‘Innovate or perish’ may be an overused maxim in business management circles, but the sense of impending upheaval that it implies has never been more true than it is for the finance industry today, as market players new and old, large and small grapple with the challenges and opportunities thrown up by nascent but already transformative information and communications technologies. Also evolving with these changes is the regulatory environment, the most recent example of which is some important recent amendments to the Banking Act and the Payment Services Act, passed on 25 May 2016, which will come into force within a year from the promulgation date, 3 June 2016.

Two of these amendments will have a significant impact on the nascent FinTech industry in Japan; these are the amendment of the Banking Act in relation to investments in finance-related IT companies, and the amendment of the Payment Services Act in relation to virtual currencies and pre-paid cards.

**AMENDMENTS TO THE BANKING ACT**

**(A) Easier for banks to invest in finance-related IT companies**

One of the fastest and most efficient ways for a bank to provide innovative services using FinTech is to tie up with a finance-related IT company. However, the activities of banks in Japan are restricted to those that are specifically permitted by law, such as core deposit-taking and lending businesses, exchange transactions, and businesses that are incidental to any of them, as well as certain limited securities businesses. The scope of the businesses that subsidiaries of banks are permitted to engage in is also restricted, albeit somewhat less so than banks themselves.

To prevent banks avoiding the rules applicable to them and their subsidiaries by conducting business through companies which are not subject to the same restrictions, banks are currently only able to acquire up to 5% of the voting rights, on a group-wide basis (or 15% in the case of bank holding companies), in any company that engages in a business other than a business permitted to be conducted by banks and their subsidiaries. Whilst there are certain exceptions to the investment restrictions for investments in start-ups, the amendment further extends the exception so that the banks may strategically and flexibly collaborate with the FinTech industry that is now required in order to take advantage of recent and anticipated technological changes.

Under the amendment, banks may, subject to certain approvals, acquire and hold voting rights over the previous limits in the case of voting rights in companies that operate ‘a business that improves, or is expected to improve the bank’s performance of its business or improve customer convenience, through information communications or other technologies.’

**(B) Easier to conduct settlement services as a business**

Subsidiaries of banks are able to engage in ‘Dependent Businesses’, which includes settlements and systems management businesses that utilize information and communications technologies, but the subsidiary must engage in that business ‘mainly’ for the parent company group, and revenue from the parent company group must comprise 50% or more the subsidiary’s revenue. This is clearly a barrier to banks being able to work with outside FinTech companies on settlements and systems management work.

The amendment relaxes the requirement that a bank subsidiary engaged in a Dependent Businesses be reliant on the parent for revenue. Although the scope of the amendment has yet to be finalized, it is expected that it will free bank subsidiaries to take on systems management work and other services from outside their parent company group.

**AMENDMENTS TO THE PAYMENT SERVICES ACT AND THE ACT ON PREVENTION OF TRANSFER OF CRIMINAL PROCEEDS**

**(A) The legal system regulating virtual currency exchanges**

There has been concern for some time about the potential for misuse of virtual currencies. This was reiterated at the June 2015 G7 Summit in Elmau, at which it was declared that appropriate regulation was necessary, and also under the June 26 2015 Guidance issued by the inter-governmental Financial Action Task Force (FATF), which stressed the potential for their use in money laundering, due to the speed of transfers...
and anonymity offered by virtual currencies.

Japan has already learned its lesson about the need for systems to ensure the financial health of virtual currency exchanges, and customer protections, after the 2014 collapse of Mt. Gox, at the time one of the largest virtual currency exchanges in the world, which caused extensive losses to its customers.

In light of these events, the government has introduced a registration system for virtual currency exchange operators by amendment of the Payment Services Act, the main legislation governing funds settlement services.

Bitcoin, the most well-known virtual currency, has not actually been recognized as a currency in Japan. As such, Bitcoin in Japan has, until now, been free of laws and regulations including the Banking Act and the Financial Instruments and Exchange Act. This amendment, however, introduces a definition of ‘virtual currency’ to the Payment Services Act in order to regulate ‘virtual currency’. Under the amendment, something is essentially a ‘Virtual Currency’ when:

1. it can either (a) be used for payment of value when conducting buying, selling, lending or service transactions with unspecified persons, or (b) be exchanged for a currency that meets the definition in (a);
2. it has asset value;
3. it is recorded electronically;
4. it is not a Currency Denominated Asset in the currency of Japan or any foreign currency; and
5. it is transferred electronically.

‘Currency Denominated Asset’ means an asset that is denominated in a currency, or other asset that uses a currency to perform a financial liability, make a repayment or the equivalent. For example, this would include pre-paid payment instruments.

Armed with this new definition of a virtual currency, the amended Payment Services Act then goes on to require anyone who wishes to provide Virtual Currency Exchange Services to meet certain registration requirements and register. For this purpose, Virtual Currency Exchange Services means any of the following acts made in the course of trade: (i) the sale, purchase or exchange of virtual currencies; (ii) intermediary, agency or delegation services in relation to the acts in (i); or (iii) management of customers’ money or virtual currency in connection with the acts in (i) or (ii).

