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Approaches and developments

There has been a series of significant Fintech-related changes to the regulations in Japan. We note that most of those changes are driven by the regulators' intention to stimulate Fintech business and innovation in legacy financial institutions in Japan. Additionally, regulators have had to deal with various consumer protection issues that have arisen in Japanese Fintech industries, which resulted in their decision to strengthen the regulations governing emerging Fintech businesses in order to address new risks for consumers arising from the new services. We set forth below typical cases of this regulatory trend in Japan.

Crypto assets

Japan was the first country to establish a regulatory framework for crypto assets. The crypto asset 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 crypto asset markets globally.

In January 2018, however, one of the largest crypto asset exchanges in Japan announced that it had lost approximately USD 530 million worth of cryptocurrencies in a hacking attack on its network. Thereafter, the Financial Services Agency of Japan (the "FSA") began performing on-site inspections of registered exchanges and deemed registered exchanges (which conduct business on a temporary basis), including the hacked exchange.

In response to the hacking incident, the regulatory framework for crypto assets was amended to (i) enhance customer protection by introducing stricter regulations applicable to crypto assets, and (ii) include specific regulations on crypto asset derivatives and digital securities. The new regulatory framework entered into force on May 1, 2020. Please refer to "**Key regulations and regulatory approaches**" below for details.

Open APIs

Open APIs (Application Programming Interfaces) are another trend for Fintech business operators in Japan. In March 2017, the Diet passed a bill amending the Banking Act to regulate "electronic payment intermediary service providers" to facilitate open APIs. The amendments, including relevant subordinate regulations, went into effect on June 1, 2018. Under the amendments, financial institutions must adopt and make public the standards for decisions to enter into contracts with specific electronic payment intermediary service providers (please refer to "**Key regulations and regulatory approaches**" below for the definitions and related regulations for electronic payment intermediary service providers). Financial institutions must treat electronic payment intermediary service providers that meet such standards in a fair and non-discriminatory manner. Financial institutions intending to enter into contracts with electronic payment intermediary service providers were required to

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make efforts to develop an open API system by the end of May 2020. According to a survey conducted by the FSA in March 2020, more than 110 banks operating in Japan have made their APIs open to Fintech companies.

One-stop financial services intermediary

The rapid development of information and communication technologies in recent years has enabled entrepreneurs to create and offer innovative services to the financial industry. In particular, there has been a growing need for one-stop online platforms enabling access to financial services of various kinds. There has also been a rise in demand for convenient cashless payment services. Against this backdrop, the FSA submitted a bill to the Diet in March 2020 and the bill was passed by the Diet in June 2020. The bill is designed, amongst others, to introduce a new category of business termed "financial services intermediary business". Please refer to "**Key regulations and regulatory approaches**" below for details.

Fintech offering in Japan

In Japan, crypto asset-based businesses, cashless payment or mobile payment services, financial account aggregation services, robo-advisors, and crowd funding are relatively active Fintech offerings. Meanwhile, other innovations such as peer-to-peer lending and Insurtech have yet to penetrate the Japanese market.

It is notable that an increasing number of companies have entered into or expanded their businesses in the mobile payment market in the past several years, and they are currently facing great competition.

From a legal perspective, these mobile payment services (including QR code payment services) fall within three models: prepaid; direct debit payment; and deferred payment. The prepaid model requires a user to transfer funds from a bank account prior to a payment. The deferred payment model requires a user to link an existing credit card to the QR code application. Both models are relatively common in Japan, and the direct debit payment model is less popular but has been expanding recently. As different regulations apply to each model, entities seeking to undertake business related to QR code payments in Japan are recommended to consult a regulatory specialist for compliance purposes.

In 2020, digital securities may become a key focus area. Because the new regulatory framework has clarified the regulations on digital securities (see "**Key regulations and regulatory approaches**"), quite a number of financial institutions are entering into this new market. For instance, in November 2019, Mitsubishi UFJ Financial Group announced the establishment of a research consortium to develop standards around digital securities management. In February 2020, Mizuho Financial Group launched a demonstration test for issuing digital securities targeting individual investors. In March 2020, Nomura Holdings revealed that it would be issuing digital securities using blockchain technology.

Regulatory and insurance technology

Regtech has not yet come to Japan; however, the FSA officially announced in its Assessments and Strategic Priorities 2018 that it would enhance Regtech and Suptech (Supervisory Technology) in Japan. One of the recent legislative changes in this area is that, in 2018, the subordinate regulations of the Act on the Prevention of Transfer of Criminal Proceeds were amended in order to finally make several methods of e-KYCs available in Japan.

