

THE VIRTUAL
CURRENCY
REGULATION
REVIEW

THIRD EDITION

Editors

Michael S Sackheim and Nathan A Howell

THE LAWREVIEWS

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PREFACE

We are pleased to introduce the third edition of *The Virtual Currency Regulation Review* (the *Review*). The increased acceptance and use of virtual currencies by businesses and the exponential growth of investment opportunities for speculators marked late 2019 and early 2020. In 2019, it was reported that several of the largest global banks were developing a digital cash equivalent of central bank-backed currencies that would be operated via blockchain technology, and that Facebook was developing its own virtual currency pegged to the US dollar – Libra – to be used to make payments by people without bank accounts and for currency conversions. In 2019, the US House of Representatives’ Committee on Financial Services held a hearing on the potential impact of Libra in which one witness testified that Libra posed a fundamental threat to the ability of sovereign nations to maintain distinct monetary policies and respond to currency crises.

The *Review* is a country-by-country analysis of developing regulatory initiatives aimed at fostering innovation, while at the same time protecting the public and mitigating systemic risk concerning trading and transacting in virtual currencies. In February 2020, the International Organizations of Securities Commissions (IOSCO) published a final report titled ‘Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms’. The final report describes issues and risks identified to date that are associated with the trading of cryptoassets on cryptoasset trading platforms (CTPs). In relation to the issues and risks identified, the report describes key considerations and provides related toolkits that are useful for each consideration. The key considerations relate to: (1) access to CTPs; (2) safeguarding participant assets; (3) conflicts of interest; (4) operations of CTPs; (5) market integrity; (6) price discovery; and (7) technology. IOSCO advised that these seven key considerations (and the related toolkits described in the report) represent specific areas that IOSCO believes jurisdictions could consider in the context of the regulation of CTPs.

Fortunes have been made and lost in the trading of virtual currencies since Satoshi Nakamoto published a white paper in 2008 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.

In 2020, the global outbreak of the novel coronavirus (or covid-19) impacted virtually every person on the planet and had severe and sudden effects on every major economy. At the time of writing, the pandemic is ongoing and, while some locations are pushing past their respective ‘peaks’ of infection, cities that are central to the global financial markets, such as New York City, remain under strict lockdown orders, with many workers in the financial services sector working remotely. It is unclear when these cities will return to a version of ‘normal’. In the midst of all this chaos, there is a natural experiment under way in the cryptocurrency markets. We are perhaps learning what happens when our governments are strained and their competence is questioned. Since mid-March 2020, when the pandemic hit the United States in earnest (it had already been raging in China, Italy, Iran, etc.), the price of Bitcoin has gone up in essentially a straight line – from approximately US\$5,000 to almost US\$10,000 as at mid-May. Now, to be fair, this follows a significant price decline preceding March, but it is at least interesting to observe that the most widely held cryptocurrency is weathering a significant economic storm with apparent ease.

When we first launched the *Review* three years ago, we were optimistic but sceptical about whether virtual currencies would be widely and consistently in commercial use. However, the virtual currency revolution has come a long way and has endured a sufficient number of events that could or should have been fatal for the asset class. Our confidence in the long-term viability of virtual currency has only increased over the previous year. Virtual currencies and the blockchain and other distributed ledger technology on which they are based are groundbreaking, and are being deployed right now in many markets and for many purposes. As lawyers, we must now endeavour to understand what that means for our clients.

Virtual currencies are 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 *Review*. As practitioners, we cannot afford to focus solely on our own jurisdictional 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 derivatives 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’. In some countries, a virtual currency, which is not a fiat currency, may be regulated in the same manner as money; in other countries, virtual currency may be regulated similarly to securities or commodities. We make one general observation at the outset: there is no consistency across jurisdictions in their approach to regulating virtual currencies. Perhaps the efforts of IOSCO will help to change that going forward, but 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.

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 and virtual currency scofflaws shop for jurisdictions with regulatory structures that provide no meaningful regulation. While some market participants are interested in finding the jurisdiction with the lightest touch (or no touch), most legitimate actors 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 principal source of strength of virtual currencies – decentralisation – is the same characteristic that the regulators themselves seem to be displaying. There is no central authority over virtual currencies, either within or 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. Again, we are hopeful that IOSCO's efforts will help to encourage the emergence of optimal regulatory structures over time. Ultimately, the borderless nature of these markets allows market participants to 'vote with their feet', and they will gravitate towards jurisdictions that achieve the right regulatory balance of encouraging innovation and protecting the public and the financial system. It is much easier to do this in a primarily electronic and computerised 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 third edition of the *Review* provides a practical analysis of recent legal and regulatory changes and developments, and of their effects, and looks forward to 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 at a high level.

