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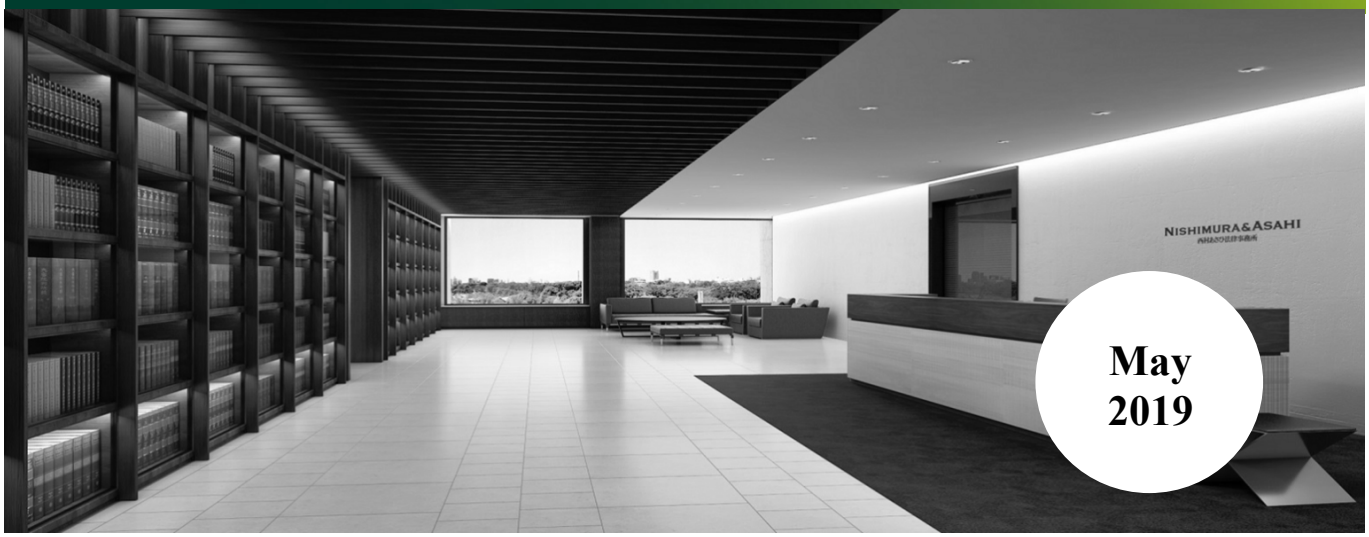

Outline of the 2019 Amendment Bill for the PSA, FIEA, and Other Statutes

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1. Introduction

On March 15, 2019, the Government of Japan submitted to the National Diet, Japan's parliament, a bill to amend the Payment Services Act (the "PSA"), the Financial Instruments and Exchange Act (the "FIEA"), and other statutes (the "Bill").[1] An overview of the amendments proposed thereunder is as follows:

Topics of proposed amendments		Statutes proposed to be amended
Crypto-assets (virtual currencies)	Renaming to "crypto-asset" and redefinition	The PSA, etc.
	Regulations on crypto-asset exchange services	
	Regulations on financial instruments businesses	The FIEA, etc.
	Unfair trading regulations	
	Tort liability for retail distribution	The Act on Sales, etc. of Financial Instruments (the "Financial Instruments Sales Act")
"Electronically recorded and transferable rights"		The FIEA
Financial institutions' information services		The Banking Act, the FIEA, the Insurance Business Act, etc.
Insurance companies and their InsurTech subsidiaries		The Insurance Business Act
Treatment of security interests for OTC derivatives and certain other transactions upon the commencement of reorganization proceedings		The Act on Close-Out Netting of Specified Financial Transactions Conducted by Financial Institutions (the "Netting Act")
Data seizure by criminal investigators of the Securities and Exchange Surveillance Commission (the "SESC"), etc.		The FIEA

[1] The Bill and related materials filed with the National Diet are available at the Financial Services Agency's website.

This article will provide a brief explanation of the proposed amendments.