Insurtech appears to still be behind other areas of Fintech, such as mobile payment and crypto assets businesses in Japan. While quite a few Japanese insurance companies appear

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to be interested in Insurtech and, therefore, either attempted to develop their own Insurtech tools or invest in overseas Insurtech enterprises, we have not seen many Insurtech startups in Japan so far. Notably, in 2019, some major Japanese insurance companies such as Mitsui Sumitomo Insurance Company and Sompo Japan Insurance launched their new "risk tech" services, using data they had collected through their existing businesses.

Regulatory bodies

There are several relevant regulatory bodies for Fintech businesses in Japan.

A firm (including an overseas firm) that wishes to undertake regulated activities in Japan is required to obtain the applicable licence from Japanese financial regulators, the FSA or one of the Local Financial Bureaus that the FSA has delegated a part of its authority to, except for services related to deferred payments, which require authorisation from the Ministry of Economy, Trade and Industry of Japan (the "METI").

Fintech-related laws such as the Banking Act, the Payment Services Act (the "PSA") and the Installment Sales Act incorporate regulations addressing both prudential supervision and consumer protection. As a result, a regulator who governs each act will be a single regulator from the perspective of both prudential supervision and consumer protection.

Key regulations and regulatory approaches

<u>Crypto asset-related services</u>

Crypto asset exchange services

Regulations on crypto assets came into force on April 1, 2017. The PSA was amended to introduce registration requirements for "crypto asset exchange service providers". In June 2019, the PSA was further amended to enhance customer protection by introducing stricter regulations applicable to crypto assets. The amended PSA came into force on May 1, 2020.

For purposes of the PSA, "crypto asset" is defined as:

i. proprietary value 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 (a) sold to or purchased from an unspecified person, provided such sale and purchase is recorded on electronic or other devices through electronic means, and (b) transferred through an electronic data processing system; or
ii. proprietary value that may be exchanged reciprocally for such proprietary value specified in the preceding item with an unspecified person, where such proprietary value may be transferred through an electronic data processing system.

Most of the so-called payment tokens and utility tokens would fall within the definition of a crypto asset.

Crypto asset exchange services ("CAES") have been defined to include any of the following acts carried out as a business:

i. the sale/purchase of crypto assets or exchanges for other crypto assets;
ii. intermediary, agency or delegation services for the acts listed in (i) above;
iii. the management of users' money in connection with the acts listed in (i) and (ii); or
iv. the management of crypto assets for the benefit of another person.

As a consequence of this definition, not only typical crypto asset exchanges, but also so-called OTC brokers, are regulated as CAES providers under the PSA. Moreover, most ICOs or token sales fall within the definition of CAES. As a result, a token issuer must, as a general rule, be registered as a CAES provider if the token sale (i.e., the ICO) is targeted at residents

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in Japan. Notwithstanding the foregoing, a token issuer does not need to undergo registration as a CAES provider if the issuer has completely outsourced its token issuance to a reliable ICO platform provider that is registered as a CAES provider.

It should be noted that, as a result of the 2019 amendment to the PSA, managing customers' crypto assets and transferring such crypto assets to addresses designated by customers will constitute a CAES because "managing crypto assets for the benefit of another person" has been included in the definition. Accordingly, a custodial wallet service provider must undergo registration as a CAES provider if its wallet service is provided to residents in Japan.

A CAES provider is required to manage its customers' money separately from its own money, and to entrust its customers' money to a trust company or any other similar entity. A CAES provider shall manage the crypto assets of customers ("Entrusted CA(s)") separately from its own crypto assets. In addition, a CAES provider is required to manage 95% or more of the value of total Entrusted CAs with full-offline wallets or by other technical measures that have an equivalent level of safety as full-offline wallets.

Crypto asset derivatives

As stated in "**Approaches and developments**" above, the amended FIEA which entered into force on May 1, 2020 includes specific regulations on crypto asset derivatives. As a consequence of the inclusion of "crypto assets" and standardised instruments of crypto assets created by financial instruments exchanges within the definition of financial instruments, and the inclusion of crypto asset prices, interest rates, etc. within the definition of financial indicators, respectively, crypto asset derivative transactions are now subject to the provisions of the FIEA, regardless of the type of derivative transactions involved. For instance, the provision of OTC crypto asset derivative transactions or acting as an intermediary or broker in relation thereto constitutes Type 1 Financial Instruments Business under the amended FIEA. Accordingly, a company engaging in these transactions will need to undergo registration as a Type 1 Financial Instruments Business Operator ("Type 1 FIBO"). In addition to various rules of conduct applicable to those Type 1 FIBOs providing crypto asset derivative services under the FIEA, it is noteworthy that the amended FIEA introduced strict leverage ratio regulations. If a Type 1 FIBO engages in crypto asset derivative transactions, the amount of margins to be deposited by a customer must (i) if the customer is an individual, not fall below 50% of the amount of crypto asset derivative transactions (i.e., the leverage ratio of up to two times), or (ii) if the customer is a corporation, not fall below the amount of crypto asset derivative transactions, multiplied by 50% or the crypto asset risk assumption ratio based on the historical crypto asset volatilities as specified in the public notice.