Virtual currency is the broad term that is used in the *Review* to refer to Bitcoin, Ether, Tethers and other stablecoins, cryptocurrencies, altcoins, ERC20 tokens, digital, virtual and crypto assets, and other digital and virtual tokens and coins, including coins issued in initial coin offerings. We recognise that in many instances the term 'virtual currency' will not be appropriate, and other related 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.

Based on feedback on the first and second editions of the *Review* from members of the legal community throughout the world, we are confident that attorneys will find the updated third edition to be an excellent resource in their own practices. We are still in the early days of the virtual currency revolution, but it does not appear to be a passing fad. The many lawyers involved in this treatise have endeavoured to provide as much useful information as practicable concerning the global 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, for their invaluable assistance in organising and editing the third edition of the *Review*, and particularly the United States chapter. The assembly of this third edition is made all the more remarkable by the fact that

many of the authors and contributors are working from home, with dogs barking in the background and children at their feet. Special thanks go out to all those dogs and children for being as tolerant as possible as we try to conduct the work of busy lawyers and also produce this *Review*.

Michael S Sackheim and Nathan A Howell

Sidley Austin LLP

New York and Chicago

August 2020

JAPAN

Ken Kawai, Takeshi Nagase and Huan Lee Tan¹

I INTRODUCTION TO THE LEGAL AND REGULATORY FRAMEWORK

Japan has one of the largest cryptoasset markets globally, and was the first country to establish a regulatory framework for cryptoassets. In addition to enabling the registration of cryptoasset exchange service providers (CAESPs) wishing to provide cryptoasset exchange services (CAES) to residents in Japan, this framework seeks to protect cryptoasset exchange customers and prevent cryptoasset-related money laundering and terrorism financing.

The cryptoasset regulatory framework in Japan has fuelled the growth of the Japanese cryptoasset market. However, this development was disrupted in January 2018 when one of the largest cryptoasset exchanges in Japan announced losses of approximately US\$530 million from a cyberattack on its network, giving rise to concerns about the adequacy of the existing regulatory framework. Adding to the unease is that cryptoassets are also increasingly being used for speculative purposes, rather than as a means of settlement.

This situation eventually led to the revision of certain legislation governing cryptoassets, including the Payment Services Act (PSA) and the Financial Instruments and Exchange Act (FIEA). These revisions, the primary purpose of which is to strengthen the regulatory framework surrounding cryptoassets, came into force on 1 May 2020.

The key provisions of the revised FIEA (the FIEA Revisions) are to: (1) establish electronically recorded transferable rights and regulations applicable thereto; (2) introduce regulations governing cryptoasset derivative transactions; and (3) introduce regulations governing unfair acts in cryptoasset or cryptoasset derivative transactions.

The key provisions of the revised PSA (the PSA Revisions) are to: (1) revise the term ‘virtual currency’ to ‘cryptoasset’; (2) enhance regulations governing cryptoasset custody services; and (3) tighten regulations governing CAES.

II SECURITIES AND INVESTMENT LAWS

i Establishment of electronically recorded transferable rights and tokenised securities

The FIEA has traditionally classified securities into: conventional securities, such as shares and bonds (Paragraph 1 Securities); and contractual rights, such as trust beneficiary interests and interests in collective investment schemes that are deemed securities (Paragraph 2 Securities). Paragraph 1 Securities, which are more liquid, have been subject to relatively more stringent

¹ Ken Kawai is a partner, Takeshi Nagase is a senior associate and Huan Lee Tan is a foreign legal associate at Anderson Mori & Tomotsune.

disclosure and licensing (registration) requirements. Paragraph 2 Securities, being less liquid, have been subject to relatively more lenient requirements. Against this backdrop, securities issued using an electronic data processing system such as blockchain, are expected to be even more liquid than Paragraph 1 Securities. For this reason, the FIEA Revisions have introduced a new regulatory framework for securities transferable through electronic data processing systems. More specifically, under the FIEA Revisions, securities transferable by electronic data processing systems have been classified into the following three categories:

- a* Paragraph 1 Securities (such as shares and bonds) that are transferable through electronic data processing systems (tokenised Paragraph 1 Securities);
- b* contractual rights (such as trust beneficiary interests and interests in collective investment schemes) that are conventionally categorised as Paragraph 2 Securities and transferable through electronic data processing systems (also known as electronically recorded transferable rights (ERTRs)); and
- c* contractual rights (such as trust beneficiary interests and interests in collective investment schemes) that are conventionally categorised as Paragraph 2 Securities and are transferable through electronic data processing systems, but whose negotiability is restricted to a certain extent (non-ERTR tokenised Paragraph 2 Securities).

