of cryptocurrencies were subject to Japanese consumption tax to the extent that the office of the transferor is located in Japan. However, this position changed in 2017. Under the amended tax laws, consumption tax is no longer imposed on a sale of cryptocurrency after 1 July 2017 if the relevant cryptocurrency is deemed a virtual currency under the PSA, such as Bitcoin. Additionally, it was announced by the National Tax Agency of Japan that gains from the sale or use of virtual currencies will be treated as miscellaneous income where the taxpayer is unable to offset gains from the sale or use of virtual currencies against losses incurred elsewhere. Furthermore, inheritance tax will apply to investments in virtual currencies.

X OTHER ISSUES

Under the Foreign Exchange and Foreign Trade Act of Japan, a person who makes any payment from or receives any payment in Japan in excess of ¥30 million is required to notify the Minister of Finance of such payment or receipt. This notification requirement has recently been extended to cover virtual currency. Specifically, it was announced by the government on 18 May 2018 that the Minister of Finance must be notified of payments or receipts of virtual currencies with a market value exceeding ¥30 million as of the payment date.

XI LOOKING AHEAD

In January 2018, Coincheck, one of the largest cryptocurrency exchanges in Japan, announced its loss of approximately US$530 million worth of cryptocurrencies from a cyberattack.

This incident came to be viewed as a social problem owing to the relatively large number of Coincheck customers in Japan, and resulted in the FSA taking a more stringent approach toward cryptocurrency exchanges and registration applicants. The incident also triggered a series of on-site and offsite inspections by the FSA on several cryptocurrency exchanges (including Coincheck), and caused the FSA to suspend its approval of new applications for more than six months. Eventually, in April 2018, Coincheck was acquired by Monex Group Inc, one of the largest online brokerage companies in Japan.

Following the incident, on 8 March the FSA announced its formulation of a study group on exchange services (and similar services) to address outstanding regulatory issues in respect of cryptocurrencies, including the numerous issues discovered through on-site inspections of cryptocurrency exchanges and the speculative (as opposed to settlement) use of cryptocurrencies.

20 Such as the Act on Specified Commercial Transactions, the Consumer Contract Act, and the Act against Unjustifiable Premiums and Misleading Representations.

The incident has also accelerated the integration of the exchange industry. The Japan Virtual Currency Exchange Association (JVCEA), a newly founded self-regulatory organisation whose membership consists of 16 licensed exchanges, was established on 29 March 2018. The JVCEA is aiming to be an FSA-accredited self-regulatory organisation, and is in the process of preparing regulations with which its members must comply.

Additionally, the FSA on 22 June 2018 also issued administrative orders under the PSA against six exchange providers requiring the improvement of their business operations. These orders were based on the FSA's findings from both on-site and offsite inspections, in which the management structures of the six exchange providers were found to be inadequate for ensuring appropriate and reliable business operations. Specifically, it was noted in the administrative orders that the internal systems of the six exchange providers were deficient in the following areas:

a preventing money laundering;
b eliminating business dealings with antisocial effects;
c operational security;
d segregating clients' assets from their own assets;
e responding to customer complaints; and
f conducting due diligence investigations of newly listed coins or tokens.

As a consequence of these findings, the FSA has adopted a different stance on cryptocurrency exchange businesses. The FSA is currently revising its internal standards for approving applications for registration as exchange providers, and the new standards are expected to require the fulfilment of higher standards, especially in the six areas listed above.

In summary, in the aftermath of the Coincheck incident, the FSA has adopted a more stringent approach towards the cryptocurrency industry. Given this development, a rise in the number of mergers and acquisitions involving registered exchanges is expected going forward.

Appendix 1

ABOUT THE AUTHORS

KEN KAWAI

Anderson Mori & Tomotsune

Ken Kawai has extensive experience advising financial institutions, FinTech startups, investors and corporate clients on complex finance and financial regulatory matters.

Ken focuses primarily on the FinTech industry, and regularly advises FinTech companies, financial institutions, international organisations and self-regulatory organisations on legal issues surrounding FinTech, including the complex legal framework governing cryptocurrencies, initial coin offerings and blockchain.

Ken also specialises in derivatives, and has counseled global banks, broker-dealers and investors on regulatory matters and best practices in respect of derivatives and related products. He derives his deep and practical knowledge in this area from his 17-year career at MUFG Bank, Ltd (formerly known as the Bank of Tokyo-Mitsubishi and, prior to that, the Bank of Tokyo Ltd), where he was involved in derivatives trading and marketing.

Ken's practice also extends to corporate bankruptcy, insolvencies and reorganisations, in respect of which he has represented debtors and creditors in several complex multijurisdictional insolvency cases. He also advises several global systemically important institutions and related institutions on bank recovery and resolution regimes.

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Takeshi handles finance and corporate transactions, and has considerable experience advising on all legal aspects of public and private M&As, joint ventures, FinTech, and other corporate and financial advisory matters. His clients range from prominent financial institutions to virtual currency start-ups. Between 2013 and 2014, Takeshi served on secondment in the Disclosure Department of the Financial Services Agency of Japan, where he was an instrumental part of the team that revised the laws and guidelines governing disclosure by listed companies, and prepared the Japanese Stewardship Code. Additionally, he handled a broad range of finance and corporate transactions on a secondment stint with the legal department of a major Japanese securities firm from 2015 to 2017. As a result of the unique perspective he has gained from these professional experiences, Takeshi is often sought for his advice on finance-related matters, particularly by clients seeking to evaluate transactions from the regulator's point of view. Recently, Takeshi has extended his focus to virtual currency laws, including regulatory requirements applicable to registration of virtual currency exchange service providers, initial coin offerings, and the like.

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