Digital securities

The FIEA has conventionally classified securities into: (i) traditional securities such as shares and bonds ("Paragraph 1 Securities"); and (ii) contractual rights such as trust beneficiary interests and collective investment scheme interests ("Paragraph 2 Securities"). While Paragraph 1 Securities are subject to relatively stricter requirements in terms of disclosures and licensing/registration as they are highly liquid, Paragraph 2 Securities are subject to relatively looser requirements as they are less liquid. However, if securities are issued using an electronic data processing system such as blockchain, it is expected that such securities may have higher liquidity than securities issued using conventional methods, regardless of whether they are Paragraph 1 or Paragraph 2 Securities. For this reason, the amended FIEA introduces a new regulatory framework for securities which are transferable by using electronic data processing systems. Under the amended FIEA, securities which are transferable by electronic data processing systems are classified into the following three categories:

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(i) Paragraph 1 Securities such as shares and bonds which are transferable by using electronic data processing systems (Tokenized Paragraph 1 Securities).
(ii) Contractual rights such as trust beneficiary interests and collective investment scheme interests, conventionally categorised as Paragraph 2 Securities, which are transferable by using electronic data processing systems (electronically recorded transferable rights ("ERTRs")).
(iii) Contractual rights such as trust beneficiary interests and interests in collective investment schemes, conventionally categorised as Paragraph 2 Securities, which are transferable by using electronic data processing systems but have their negotiability restricted to a certain extent (Non-ERTR Tokenized Paragraph 2 Securities).

An issuer of Tokenized Paragraph 1 Securities or ERTRs is in principle required, prior to making a public offering or secondary distribution, to file a securities registration statement as is the case for traditional Paragraph 1 Securities, unless the offering or distribution falls under any category of private placements. Any person who engages in the business of the sale, purchase or handling of the offering of Tokenized Paragraph 1 Securities or ERTRs is required to undergo registration as a Type I FIBO. In light of the higher degree of freedom in designing Tokenized Paragraph 1 Securities or ERTRs and the higher liquidity of these securities, a Type 1 FIBO that handles these digital securities will be required to control risks associated with digital networks such as blockchain used for digital securities.

Electronic payment intermediary services

On June 1, 2018, the amendment to the Banking Act came into force to regulate electronic payment intermediary service providers in order to facilitate open APIs. Electronic payment intermediary service providers are defined broadly enough to include intermediaries between financial institutions and customers, such as entities using IT to communicate payment instructions to banks based on entrustment from customers, or entities using IT to provide customers with information about their financial accounts held by banks. Entities providing financial account aggregation services are also categorised as electronic payment intermediary service providers. They are required to register with the FSA in order to provide these services.

Below are the key regulations applicable to registered electronic payment intermediary service providers:

i. An electronic payment intermediary service provider that intends to conduct services that constitute electronic payment intermediary services must, in principle, disclose certain matters in advance. Such matters include the trade name or address, authority, indemnity, and the contact details of the office dealing with complaints.
ii. With regard to electronic payment intermediary services, electronic payment intermediary service providers must (a) provide information to prevent misunderstandings, (b) ensure proper handling of user information, (c) maintain safety management measures, and (d) take measures to manage outsourcing contractors.
iii. Electronic payment intermediary service providers must conclude a contract regarding electronic payment intermediary services with a bank prior to performing acts that constitute electronic payment intermediary services.
iv. The contract must specify (a) the allocation of indemnity liability in cases where users suffer damage, (b) measures for proper handling of user information, and (c) measures for safety management. Both the bank and the electronic payment intermediary service providers must publish (a) to (c) above without delay when concluding the contract.

Financial services intermediary business

In June 2020, the Act on Sales, etc. of Financial Instruments (the "ASFI") was amended in

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order to establish an industry suitable for financial services intermediaries who are seeking to provide a convenient one-stop service through which users can receive various financial services. This amendment will come into force within one and a half years.