2. Amendments relating to crypto-assets (virtual currencies)

Currently, in regard to "virtual currencies," such as Bitcoin and certain ICO tokens, the PSA provides regulations applicable to "virtual currency exchange service providers" ("VCESPs") for the purpose of user protection.

The Bill proposes the amendments explained below, based on a report from the "Study Group on Virtual Currency Exchange Services, etc." released by the Financial Services Agency (the "FSA") at the end of last year (the "Study Group Report").[2]

(1) Renaming "virtual currency" to "crypto-asset"

The Bill proposes to rename the term "virtual currency" *(kaso-tsuka*), as used in the PSA and other statutes, to "crypto-asset" (*ango-shisan*),[3] and thus replace the term "virtual currency" contained in any other defined terms with "crypto-asset."

(2) Definition of "crypto-asset"

The Bill proposes to define the term "crypto-asset" by wording essentially identical to that used to define "virtual currency" under the existing PSA, but to exclude tokens that represent "electronically recorded and transferable rights"[4] (which will be explained in 3 below), to eliminate the possibility of such tokens being subject to dual regulation and supervision as a result of falling under both definitions.

(3) Regulations on crypto-asset exchange services

(a) Crypto-asset administration

Under the existing law, the administration of users' virtual currencies falls under the definition of "virtual currency exchange services" only where conducted in association with dealing, brokerage, or matchmaking services of virtual currency by the same service provider.[5] In order to regulate custody services providing so-called "online wallets" without actually providing any such services, the Bill proposes defining "crypto-asset exchange services" to include "administration of crypto-assets for others (except where such administration in the course of trade is specially provided for in other Acts)" conducted in the course of trade.[6]

(b) Entry regulation

The Bill proposes that regulators refuse, or are able to rescind, registration as a crypto-asset exchange service provider ("CAESP") if the applicant, or the provider, is not a member of a certified self-regulatory organization for CAESPs,[7] and

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2 The report from the "Study Group on Virtual Currency Exchange Services, etc." (December 28, 2018). For an outline of the report, please refer to the N&A Finance Law Newsletter, "New Crypto Regulations Proposed in Japan" (January 9, 2019).

3 Article 2, paragraph 5 of the PSA, as amended by Article 1 of the Bill (the "Amended PSA").

4 Article 2, paragraph 3 of the FIEA, as amended by Article 2 of the Bill (the "Amended FIEA").

5 Article 2, paragraph 7, item 3 of the PSA.

6 The body and item (iv) of Article 2, paragraph 7 of the Amended PSA.

7 The Japan Virtual Currency Exchange Association is expected to fall under this category (Article 6 of the Supplementary Provisions of the Bill).

(i) does not prepare internal rules that are equivalent to the self-regulatory rules of such associations, or (ii) does not have a system in place to comply with such internal rules.[8]

(c) Strengthening of provider regulation and user property protection

The Bill proposes that a CAESP, in principle, provide prior notification of any change in (i) the name of the crypto-assets it handles or (ii) the contents and methods of its crypto-asset exchange service, instead of post notification, as required under the current law.[9]

Furthermore, the Bill also proposes strengthening of conduct regulations by obligating CAESPs to, for example, adhere to certain requirements and prohibitions applicable to the execution and solicitation of contracts and advertisements for crypto-asset exchange services, and, if they deal with crypto-asset margin transactions, to provide certain information with respect to such transactions.[10]

Certain amendments are also proposed on the administration of users' assets. The method of segregating user property available to VCESPs under the current PSA is not intended to ensure bankruptcy remoteness.[11] However, the Bill proposes requiring CAESPs to place users' fiat currencies in trust to secure the contractual rights of the users depositing cash with CAESPs.[12] While CAESPs will not be not required to place users' crypto-assets in trust, they will be required, not only to segregate the users' crypto-assets from the proprietary crypto-assets, as required under the current PSA, but also to administer the users' crypto-assets in accordance with a certain secure method to be specified by a Cabinet Office Order[13] (except for such crypto-assets that satisfy certain requirements for exemption).[14] With regard to such exempted users' crypto-assets, the Bill proposes requiring CAESPs to retain the same kinds and amounts of its proprietary crypto-assets, segregated from the rest thereof, and administer them in accordance with a certain secure method to be specified by a Cabinet Office Order as well.[15,16] In order to secure the contractual rights of users depositing crypto-assets within CAESPs, the Bill seeks to entitle such users of a CAESP to preferred satisfaction of such rights, by using the segregated users' crypto-assets administered by the CAESP and such portion of the proprietary crypto-assets to be segregated by the CAESP (both noted above and excluding those transferred from the CAESP to any third party acquirer), prior to other creditors.[17]