The registration requirements are that the applicant must (i) be a stock company (kabushiki kaisha) or foreign company operating a virtual currency exchange that is registered as the foreign equivalent of a kabushiki kaisha stock company; (ii) have a specified asset base; and (iii) have an internal organization sufficient to pursue its business appropriately and accurately.

In order to provide protections for customers of such exchanges, the amended Payment Services Act also introduces a duty on virtual currency exchange operators to provide customers with an explanation of the virtual currency and the trading contract terms, and a requirement that any virtual currency, or money received from and held on behalf of customers, be managed separately from the operator’s own assets. With the Mt. Gox experience still fresh in the minds of the public, the segregation of assets must be audited regularly by a certified public accountant (including a foreign certified public accountant) or an auditing company. Virtual currency exchange operators also have a duty to maintain books and records, to submit audited reports to the competent authorities. The competent authorities may have the power to supervise the virtual currency exchange operators, which includes on-site inspections and improvement orders, etc.

Given the importance of self-regulation, virtual currency exchange operators are also permitted to set up a self-regulatory body.

As a result of concerns over the use of virtual currencies for money laundering and terrorist funding, amendments to the Act on Prevention of Transfer of Criminal Proceeds, will require virtual currency exchange operators to confirm the personal identity of customers, to compile and retain personal identification records and transaction records, and to notify the authorities of suspicious transactions. The precise details of which services provided by a virtual currency exchange operator will be subject to these regulations are expected to be clarified when the government releases an enforcement order for the amendment.

Important issues facing virtual currencies which have yet to be clarified include whether or not the sending of a virtual currency constitutes a ‘funds transfer business’, which is regulated, and whether or not virtual currency transactions are taxable (particularly with regard to consumption tax). It is conceivable that consumption tax will apply given that trading in virtual currencies is regarded as the transfer of asset value. But if virtual currency functions in the same manner as legal tender, then it is also arguable that such transactions should not be taxable.

(B) Streamlined methods of display for prepaid cards

Existing rules under the pre-amendment Payment Services Act in relation to the methods by which customers are provided with information on prepaid cards and other payment instruments (such as amount available) have been revised and rationalized to eliminate the obligation to ‘display’ information, due to the increase of prepaid cards within electronic devices and terminals.

These devices tend to be designed to be used via the Internet and so the current amendment removes the abovementioned duty to
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‘display’, so that it is now possible to simply ‘provide’ the required information about the pre-paid payment instrument described above on the Internet.

(C) Other matters

Given the increasing use of pre-paid payment instruments on the Internet, issuers who discontinued a pre-paid payment instrument and were previously required to give public notice of discontinuance and repayment in a newspaper, will be permitted by the amendment to give the public notice electronically on the Internet.

Along with the increased use of pre-paid payment instruments through the Internet, there has been an increase in problems arising between customers and merchants, other than the issuer. To help deal with such problems, the amendment provides that issuers have a duty to set up a complaints handling system to handle complaints promptly and appropriately.

**AMENDMENTS TO THE ELECTRONICALLY RECORDED MONETARY CLAIMS ACT**

At present, there are four organizations in Japan known as ‘electronic monetary claims recording institutions’. Originally, it was not generally envisaged that there would be movement of electronic monetary claims between these organizations. However, as IT infrastructure has improved it has become possible to improve the convenience of using electronic monetary claims by creating a procedure for transferring them from one institution to another. The latest amendment will allow this, and electronic monetary claims are likely to become more useful as a result.

**About the author**

Yuri Suzuki specialises in banking & finance, structured finance, IT, M&A, international transactions, and international trade. She is the head of the firm’s fintech team and a member of the administrative board of Fintech Association Japan. She is co-author of ‘Managing Japan’s Fintech Groundswell’, IFLR May, IFLR (April, 2016).

Ms Suzuki is qualified as an attorney (Bengoshi) in Japan (2001) and holds a law degree from Waseda University (1997) and an LLM from New York University (2005). She has been a partner at Atsumi & Sakai since 2008 and a trustee of the Japan Institute of Life Insurance since 2015. She worked in the Chicago office of Kirkland & Ellis in 2005/6.

Ryosuke Oue is a member of the fintech team at Atsumi & Sakai. He specialises in banking & finance, structured finance, and international transactions. He acts for a wide range of Japanese and international clients in the financial area, and has extensive experience in advising foreign investors to renewable energy businesses in Japan.

Mr Oue is qualified as an attorney (Bengoshi) in Japan (2005) and holds a law degree from Hitotsubashi University (2000), and an LLM from University of Washington (2013). He has been a partner at Atsumi & Sakai since 2014 and an examining commissioner of the Kinzai Institute for Financial Affairs as an Examination Institution since 2015. He also spent some years working in a leading Japanese multi-national construction company.