Under the current regulatory framework in Japan, financial intermediary services are divided by "functions", such as bank agents and electronic payment service providers under the Banking Act, financial instruments intermediary service providers under the FIEA, and insurance agents and insurance brokers under the Insurance Business Act. Therefore, a business operator handling products and services across multiple "functions" would be required to apply for multiple licences. In addition to that, if a business intends to act as the agent or the intermediary for multiple financial institutions (i.e. the principals) in handling the products and services provided by such financial institutions, it would have to bear the significant burden of responding to the instructions given by each relevant principal financial institution.

Under the amended ASFI, by obtaining a new registration as a "financial services intermediary business operator" ("FSIBO"), a business operator will be permitted to act as an intermediary for cross-sectional financial services without being subject to the supervision of any principal financial institutions.

Since an FSIBO is not subject to the supervision of principal financial institutions, the scope of its business will be restricted in a manner as described below:

i it may not offer financial services as an "agent" of any financial service provider; and

ii it may not handle financial instruments which are expected to be specified by the relevant cabinet order as requiring highly specialised explanations to customers, such as derivative transactions or structured deposits.

In addition to the above, an FSIBO will be required to pay a security deposit to meet the needs of its own intermediary business and prohibited from holding customers' funds regardless of whether or not it is only holding such funds temporarily.

Other services

Apart from the regulations applicable to crypto asset-related services, services related to digital securities, electronic payment intermediary services and financial services intermediary business, there is no regulatory framework specifically designed to regulate Fintech businesses in Japan. However, if the services provided by the Fintech companies are subject to existing financial regulations, they are also required to comply with these existing regulations, which include obtaining any applicable licence or registration. A firm (including an overseas firm) that wishes to undertake regulated activities in Japan is required to obtain the applicable authorisation from Japanese financial regulators, the FSA or one of the Local Financial Bureaus to which the FSA has delegated a part of its authority or the METI. Please note that if an entity conducts solicitation activities in Japan for using its services, even if this is done from abroad, such act may be considered to be an undertaking of regulated activities in Japan.

Money transfer services are regulated under the Banking Act and other acts applicable to other depository institutions, which require firms who wish to enter into this business to obtain the relevant licence from the FSA; however, services involving money transfers of not more than JPY 1 million per transaction can be provided without the aforesaid licence if the firm obtains registration as a "funds transfer service provider" under the current PSA.

In this regard, the PSA was amended in June 2020 and will come into effect within a year, in order to facilitate the increased use of cashless payments. The amended PSA classifies fund

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transfer services ("FTS") into the following three categories: (1) FTS involving remittances exceeding JPY 1 million per transaction ("Category 1 FTS"); (2) FTS that correspond to the current classification of FTS in the PSA ("Category 2 FTS"); and (3) FTS involving remittances of small amounts of several tens of thousands of yen ("Category 3 FTS").

Under the amended PSA, a Category 1 FTS provider must be authorised to operate by the FSA and comply with a stricter code of conduct than a Category 2 FTS provider. For instance, Category 1 FTS providers must transfer funds without delay after receiving funds from a customer. The requirements applicable to a Category 2 FTS provider will remain mostly the same as those applicable to a current FTS provider. A Category 3 FTS provider may operate if registered with the FSA and is subject to a more relaxed code of conduct than a Category 2 FTS provider.

Regarding e-money, an issuer of e-money must comply with the applicable rules under the PSA. If e-money can be used only for payments to the issuer for its goods or services, the PSA does not require the issuer to obtain registration, provided that it complies with certain reporting obligations. On the other hand, if e-money can be used not only for payments to the issuer for its goods or services but also for payments to other entities designated by the issuer, then the issuer is required to obtain registration as an "issuer of prepaid payment instruments" under the PSA.

Please note that an online payment instrument can be considered either as a "funds transfer" system, a "prepaid payment instrument", a "crypto asset" or something else. As the scope of each type of payment instrument is not easy to distinguish, it is recommended to consult specialists if an entity wishes to undertake business related to online payments in Japan.

Influence of supra-national regulatory bodies

The Financial Action Task Force has been influential in the development of Fintech-related regulations in Japan. For instance, the Guidance for a Risk-based Approach to crypto assets by the Financial Action Task Force ("FATF Guidance") in June 2015 was the trigger for the introduction of regulations on crypto asset exchanges in Japan. The introduction of regulations on crypto asset custody services, which we mentioned in "**Key regulations and regulatory approaches**" above, was pursuant to the recommendation of the Financial Action Task Force in October 2018.