(d) AML/CFT regulations

The Bill proposes subjecting CAESPs to anti-money laundering and countering financing of terrorism ("AML/CFT")

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8 Article 63-5, paragraph 1, item (vi) and Article 63-17, paragraph 1, item (i) of the Amended PSA.

9 Article 63-6, paragraphs 1 and 2 of the Amended PSA.

10 Article 63-9-2, Article 63-9-3, and Article 63-10, paragraph 2 of the Amended PSA.

11 Article 63-11, paragraph 1 of the PSA, Article 20 of the Cabinet Office Order on Virtual Currency Exchange Service Providers.

12 Article 63-11, paragraphs 1 and 2 of the Amended PSA.

13 In this regard, administration with so-called "cold wallets" is expected to be specified in a Cabinet Office Order according to the FSA's explanatory material for the Bill.

14 Article 63-11, paragraph 2 of the Amended PSA.

15 Also in this regard, administration with so-called "cold wallets" is expected to be specified in a Cabinet Office Order, according to the FSA's explanatory material for the Bill.

16 Article 63-11-2, paragraph 1 of the Amended PSA.

17 Article 63-19-2, paragraphs 1 and 2 of the Amended PSA and Article 333 of the Civil Code.

regulations under the amended Act on Prevention of Transfer of Criminal Proceeds (the "Criminal Proceeds Transfer Prevention Act") in the same way as VCESPs are currently covered under the current Criminal Proceeds Transfer Prevention Act.[18] Accordingly, a custodian who administers crypto-assets without providing dealing, brokerage, or matchmaking services of crypto-assets will, as a CAESP, also be subject to such regulations under the amended Criminal Proceeds Transfer Prevention Act.

(e) Grandfathering

Under the proposed transitional measures, existing VCESPs will be deemed to have been registered as CAESPs after the proposed amendment takes effect.[19]

On the other hand, even after the amendments come into effect, providers of crypto-asset administration services, which under the existing law do not fall under the definition of "virtual currency exchange services," may continue providing the services to the same users in relation to the same kinds of crypto-assets for one and a half years (in principle) without registering as a CAESP (i.e. they may not offer their existing services to new users or handle new crypto-assets). However, to be eligible for this grandfathering such providers must (i) submit a notification within two weeks from the effective date (of the amendments) to have an initial six month grandfathering period, and (ii) submit an application for registration within such six month period to have an additional one year grandfathering period.[20] Service providers that qualify for this grandfathering must comply with the amended PSA and the amended Criminal Proceeds Transfer Prevention Act as if they were registered as a CAESP.[21]

(4) Crypto-assets and regulations on financial instruments businesses

(a) Regulations on derivative dealers/brokers

Under the current law, derivative transactions in which: (i) a virtual currency is the underlying asset; or (ii) an index relating to a virtual currency (such as the market value index) serves as the reference index thereto, are not subject to regulations under the FIEA nor the Commodity Futures Transaction Act.

The Bill proposes to have the term "derivative transactions" under the FIEA include derivative transactions in which: (i) a crypto-asset is the underlying asset; or (ii) an index relating to a crypto-asset is the reference index ("crypto-asset derivative transactions"), by adding "crypto-assets" as a new class of "financial instruments" as defined under the FIEA.[22] As a result, various services related to crypto-asset derivative transactions will be included in the scope of "financial instruments businesses" regulated under the FIEA. However, it should be noted that the Bill does not expressly preclude the possibility that, for example, the dealing/brokerage of crypto-asset forward transactions that can be settled in cash or in kind falls, not only under the definition of a "financial instruments business" under the amended FIEA, but also under the definition of a

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18 Article 2, paragraph 2, item 31 of the Criminal Proceeds Transfer Prevention Act, as amended by Article 24 of the Supplementary Provisions of the Bill (the "Amended Criminal Proceeds Transfer Prevention Act").