Definition of ETRTs

ERTRs refer to the rights conventionally treated as Paragraph 2 Securities (such as trust beneficiary rights and interests in collective investment schemes) that ‘are represented by proprietary value transferable by means of an electronic data processing system (but limited only 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’. In this connection, ‘those rights specified in the relevant Cabinet Office Ordinance in light of their negotiability and other factors’ are generally understood to mean rights in respect of which technical measures have been taken to prevent the transfer of the proprietary value of these rights to persons other than:

- a* qualified institutional investors; or
- b* investors eligible to conduct specially permitted businesses for qualified institutional investors (the ‘Article 63 Exemption’) such as:
 - listed companies;
 - corporations with capital or net assets of ¥50 million or more; and
 - individuals with investment assets (including cryptoassets) of ¥100 million or more, who have maintained their securities accounts for more than one year.

Technical measures have been taken to prevent the proprietary value of these rights from being transferred without an offer from the owner and approval from the issuer for every transfer.

The key purpose of the FIEA Revisions is to subject ETRTs to the disclosure and licensing (registration) requirements applicable to Paragraph 1 Securities.

Definition of tokenised securities

Tokenised securities refer to dematerialised (paperless) securities that are ‘represented by proprietary value transferable by means of an electronic data processing system (but limited only to proprietary values recorded in electronic devices or otherwise by electronic means)’. Tokenised securities can be classified into the following rights:

- a* tokenised Paragraph 1 Securities (such as tokenised shares and bonds);

- b ERTRs; and
- c non-ERTR tokenised Paragraph 2 Securities.

Under the FIEA Revisions, rights under points (a) and (b) above are deemed Paragraph 1 Securities, while rights under point (c) are treated as Paragraph 2 Securities. This classification creates a significant difference in the disclosure and licensing (registration) requirements applicable to the respective rights.²

Disclosure requirements

As a result of the application of disclosure requirements to ERTRs, issuers of ERTRs are (in principle) required, upon making a public offering or secondary distribution of ERTRs, to file a securities registration statement and issue a prospectus. A person who causes other persons to acquire ERTRs or who sells ERTRs to other persons through a public offering or secondary distribution must deliver a prospectus to the other persons in advance or at the time of the acquisition or sale.

Licensing (registration) requirements

As ERTRs are expected to constitute Paragraph 1 Securities, a person acting as a broker, agent or intermediary in respect of the sale or purchase of ERTRs or the handling of an offering of ERTRs in the course of a business is required to undergo registration as a Type I financial instruments business operator (FIBO) under the FIEA.

ii Introduction of regulations governing cryptoasset derivative transactions

Regulations governing cryptoasset derivative transactions have been introduced by the FIEA Revisions to protect users and to ensure that such transactions are appropriately conducted. More specifically, for the purposes of subjecting derivative transactions involving financial instruments or financial indicators to certain entry regulations and rules of conduct issued under the FIEA, cryptoassets have been inserted in the definition of ‘financial instruments’ under the FIEA Revisions. Furthermore, the prices, interest rates and other aspects of cryptoassets have been incorporated into the definition of ‘financial indicators’.

As cryptoassets are now included in the definition of financial instruments, the conduct of over-the-counter derivative transactions related to cryptoassets or intermediary or brokerage activities in relation thereto will also constitute Type I financial instruments business under the FIEA.

iii Introduction of prohibitions against unfair acts in cryptoasset or cryptoasset derivative transactions

In respect of cryptoasset spot transactions and cryptoasset derivative transactions, the FIEA Revisions contain prohibitions against the following: wrongful acts; dissemination of rumours, fraudulence, assault or intimidation; and market manipulation. These prohibitions

2 Disclosure requirements do not apply to rights under point (c) unless these rights constitute rights in securities investment business and solicitation for interest in these rights has been conducted, as a result of which 500 persons or more come to hold the rights. Only Type II financial instruments business operators (FIBOs), and not Type I FIBOs, are permitted to handle public offerings and private placements of rights under point (c).

(which are without limit as to the violating party) are intended to enhance the protection of users and to prevent the obtainment of unjust benefits. Breach of these prohibitions is punishable by penalties.

