

**Financial Regulation Newsletter****The Essential Points of the Amendments to the Regulation on Virtual Currency Exchange Services**

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**1. Introduction**

On May 25, 2016, in response to the progress of information and communications technology, etc., the Payment Services Act (hereinafter referred to as the “Payment Services Act”) and several Finance Related Laws including the Banking Act, etc. (hereinafter referred to as the “Amendment Act”), were amended. In this Newsletter, we introduce the main points of the revisions to respond to the development of IT in financial services, mainly in the amendment of the Payment Services Act concerning virtual currency exchange services (hereinafter, the Payment Services Act after the amendment is referred to as the “Amended Payment Services Act”). Although it is not discussed in this Newsletter, the Banking Act has also been amended to relax the regulations on the scope of the business of the companies in which bank groups may invest, which will make it easier for the bank groups to finance IT-related companies

**2. Substance of the Revision****(1) The Amendment Concerning “Virtual Currencies”**

Following the Bankruptcy of Mt. Gox<sup>1</sup> and the FATF Guidance,<sup>2</sup> the report published by the Working Group on the Sophistication of Payment Services, etc. of the Financial System Council, “Strategic Approach for Sophistication of Payment Services”<sup>3</sup> (hereinafter referred to as the “WG Report on Payment Services”), on December 22, 2015, proposed the introduction of 1) the regulation on customer protection applying to virtual currency exchangers and 2) the regulation on AML/CFT (Anti-Money Laundering and Countering Financing of Terrorism). The Amended Payment Services Act based on the proposals above has defined “virtual currency” and “virtual currency exchange services”, and introduced a registration requirement for the virtual currency exchange service operators. Also, the virtual currency exchange service operators are newly designated as “specified business operators” in the Act for Prevention of Transfer of Criminal Proceeds (hereinafter the amended version of the same law is referred to as the “Amended Proceeds of Crime Act”), the AML/CFT law of Japan. The following are the main points of the amendments relating to virtual

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currencies.

Amendments Concerning the Amended Payment Services Act

1) The Definition of Virtual Currency

Virtual currency was newly defined in Article 2, paragraph (5), items (i) and (ii) of the Amended Payment Services. The elements in the definition of virtual currency can be broken down as follows:

(A) the definition in Article 2, paragraph (5), item (i) of the Amended Payment Services Act

- (i) Can be used for payment to unspecified persons in 1) the purchase or 2) lease of goods, or 3) paying consideration for the receipt of the provision of services
- (ii) Can be purchased from and sold to unspecified persons
- (iii) Has financial value
- (iv) Is recorded by electromagnetic means in electronic devices or other items
- (v) Is not the currency of Japan, foreign currencies, nor an “asset denominated in currencies”<sup>4</sup>
- (vi) Can be transferred using electronic data processing systems

(B) the definition in Article 2, paragraph (5), item (ii) of the Amended Payment Services Act

- (i) Can be mutually exchanged with the virtual currency as set forth in (A), with unspecified persons as the counterparty
- (ii) Same as (iii) to (vi) in (A)

2) Registration Requirement

(A) “A person or a firm that carries out either the (i)(a) purchase, sale, or exchange of virtual currencies, (b) intermediation, brokerage, or agency in conducting actions set forth in (a), or (c) the management of cash or virtual currencies in relation to (a) and (b), (ii) on a regular basis<sup>5</sup>” is required to register with the Prime Minister (Article 63-2 of the Amended Payment Services Act) as a “virtual currency exchange service provider.” The business patterns falling under virtual currency exchange services are roughly classified as in the following chart. Further, where the purchase and sale of virtual currencies are included as a part of the provision of a service, such as international remittance using virtual currencies, etc. it could require registration as a virtual currency exchange service provider, as long as the person conducts any of (a) to (c). Therefore, when establishing a business model using a medium that may fall under the definition of a virtual currency, it is necessary to consider whether the business model involves virtual currency exchange services.

Purchase, sale or exchange	<ul style="list-style-type: none"> <li>· A business of establishing a virtual currencies sales office, and conducting sales by currencies or exchange of virtual currencies with other virtual currencies</li> <li>· A business of establishing and operating an ATM that enables virtual currencies to be realized and withdrawn</li> </ul>
Intermediation, brokerage, or agency	<ul style="list-style-type: none"> <li>· A business of operating an exchange or a matching platform for purchasing or selling or exchanging virtual currencies (Intermediation)</li> <li>· A brokerage business of purchasing or selling virtual currencies on behalf of a customer’s account (Brokerage)</li> <li>· An agency business of a virtual currencies sales office (Intermediation or agency)</li> </ul>

Management	·Receiving deposits from customers in order to broker virtual currencies <sup>6</sup>
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(B) The registration will be denied if the applicant:

- (i) Is not a stock company nor a foreign virtual currency exchange service provider<sup>7</sup>
- (ii) Does not own a financial basis<sup>8</sup> that conforms to the standards specified by the Cabinet Office Ordinance
- (iii) Has a deficiency in its internal system<sup>9</sup>