19 Article 4, paragraph 1 of the Supplementary Provisions of the Bill.

20 Article 2, Paragraphs 1, 2, and 3 of the Supplementary Provisions of the Bill.

21 Article 2, Paragraph 3 of the Supplementary Provisions of the Bill.

22 Article 2, paragraphs 20 through 23 and 24, item (iii)-2 of the Amended FIEA.

"crypto-asset exchange service" under the amended PSA.[23]

In addition, the Bill also proposes that the registered matters of financial instruments business operators ("FIBOs") include provision of certain services related to crypto-asset derivative transactions. This would require FIBOs to obtain a change registration from the regulator, through a certain examination process, prior to commencing such services (rather than making a post-notification, as is required for changes to ordinary registered matters) and to make a prior notification for certain changes in their contents and methods of business for such services (rather than a post-notification, as is required under the current law) .[24]

Furthermore, the Bill proposes certain regulations on conduct for explanations and representations to customers in the provision of certain services related to crypto-assets.[25]

(b) Crypto-assets deemed as cash

The Bill proposes to deem crypto-assets as cash in relation to certain provisions of the FIEA and the regulations thereunder. The treatment of crypto-assets as such will expand the scope of the FIEA's application. For example, interests in partnership-type investment funds containing crypto-asset contributions will generally fall under a type of security under the FIEA called "collective investment scheme interests." Moreover, services that exchange crypto-assets and securities on the service providers' own account will be regarded as "sale and purchase" (i.e., dealing) of such securities and thus regulated as "type I financial instruments businesses" or "type II financial instruments businesses," both of which are regulated under the FIEA.[26]

(c) AML/CFT regulations

A provider of a service that will be newly regarded as a "financial instruments business under the amended FIEA will be subject to AML/CFT regulations under the Criminal Proceeds Transfer Prevention Act as a FIBO, which is already subject to such regulations.[27]

(d) Grandfathering

Under the proposed transitional measures, even after the amendments come into effect, providers of services that will be newly regarded as financial instruments businesses (other than FIBOs and financial institutions that are qualified to engage in financial instruments business by registration) may continue providing such services for one and a half years (in principle) from the effective date, without obtaining registration as a FIBO. However, there are several applicable caveats and requirements. Such providers may only do so with respect to the customers and kinds of securities and derivative transactions they previously handled. Moreover, such providers must submit a notification within two weeks from the effective date to have an initial six month grandfathering period, and subsequently apply for registration within such six

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23 Under the current law, dealing of futures contracts based on a virtual currency is considered to be dealing of such virtual currency if physical settlements are made, rather than making a reverse trade and settling the differences (I-1-2 of "16. On Virtual Currency Exchange Services" of "Third Part: Financial Companies" of the Administrative Guidelines issued by the FSA).

24 Article 29-2, paragraph 1, item (ix), Article 31, paragraphs 3 and 4, and Article 33-6, paragraph 3 of the Amended FIEA.

25 Article 43-6, Article 63, paragraph 11, and Article 66-15 of the Amended FIEA, etc.

26 Article 2-2 of the Amended FIEA. The Bill also proposes to amend Article 50-2-4 of the Real Estate Brokerage Act to cover transactions in which crypto-assets are paid as consideration (Article 17 of the Supplementary Provisions of the Bill).