Additionally, the introduction of a risk-based approach to the AML guideline of the FSA, published in February 2018, was also a reaction to the FATF recommendations.

Financial regulators and policymakers in Japan are generally receptive to Fintech innovation and technology-driven new entrants in the regulated financial services markets, save that the FSA is taking a more conservative approach than before to crypto asset-based businesses following the hacking incident mentioned above in "**Key regulations and regulatory approaches**".

Sandbox and other initiatives

In June 2018, the Headquarters for Japan's Economic Revitalization, under the Cabinet Secretariat, opened a cross-governmental one-stop desk for the regulatory sandbox (the "Regulatory Sandbox") within the Japan Economic Revitalization Bureau. The Regulatory Sandbox can be used by Japanese and overseas companies, and it enables companies that apply and receive approval for projects not yet covered by present laws and regulations to carry out a demonstration under certain conditions without the need for amendment of existing laws or regulations. There is no limitation on the area of business regarding which companies can apply for the Regulatory Sandbox; however, AI, IoT, big data and blockchain projects are explicitly mentioned as the most prospective and suitable areas.

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Separately, in December 2015, the FSA established the "Fintech Support Desk". It is a one-stop contact point for inquiries and exchange of information on Fintech. It accepts a wide-range of inquiries on various matters from those who currently operate Fintech businesses and others who intend to start Fintech startups.

In addition, the FSA established a "Fintech Experiment Hub" in September 2017. The Hub gives support to Fintech companies and financial institutions when they conduct an unprecedented Proof of Concept ("PoC"). Please note that certain regulations are not suspended during the PoC, but the Hub aims to eliminate companies' concerns of violating applicable regulations during the PoC by providing legal and other advice.

In March 2017, the FSA announced the launch of the "Financial Market Entry Consultation Desk" to give advice on Japan's financial regulations to foreign financial business operators that plan to establish a Fintech business based in Japan.

Restrictions

There are, at present, no prohibitions or restrictions that are specific to Fintech businesses in Japan. Certain types of Fintech business are regulated (see "**Key regulations and regulatory approaches**" above), but these businesses can be carried out in compliance with applicable regulations.

As we noted above in "**Key regulations and regulatory approaches**", a remarkable recent topic with respect to restrictions is the hacking of the crypto asset exchange, which triggered revisions of the regulations governing crypto assets and crypto asset exchanges.

Cross-border business

It is worth noting that some Fintech players in Japan are collaborating with global payment businesses. For instance, Line Pay and PAYPAY, both emerging QR code payment service providers in Japan, are collaborating with Tencent and Alibaba, respectively, enabling merchants in Japan to receive payments by WeChat Pay and Alipay. Additionally, there are some international FTS providers licensed in Japan who are providing overseas FTS using their own fund remittance infrastructure at a reasonable cost compared to traditional banks.

In March 2017, the FSA and the UK's Financial Conduct Authority jointly announced that they exchanged letters on a co-operation framework to support innovative Fintech companies in Japan and the UK to enter each other's market by providing a regulatory referral system. The FSA has established similar frameworks with the Monetary Authority of Singapore ("MAS"), the Australian Securities & Investments Commission ("ASIC"), the Abu Dhabi Global Market Financial Services Regulatory Authority ("ADGM"), the Swiss Financial Market Supervisory Authority ("FINMA") and the Autorite des marches financers ("AMF").

The Tokyo Metropolitan Government (the "TMG") released a paper titled "Global Financial City: Tokyo Vision – Toward the Tokyo Financial Big Bang" in 2017. While it outlines various measures to nurture domestic players and attract foreign players throughout the financial sector, the TMG gives particular importance to asset management and Fintech businesses and sets its aim to attract 40 foreign asset managers and Fintech companies by fiscal year 2020.

As a part of such measures, the TMG opened the "Business Development Center Tokyo", which offers foreign entrepreneurs who are considering an expansion of their businesses in Tokyo a total support package covering all aspects from business through to lifestyle issues. For foreign companies planning expansion into the Special Zone for Asian Headquarters in

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particular, the Center provides both business exchange support and specialised consulting services. Furthermore, the "Tokyo One-Stop Business Establishment Center" facilitates the incorporation of its ancillary procedures, such as taxes, social security, and immigration for foreign entrepreneurs considering establishing businesses in Tokyo.

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In addition to his professional experience at Anderson Mōri & Tomotsune, he worked for the Financial Services Agency where he was mainly engaged in two separate processes of amending the Banking Act in 2016 and 2017 with the aim of creating a pro-Fintech environment for a second consecutive year.

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