Insider trading, however, is not regulated under the FIEA Revisions, owing to difficulties both with the formulation of a clear concept of cryptoasset issuers and the identification of undisclosed material facts.

III BANKING AND MONEY TRANSMISSION

i Approach of the central bank

Cryptoassets are neither deemed money nor equated with fiat currency. No cryptoasset is backed by the government or the Bank of Japan (the central bank).

ii Money transmission

Only licensed banks or registered fund transfer business operators are permitted to engage in money remittance transactions as a business. 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 do not include cryptoassets, however, a cryptoasset remittance transaction is unlikely to be deemed a money remittance transaction.

IV ANTI-MONEY LAUNDERING

To prevent cryptoasset-related money laundering and terrorism financing, the Act on Prevention of Transfer of Criminal Proceeds (APTCP) requires exchange providers to implement know-your-customer (KYC) and other preventative measures. The APTCP applies to registered exchange providers, and generally requires them to:

- a* verify and record the identity of customers when conducting certain transactions (that is, to implement the KYC process);
- b* record transactions with customers;
- c* report suspicious transactions to the FSA; 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 points (a) to (c).

Under the APTCP, CAESPs must conduct the KYC process when undertaking any of the following:

- a* executing a master agreement with a customer for providing that customer with regular CAES, management and similar services in respect of his or her money or cryptoassets;
- b* transferring cryptoassets into funds or exchanging them for other kinds of assets (or transactions similar thereto), where the receipt and payment of cryptoassets exceeding ¥100,000 in value³ is involved; or

³ This value was originally set at ¥2 million, but has since been lowered to ¥100,000, as a result of amendments to the Order for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds.

- c where the exchange provider manages a customer's cryptoassets, transferring the cryptoassets at the customer's request if their value exceeds ¥100,000.

V REGULATION OF EXCHANGES

i Regulation of CAES

Definition of CAES

The PSA and APTCP were primarily intended to regulate CAES, with a particular focus on protecting customers and preventing cryptoasset-related money laundering and terrorism financing. Pursuant to the PSA, those wishing to provide exchange services have to be registered with the Prime Minister as exchange providers.⁴ To qualify, applicants must be either a stock company or a foreign CAESP with 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 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 applicable laws and regulations.

The PSA also provides legislative definitions of 'cryptoasset exchange services' and 'cryptoasset'. Article 2, Paragraph 7 of the PSA defines exchange services as engagement in any of the following activities as a business:

- a sale or purchase of cryptoassets,⁵ or the exchange of a cryptoasset for another cryptoasset;
- b intermediating, brokering or acting as an agent in respect of the activities listed in point (a);
- c management of customers' money in connection with the activities listed in points (a) and (b); or
- d management of customers' cryptoassets for the benefit of another person.

The PSA Revisions designate the activities under point (d) above as a type of CAES. Consequently, management of cryptoassets without the sale and purchase thereof (cryptoasset custody services) is now included in the scope of CAES. Therefore, a person engaging in cryptoasset custody services must be registered as a CAESP. In this context, the FSA Administration Guidelines (revised guidelines on cryptoassets) explain the meaning of 'management of customers' cryptoassets for the benefit of another person' as follows:

although whether or not each service constitutes the management of cryptoassets should be determined based on its actual circumstances, a service constitutes the management of cryptoassets if a service provider is in a position in which it may transfer its users' cryptoassets (for example, if such service provider owns a private key with which it may transfer users' cryptoassets solely or jointly with its related parties, without the users' involvement).

4 The registration will be carried out through the FSA and the relevant local finance bureau, which act as the Prime Minister's delegate.

5 A trust company may be entrusted with cryptoassets pursuant to the Trust Business Act without being registered as a CAESP. Trust banks, on the other hand, are not permitted to engage in entrustment of cryptoassets.

Accordingly, it is understood that if a service provider merely provides its users with a cryptoasset wallet application (i.e., a non-custodial wallet) and private keys are managed by the users themselves, this service would not constitute a cryptoasset custody service.