27 Article 2, paragraph 2, item (xxi) of the Amended Criminal Proceeds Transfer Prevention Act.

month period to have an additional one year grandfathering period.[28] During this time, such providers must comply with the amended PSA and the amended Criminal Proceeds Transfer Prevention Act as if they were registered as FIBOs.[29]

In addition, FIBOs providing services related to crypto-asset derivative transactions that will require a change registration (see 4(a) above) may continue providing the same services, with respect to the customers and kinds of derivative transactions they handled, without obtaining a change registration, for one and a half years (in principle) from the effective date.[30]

(5) Unfair Trade Regulations

The Bill proposes to introduce a new series of unfair trade regulations regarding the sale, purchase, and other transactions of crypto-assets, as well as crypto-asset derivative transactions.[31] Violators of such regulations may be subject to criminal punishment,[32] but unlike the existing unfair trade regulations, such violations are not subject to administrative monetary penalties.

(6) Tort liability for retail distribution

The Bill proposes to have spot trading of crypto-assets covered by certain explanatory duties and other prohibitions applicable to financial service providers in relation to their distribution of certain financial instruments to retail customers under the Financial Instruments Sales Act, a breach of which may result in strict tort liability.[33] In addition, as crypto-asset derivative transactions will be "derivative transactions" as defined under the FIEA, they will also be subject to such duties and prohibitions under the Financial Instruments Sales Act.[34] The Bill also proposes to amend the Financial Instruments Sales Act by replacing the term "thing or right" (*mono matawa kenri*) in certain provisions therein with "property" (*zaisan*),[35] which will address concerns on the applicability of such provision to crypto-assets that do not represent any right, such as Bitcoin.

3. Amendments relating to "Electronically Recorded and Transferable Rights"

Under the current law, rights or interests represented by ICO tokens are, if the holders expect distribution of business profits, etc., considered to be securities listed in Article 2, paragraph 2, item (v) or (vi) of the FIEA, so-called "collective investment scheme interests," only when: (i) they are purchased in a fiat currency; or (ii) they are purchased in a virtual currency but are considered to be substantially purchased in a fiat currency.[36] Under the proposed Bill, as explained in 2(4)(b) above, such tokens will generally be regarded as "collective investment scheme interests" even if they are purchased in a crypto-asset.

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28 Article 10, paragraphs 1 and 2, and Article 11 of the Supplementary Provisions of the Bill.

29 Article 10, paragraph 3 of the Supplementary Provisions of the Bill.

30 Article 12 of the Supplementary Provisions of the Bill.

31 Articles 185-22, 185-23, and 185-24 of the Amended FIEA.

32 Article 197, paragraph 1, item (vi) and paragraph 2, item (ii), and Article 198-2, paragraph 1, item (i) of the Amended FIEA.

33 Article 2, paragraph 1, item (vi), (c) and Article 3, paragraph 5, item (v) of the Financial Instruments Sales Act as amended under Article 3 of the Bill (the "Amended Financial Instruments Sales Act").

34 Article 2, paragraph 1, items (viii) and (ix) of the Amended Financial Instruments Sales Act.

35 Article 3, paragraph 3 and Article 6, paragraph 2 of both the Financial Instruments Sales Act and the Amended Financial Instruments Sales Act.

36 The Study Group Report, page 20 f.

In addition, based on the Study Group Report, the Bill proposes to introduce a new regulatory category of securities for such tokens, called "electronically recorded and transferable rights" (*denshi kiroku iten kenri*), and treat them as "paragraph 1 securities" (a category of securities including bonds and shares).

(1) Definition of "electronically recorded and transferable rights"

The Bill proposes to define as "electronically recorded and transferable rights" any rights listed in any of the respective items of Article 2, paragraph 2 of the FIEA, which are deemed to be securities under the same paragraph (i.e. any right categorized as "paragraph 2 securities" under the current FIEA, such as partnership-type investment fund interests) if such rights "are represented by proprietary value (limited to that which is recorded on an electronic device or any other object by electronic means), that may be transferred by using an electronic data processing system (excluding the case(s) specified by a Cabinet Office Order in consideration of transferability and other factors)".[37]

(2) Disclosure requirements

"Electronically recorded and transferable rights" will be categorized as "paragraph 1 securities" by the Bill, rather than "paragraph 2 securities" as they are under the current law.[38] Accordingly, the requirements for private placement applicable to "paragraph 1 securities" will apply to "electronically recorded and transferable rights," and so forth.