(Article 63-5 of the Amended Payment Services Act)

### 3) Rules for Customer Protection

In order to protect customers, certain rules of conduct have been imposed on registered virtual currency exchange service providers, including:

- (A) Measures for safely managing information (Article 63-8 of the Amended Payment Services Act)
- (B) Measures for ensuring the appropriate and secure conduct of business pertaining to outsourcing (including subcontractors), such as guidance for the contractors, etc. (Article 63-9 of the Amended Payment Services Act)
- (C) Provision of information to customers (instructions for preventing misrecognition between virtual currencies and fiat currencies, provisions of information on the contents of the contract, etc.) (Article 63-10 of the Amended Payment Services Act)
- (D) Obligations to segregate management of assets regarding cash or virtual currencies<sup>10</sup> and external auditing pertaining to the condition of segregation (Article 63-11 of Amended Payment Services Act)
- (E) Measures pertaining to complaint processing measures and dispute resolution by entering into contracts regarding the usage of Financial ADR, etc. (Article 63-12 of the Amended Payment Services Act)

### 4) Supervision and Penalties by the Relevant Authority

Virtual currency exchange service providers must follow the provisions pertaining to supervision by the relevant authority (including the preparation and preservation of financial documents and books, the preparation and submission of business reports (with the financial statements and auditor's reports of a certified public accountant or auditing firm), the preparation and submission of a property management report, and the subjection to on-site inspections and a business improvement order). (Article 63-13 and following of the Amended Payment Services Act.) Also, virtual currency exchange service providers could be subject to criminal penalties. (Article 107 and following of the Amended Payment Services Act.)

### 5) Development of Provisions Regarding the Certified Association for Payment Service Providers

Provisions regarding the Certified Association for Payment Service Providers, as a self-regulatory organization of virtual currency exchange service providers, have been developed. (Article 87 and following of the Amended Payment Services Act.)

### Amendments Concerning the Act for Prevention of Transfer of Criminal Proceeds

Virtual currency exchange service providers are required to follow the KYC procedures and other relevant obligations pursuant to the Amendment Act for Prevention of Transfer of Criminal Proceeds. (Article 2, paragraph (2), item (31) of the Amended Proceeds of Crime Act) Virtual currency exchange service providers are required to verify matters for transactions including customer identification, checking the purpose of the transaction and the contents of business of counterparts, etc. (Article 4 of the Amended Proceeds of Crime Act), prepare and maintain verification records and

transactions records (Article 6 and 7 of the Amended Proceeds of Crime Act), give notification of suspicious transactions to the relevant authority (Article 8 of the Amended Proceeds of Crime Act) and take measures to appropriately conduct verification at the time of transactions, such as training for its employees and continuous monitoring of customers, etc. (Article 11 of the Amended Proceeds of Crime Act.) Also, transferring or offering to transfer the information for customers identification, such as IDs or passwords, etc. with the aim of impersonation or for profit without justifiable cause, are prohibited. (Article 30 of the Amended Proceeds of Crime Act.)

(2) Other Amendments for Streamlining the Regulations Taken in Consideration of the Revolution in IT Technologies, etc.

In addition to the revisions to the law concerning the virtual currency described in (1) above, the current existing regulations under the Payment Services Act have also been amended with the aim of streamlining the regulations, having consideration for the revolution in IT technologies. The details are as follows:

- 1) The issuer of prepaid payment instruments (prepaid cards, etc.) is obligated to provide information such as the amount available for payment and the expiration date (if specified). Such information was generally required to be shown on certificates, etc. (the physical card itself, etc.) when such certificates, etc. were issued. (Article 13 of the Amended Payment Services Act) This amendment allows the issuer of prepaid payment instruments to provide information electronically, so the issuer can ensure compliance with the provisions more easily, even when using instruments that have a tiny display screen, such as wearable devices, etc. The detailed procedures of the provision of information will be specified by Cabinet Office Orders on prepaid payment instruments.
- 2) The Amended Payment Services Act newly specifies public notice procedures in cases where the issuer of prepaid payment instruments refunds the prepaid payment instrument, and clarifies the procedures for receiving refunds. (Article 20 of the Amended Payment Services Act) In concrete terms, it requires the public notice of 1) the fact that refunds are being made, 2) the fact that holders of prepaid payment instruments must state their claim within a certain period specified to be not less than 60 days, and 3) the fact that they will be excluded from the refund procedures if they fail to state their claims within the period written in 2) above, etc., as well as the provision of information to the holder of prepaid payment instruments. (Article 20-2 of the Amended Payment Services Act.)
- 3) Pursuant to the Amended Payment Services Act, the issuer of prepaid payment instruments must take measures necessary for the proper and expeditious processing of complaints from customers concerning the issuance and the usage of prepaid payment instruments. (Article 21-2 of the Amended Payment Services Act)
- 4) Pursuant to the Amended Payment Services Act, with respect to the record date of determining the amount of security deposits for issuance, the issuer of prepaid payment instruments may select the last days of June and December every year as the record dates, in addition to the record dates on the last days of March and September every year. (Article 29-2 of the Amended Payment Services Act) This amendment will enable the handling of security deposits for issuance more correspondent to the actual unused balances.
- 5) The procedures in cases where the funds transfer service provider discontinues a part of their businesses, has been developed. (Article 61 of the Amended Payment Services Act)