Definition of cryptoasset

A cryptoasset is defined in Article 2, Paragraph 5 of the PSA as:

- a* a proprietary value that may be used to pay an unspecified person the price of any goods purchased or borrowed or any services provided, where the proprietary value may be:
 - sold to or purchased from an unspecified person, provided the 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 the proprietary value specified in point (a) with an unspecified person, where the proprietary value may be transferred through an electronic data processing system.

ii Principal regulations applicable to the operation of exchange providers

CAESPs are required to:

- a* take the measures necessary to ensure the safe management of information available to them;
- b* provide sufficient information to customers;
- c* take the measures necessary for the protection of customers and the proper provision of services;
- d* segregate the property of customers from their own property and subject such segregation to regular audits by a certified public accountant or audit firm; and
- 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 alternative dispute resolution proceedings.

iii Additional regulations under the PSA Revisions

Under the PSA Revisions, the following changes are proposed to be made to the current regulatory system governing CAESPs, both to enhance user protection and to clarify the rules relating to CAESPs:

- a* expansion of grounds on which applications for registration as a CAESP may be rejected;
- b* introduction of a system of advance notification for any proposed amendment to certain aspects of the relevant cryptoasset, such as its name;
- c* introduction of regulations governing advertisements and solicitation in respect of exchange services;
- d* introduction of disclosure requirements where cryptoassets are exchanged (or where certain similar transactions are undertaken) via the grant of credit to users;
- e* enhancement of the obligation on CAESPs to preserve users' assets; and
- f* grant of rights to users to enable their receipt of preferential payment when claiming for the return of cryptoassets.

With respect to point (e) above, a CAESP is required under the PSA Revisions 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. In other words, a CAESP is required not only to manage the money of users in bank accounts separately from its own, but also to entrust such money to a trust company or trust bank, acting as trustee.

In addition, a CAESP is required to manage the entrusted cryptoassets, in principle, by using a cold wallet that has never been and will never be connected at any time to the internet (totally offline wallet) or through other methods by taking technical safety management measures equivalent to a totally offline wallet.⁶ A CAESP may exceptionally manage cryptoassets through other methods, such as using multi-signature hot wallets, if these methods are necessary for ensuring users' convenience and smooth performance of cryptoasset exchange services. However, the yen equivalent of the entrusted cryptoassets managed by the other methods must not exceed 5 per cent of the yen equivalent of the total entrusted cryptoassets.

VI REGULATION OF MINERS

As the mining of cryptoassets does not fall within the definition of CAES, mining activities are not regulated under existing Japanese regulations. However, interests in mining schemes formulated as collective investment scheme interests or interests in cloud mining schemes may be deemed securities under the FIEA and could therefore be subject to its provisions.

VII REGULATION OF ISSUERS AND SPONSORS

i Regulation of initial coin offering tokens and token issuers

Tokens issued by way of an initial coin offering (ICO) take many forms, and the Japanese regulations applicable to a token vary depending on the ICO scheme involved.

Cryptoasset-type tokens

A token that falls within the definition of a cryptoasset will be subject to cryptoasset-related regulations under the PSA. A token that is subject to the PSA must be sold by or through a CAESP.

The Japan Virtual and Crypto Asset Exchange Association (JVCEA), a self-regulatory organisation established under the PSA, published a draft of self-regulatory rules and guidelines for ICOs of cryptoasset-type tokens entitled Rules for Selling New Crypto Assets (the ICO Rules). Based on the ICO Rules, ICOs may be categorised into two types: (1) where a CAESP issues new tokens and sells these tokens by itself; and (2) where a token issuer delegates the sale of newly issued tokens to CAESPs. Generally, in addition to ensuring the security of newly issued tokens, including the blockchain, smart contract, wallet tool and other aspects thereof, the ICO Rules require that the following be satisfied for all ICOs:

- a maintenance of a business structure that facilitates review of the business for which funds are raised via an ICO;
- b disclosure of information on the token issuer, the token issued, the proposed use of proceeds raised and other matters;
- c segregation of the management of ICO proceeds (both fiat and cryptoassets) from the management of the issuer's own funds;

⁶ The revised guidelines provide that in determining whether measures equivalent to a totally offline wallet have been taken, each case will be judged based on its specific circumstances.

- d* proper accounting treatment and financial disclosure of ICO proceeds; and
- e* proper valuation of newly issued tokens.

Securities-type tokens

As noted in Section II.i, where distributions are made to token holders on the profits of a token issuer's business and calculated based on the ratio of a token holder's token ownership, the token involved may constitute an ERTR and consequently subject the token issuer to the provisions of the FIEA.

As ERTRs are expected to constitute Paragraph 1 Securities, a broker, an agency or an intermediary selling or purchasing ERTRS or handling a public offering of ERTRs in the course of business will be required to undergo registration as a Type I FIBO.