In addition, while "paragraph 2 securities" are currently exempt from the initial and ongoing disclosure requirements, except for certain cases in which the contributed assets are mainly invested in securities, the Bill proposes not to exempt "electronically recorded and transferable rights" from such requirements.[39]

(3) Regulations on financial instruments business

(a) Business categories

While, under the current law, dealing, brokerage, and distribution (excluding distribution made by the issuer or seller itself) of rights that would be categorized as "electronically recorded and transferable rights" fall under "type II financial investments business," the Bill proposes to categorize them as "type I financial instruments business."[40] Similarly, while so-called "collective investment scheme interests" that would fall under "electronically recorded and transferable rights" are currently covered by "type II small amount electronic public offering services" (a special category of "type II financial investments business" for crowdfunding), they will be covered by "type I small amount electronic public offering services" (a special category of "type I financial investments business" for crowdfunding).[41] In addition, the Bill also proposes to classify custody services for "electronically recorded and transferable rights" as a "type I financial instruments business" if such services are provided in relation to other certain services provided as part of the financial instruments business of the same operator.[42]

On the other hand, no revisions are proposed for the following regulatory treatments: (i) the offering activities by the

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37 Article 2, paragraph 3 of the Amended FIEA.

38 *Id*.

39 Article 3, item (iii) of the FIEA, Articles 2-9 and 2-10 of the Order for Enforcement of the Financial Instruments and Exchange Act, and Article 3, item (iii), (b) of the Amended FIEA.

40 Article 28, paragraph 2, item (ii) of the FIEA and Article 28, paragraph 1, item (i) of the Amended FIEA.

41 Article 29-4-3, paragraph 4 of the FIEA and Article 29-4-2, paragraph 10, item (ii) of the Amended FIEA.

42 Article 2, paragraph 8, item (xvi) of the Amended FIEA.

issuers of so-called "collective investment scheme interests" (such as the general partner), even if they would fall under "electronically recorded and transferable rights," are categorized as "type II financial instruments business;" (ii) fund management activities by the issuer of such interests are categorized as "investment management business;" and (iii) the registration exemption for "specially permitted businesses for qualified institutional investors, etc." under Article 63 of the FIEA is available for both of these activities.[43]

(b) Registration and notification system

The Bill proposes that the registered matters of FIBOs include provision of certain services related to (i) certain rights that are deemed to be securities under Article 2, paragraph 2 of the FIEA and specified by a Cabinet Office Order, and (ii) derivative transactions in which: (a) such rights are the underlying assets or (b) an index relating to any of such rights is the reference index. It seeks to require FIBOs to obtain a change registration, through a certain examination process, prior to commencing such services (rather than making a post-notification, as is required for changes to ordinary registered matters) and to make a prior notification for certain changes in their contents and methods of business for such services (rather than a post-notification, as is required under the current law).[44] At the very least, "electronically recorded and transferable rights" will likely be specified as such rights by a Cabinet Office Order.

(c) Grandfathering

Under the proposed transitional measures, a FIBO providing a service mentioned in (b) above may continue to provide the same service with respect to the customers and kinds of securities and derivative transactions it handled, without obtaining the required change registration for one and a half years (in principle) from the effective date.[45]

4. Other Amendments

In the Bill, there are several proposals about a variety of topics other than crypto-assets and "electronically recorded and transferable rights," owing to the progression of information and communication technology.

(1) Sharing of information to third parties by financial institutions

With respect to financial institutions subject to business scope restrictions (namely, banks and other depository institutions, FIBOs that conduct type I financial instruments business or investment management business, and insurance companies), the Bill proposes to clarify that they can provide customer information (with customer consent), or other information, to third parties if such information contributes to the advancement of such financial institutions' main businesses or to the enhancement of user convenience.[46] This includes permitting transmission of other companies' advertisements to customers, providing services in cooperation with other companies, and conducting management and handling of information between customers and business operators (information trust functions, or so-called "information banks"). However, compliance with bank secrecy, the Act on the Protection of Personal Information, and other related laws and regulations, as well as supervisory guidelines and self-regulatory rules, will still be required even after the amendment takes effect.