(3) Effective Date / Transitional Measures

The Amendments shall come into effect as from the date to be specified by Cabinet Order, within a period not exceeding a year from the day of promulgation (June 3, 2016). (Article 1 of the Supplementary Provisions of the Amendment Act) By the time of the effective date, it is expected that the related Cabinet Orders will be established through the public consultation procedure. Persons who have already conducted the virtual currency exchange services on the effective date are given 6 months' grace period to register, from the effective date. However, since the Amended Payment Services Act will apply to them even before the registration (Article 8 of the Supplementary Provisions of the Act), the rules of conduct on (1) 3) above apply to them, and they will be under the regulatory oversight of the relevant authority

from the effective date.

### 3. Conclusion

Pursuant to the amendments written above, virtual currency exchange services are placed under the regulatory oversight of the relevant authority by the registration system. However, since other legal issues regarding the virtual currency (such as whether or not purchases and sales of the virtual currency will be subject to taxation under the Consumption Tax Act, etc.) are still unresolved, it will still be necessary to keep abreast of changes to the tax laws and other relevant laws.<sup>11</sup>

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<sup>1</sup> This refers to the case where K.K. Mt. Gox, that managed “Mt. Gox”, which was once the biggest exchange office of bitcoin, lost its customers’ bitcoins and the cash that the company had received as deposits from its customers for the purchase of bitcoins, and eventually filed for bankruptcy proceedings.

<sup>2</sup> This refers to the Guidance published by the FATF on June 26, 2015 (the Financial Action Task Force) that states, “Each country should assess the registration and license system with respect to the exchangers of virtual currencies and fiat currency, as well as regulation of anti-money laundering and counter-terrorist financing, such as customer identification, notification of suspicious transactions and preservation of records.” (<http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf>).

<sup>3</sup> [http://www.fsa.go.jp/singi/singi\\_kinyu/tosin/20151222-2/01.pdf](http://www.fsa.go.jp/singi/singi_kinyu/tosin/20151222-2/01.pdf)

<sup>4</sup> This refers to assets that are indicated in fiat currencies, or regarded as being performed by fiat currency with respect to the obligation. Further, an asset the performance of obligations of which shall be conducted in an asset denominated in currencies is also deemed to be an asset denominated in currencies. (Article 2, paragraph (6) of the Amended Payment Services Act)

<sup>5</sup> “On a regular basis” means to act repeatedly and continuously. Also, in cases where virtual currencies are purchased, sold, or exchanged solely for settlement of trading or investment on behalf of such person or firm, it is not considered to be virtual currency exchange services.

<sup>6</sup> As a result of such action of management being considered as virtual currency exchange services, it is made clear that such actions conducted by virtual currency exchange service providers do not violate the Act Regulating the Receipt of Contributions, the Receipt of Deposits, and Interest Rates (Article 2, paragraph (1) of the same Act).

<sup>7</sup> This refers to a person or a firm that carries out virtual currency exchange services, registered in the foreign state as a virtual currency exchange service provider, according to the laws and regulations of the said foreign state equivalent to the Amended Payment Services Act. (Article 2, paragraph (9) of the Amended Payment Services Act) In the case where a foreign virtual currency exchange service provider is to be registered in Japan, it is required to have a representative person in Japan (limited to a person who is domiciled in Japan).

<sup>8</sup> According to the WG Report on Payment Services, it is assumed that a minimum amount of stated capital or regulation of a minimum amount of net assets is imposed.

<sup>9</sup> This refers to the establishment of a system for ensuring the proper and secure conducting of virtual currency exchange services (Article 63-5, paragraph (1), item (iv) of the Amended Payment Services Act) and the establishment of a system that is necessary to ensure compliance with the provisions (Article 63-5, paragraph (1), item (v) of the Amended Payment Services Act) in the Chapter that prescribes virtual currencies in the Amended Payment Services Act. (Chapter 3-2 of the said Act)

<sup>10</sup> Although the contents of the obligation to segregate management will be specified in a Cabinet Order, according to the WG Report on Payment Services, virtual currency exchange service providers are expected to manage assets under the condition that their own property and customers’ property are clearly segregated and immediately discriminable, but entrustments or deposits are not necessary.

<sup>11</sup> The Financial Services Agency currently requests the Ministry of Finance to clarify the treatment of virtual currencies under the consumption tax in its 2017 Taxation Revision Requests.



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