In addition, any ERTR issuer that solicits the acquisition of ERTRs (i.e., undertaking a security token offering (STO)) will be required to undergo registration as a Type II FIBO, unless it qualifies as a specially permitted business for qualified institutional investors.

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 applicable regulations under the PSA. (A token subject to the prepaid payment instrument regulations under the PSA would not simultaneously be subject to the PSA regulations applicable to cryptoasset (and vice versa).)

ii Regulation of sponsors

As one of the primary purposes of cryptoasset regulation in Japan is the protection of cryptoasset exchange customers, sponsors of ICO issuers are not regulated by the PSA or other laws in respect of cryptoassets.

VIII CRIMINAL AND CIVIL PENALTIES

i Penal provisions applicable to exchange providers

The existing penal provisions found in the PSA are applicable to CAESPs. The following is a summary of some of the major violations under the PSA, and the penalties applicable for these 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:
 - 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:
 - a violation of the obligation to segregate customers' funds and cryptoassets from an exchange provider's funds and cryptoassets; 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:

- failure to give public notice of a business assignment, merger, demerger, company split or discontinuance of business, or dissolution in respect of 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 any required attachment 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
 - refusal to respond to questions or provision of false responses at an on-site inspection, or refusing to provide cooperation in respect of the 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 any false statement in a registration application or attachments thereto.
- e* A fine not exceeding ¥1 million is imposable for violating an order for the improvement of business operations.
- f* Imprisonment for a term not exceeding six months or a fine not exceeding ¥500,000, or both, is imposable for any failure to make the required disclosure regarding advertisement or solicitation in respect of CAES.
- g* Imprisonment for a term not exceeding one year or a fine not exceeding ¥3 million, or both, is imposable for any misrepresentation or any representation under a cryptoasset exchange agreement that will likely lead to an inaccurate understanding of the nature or other aspects of a cryptoasset.
- h* Imprisonment for a term not exceeding six months or a fine not exceeding ¥500,000, or both, is imposable for:
- any misrepresentation or representation in an advertisement concerning an exchange service that will likely lead to an inaccurate understanding of the nature or other aspects of a cryptoasset; or
 - any representation under a cryptoasset exchange agreement or in an advertisement concerning an exchange service, to induce the sale or purchase of a cryptoasset or the exchange of a cryptoasset for another cryptoasset that is not for the purpose of enabling the use of the relevant cryptoasset as a means of payment but is instead for the exclusive purpose of promoting interest in a particular cryptoasset.

ii Civil fraud

The PSA contains no specific regulation for the prevention of unfair trading or sale of tokens. However, the Civil and Penal Codes of Japan, and certain consumer protection laws and regulations,⁷ 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.

In addition, as a result of the PSA and FIEA Revisions, the Act on Sales, etc. of Financial Instruments (ASFI) was also amended to render it applicable to acts that result in the acquisition of cryptoassets. Without these amendments to the ASFI, customers wishing to

⁷ Such as the Act on Specified Commercial Transactions, the Consumer Contract Act and the Act against Unjustifiable Premiums and Misleading Representations.

claim against CAESPs will be required to establish a claim in tort. To address this unsatisfactory situation, the revised ASFI (the ASFI Revisions) expressly impose accountability on exchange providers, including presuming the amount of damages that such service providers would owe, to reduce the burden of proof on the part of service users.

IX TAX

The treatment of consumption tax in respect of cryptoassets has been a hot topic in Japan. In the past, sales of cryptoassets were subject to Japanese consumption tax to the extent that the office of the transferor was located in Japan. However, following amendments to applicable tax laws, as of 1 July 2017, consumption tax cannot be imposed on a sale of cryptoassets, if the relevant cryptoasset is deemed a cryptoasset 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 cryptoassets will be treated as miscellaneous income, such that gains from the sale or use of cryptoasset cannot be offset against losses incurred elsewhere.

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 the payment or receipt. This notification requirement was extended to cover cryptoassets. Specifically, it was announced by the government on 18 May 2018 that the Minister of Finance must be notified of payments or receipts of cryptoassets with a market value exceeding ¥30 million as of the payment date.

XI LOOKING AHEAD

The PSA Revisions, the FIEA Revisions and the ASFI Revisions have introduced a new legal framework for the governance of cryptoassets. Although the framework imposes heavier regulatory burdens on CAESPs, it will also bring certain advantages, such as a more orderly, structured cryptoasset industry and enhanced user protection. These benefits, together with the FIEA Revisions that allow for the conduct of cryptoasset derivative transactions and STOs, are expected to facilitate greater growth in the Japanese cryptoasset market.

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