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43 Article 2, paragraph 8, item (vii), (f) and item (xv), (c), Article 28, paragraph 2, item (i) and paragraph 4, item (iii), and Article 63 of the FIEA.

44 Article 29-2, paragraph 1, item (viii), Article 31, paragraphs 3 and 4, and Article 33-6, paragraph 3 of the Amended FIEA, .

45 Article 12 of the Supplementary Provisions of the Bill.

46 Article 10, paragraph 2, item (xii) of the Banking Act as amended by Article 10 of the Bill, Article 35, paragraph 1, item (xvi) of the Amended FIEA, Article 98, paragraph 1, item (xiv) of the Insurance Business Act as amended by Article 11 of the Bill (the "Amended Insurance Business Act"), etc.

(2) Subsidiary acquisition of InsurTech companies, etc., by insurance companies

Similar to the 2016 amendment of the Banking Act,[47] the Bill also proposes to make it possible for an insurance company to invest in and hold up to 100% of the voting rights of "a company conducting business that contributes or is expected to contribute to the advancement of the insurance businesses conducted by the insurance company or the enhancement of the convenience of users of the insurance company by utilizing information and communication technology or any other technology," by obtaining authorization from the relevant supervisory authority as an exception to the so-called "10% rule."[48]

The background to this amendment is that, like banks, it is considered appropriate for insurance companies to be allowed to own these companies, such as InsurTech companies, as their subsidiaries in order to advance their insurance businesses and enhance user convenience.[49]

(3) Amendment of the Netting Act in relation to the treatment of security interests for OTC derivatives and certain other transactions in the case of the commencement of reorganization proceedings

Starting with mega financial institutions (Phase 1 entities), margin requirements for OTC derivatives transactions, which took effect in September 2016, have gradually expanded their scope of application globally. Now, Phase 5 (IM Big Bang), applicable to smaller financial institutions and taking effect from September 2020, is a center of interest for market participants. Under the margin requirements, parties will be required to exchange variation margin[50] and initial margin ("IM").[51] For IM, each party can post collateral to each other, and such collateral must be available without delay in the case of the counterparty's default.

Credit Support Annex ("CSA") and Credit Support Deed ("CSD") contract templates prepared by the ISDA (the International Swaps and Derivatives Association, Inc.) are used in collateral practices of OTC derivatives which often involve cross-border transactions. Regarding IM, in combination with the utilization of a third party custodian, IM CSA/CSD are governed by New York law/English law, and security interests, such as pledges/charges, are created thereunder. Similarly, it seems common to create pledges under Japanese law in the posting of Japanese government bonds as collateral for IM in cross-border transactions. However, since the introduction of margin requirements, market participants have discussed the existence of the risk that, if reorganization proceedings under the Corporate Reorganization Act or the Act on Special Measures of Reorganization Proceedings of Financial Institutions are commenced against a Japanese financial institution that is the counterparty to OTC derivative transactions, the obligations secured by the collateral posted by the Japanese financial institution will become subject to the proceedings and thus the secured creditor

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47 It has become possible for a bank to invest in and hold voting rights of "a company conducting business that contributes or is expected to contribute to the advancement of the banking businesses conducted by the bank or to the enhancement of the convenience of users of the bank by utilizing information and communication technology or any other technology," such as a FinTech company, comprising 100% at maximum, by obtaining authorization from the relevant supervisory authority as an exception to the so-called "5% rule" (Article 16-2, paragraph 1, items (xii)-3 and paragraph 7 of the Banking Act, Article 17-5-2 of the Regulation for Enforcement of the Banking Act). A similar amendment was also made in relation to bank holding companies (Article 52-23, paragraph 1, item (xi)-3 of the Banking Act, Article 34-19-2 of the Regulation for Enforcement of the Banking Act).

48 Article 106, paragraph 1, item 13-2 and paragraph 7 of the Amended Insurance Business Act, etc.

49 "Report on the development of regulations for financial institutions regarding data utilization" by the Study Group on the Financial System under the Financial System Council (January 16, 2019), p. 4. Regarding FIBOs that conduct type I financial instruments business or investment management business, since they are not subject to restrictions on the scope of business of their subsidiaries, it is already possible for them to have a FinTech subsidiary under the current law.

50 "Variation Margin" corresponds to the fluctuations in the market value of transactions.

51 "Initial Margin" corresponds to the future fluctuation in the market value of transactions assuming the period required to replace the relevant position after a counterparty's default.

will not be able to exercise their security interests in the collateral.[52] This is because the Netting Act only protects collateral transactions by way of a "loan for consumption/deposit for consumption" (i.e. a title transfer), plus set-off, but does not protect any collateral transactions in which a security interest is created. Therefore, the Bill aims to release the IM CSA/CSD creating security interests from the above risks in new Article 4, under which, if an order to commence reorganization proceedings is issued by a court against a financial institution that conducts OTC derivatives transactions or any other transactions covered by the Netting Act, the collateral for the transactions will be retroactively deemed to have been acquired by the counterparty or a third party at the time when a petition for commencement of reorganization proceedings was filed or the collateral was transferred to such third party, respectively. The value of the collateral will be further deducted from the amount of the claim after the close-out netting of the transactions (including collateral transactions in the form of a "loan/deposit for consumption").

It should be noted that if a security interest is to be exercised by transferring the collateral to a third party, the exercise must be made on or after the filing of the petition for commencement of reorganization proceedings and before the commencement of the reorganization proceedings.[53]

Going forward, it seems that matters such as the following will be of interest to derivatives market participants: (i) confirmation of whether IM CSA/CSD will satisfy the requirements of security interest agreements under the Amended Netting Act,[54] (ii) the type of collateral to be protected under the newly added Article 4 thereof, as well as the method of valuation of the collateral for the purpose thereof, which will be specified by a Cabinet Office Order, and (iii) consideration for the use of security interest agreements other than IM CSA/CSD.[55]

Under the proposed transitional measures, the newly added Article 4 of the Netting Act will apply only to collateral in which a security interest is created by a party against whom a petition for commencement of reorganization proceedings is filed on or after the effective date.[56]

(4) Data seizure in criminal investigations by officials of the SESC, etc.

The number of crimes using computers has continued to increase recently, and in order to address such cases properly, there is increasing need to gather and analyze electromagnetic records as evidence, even in the investigations of crimes under the FIEA by officials of the SESC or local financial bureaus. However, unlike under the Code of Criminal Procedure or the Act on General Rules for National Taxes, etc., since there is no regime for seizure of electromagnetic records under the FIEA, the Bill proposes to introduce such regime by amending the FIEA.[57]

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52 See Article 2, paragraph 10 of the Corporate Reorganization Act, and Article 4, paragraph 10 and Article 169, paragraph 10 of the Act on Special Measures of Reorganization Proceedings of Financial Institutions.

53 Article 4, paragraph 4 of the Netting Act, as amended by Article 13 of the Bill (the "Amended Netting Act").

54 It must be stipulated in the security interest agreement that if a petition for commencement of reorganization proceedings is filed against either of the parties to transactions under a master agreement, the secured party may acquire or dispose of the collateral to satisfy the secured obligations (Article 4, paragraphs 1 and 4 of the Amended Netting Act).

55 The wording of the Amended Netting Act merely states security interest agreements containing certain contract provisions, and there is no specific identification as "IM CSA/CSD."

56 Article 15 of the Supplementary Provisions of the Bill.

57 Article 211, etc. of the Amended FIEA.

5. What's next

If the Bill becomes law, it will come into effect within one year from the date of promulgation.[58] The detailed rules based on the proposed amendments will be provided by the relevant regulations, such as Cabinet Orders and Cabinet Office Orders, which will be issued after the public consultation process.

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[58] Article 1 of the Supplementary Provisions of the Bill.