Baker & McKenzie

Client Alert

April 2015

FinTech Client Alert No. 1

Developments in technology for the financial sector ("**FinTech**") are garnering attention all around the world. Governments and international organizations are among those at the forefront of FinTech related discussions, including how financial institutions ("**FIs**") operate, how FIs interact with others and how financial markets are structured and regulated. Japan is no exception and has started looking at ways to ensure that it remains relevant as a financial center for years to come.

Proposed revisions to Banking Act

The Japanese Financial Services Agency (the "**JFSA**") announced during the March 2015 meeting of the Financial System Council (*kinyuu-shingikai*) that it is investigating what legislative revisions would be required to enable banking groups to engage in e-commerce and provide online payment settlement services.

The global financial markets have already seen considerable growth in payments, data analytics, cyber security and digital identities/currencies. Banks are investing in tech start-ups in an effort to obtain a competitive advantage through innovation. IT companies are also disrupting the traditional banking model by looking to provide financial services directly to their customers. However, the range of activities currently permitted under the Banking Act are limited and local Japanese banks have not been able to keep up with their global peers when it comes to offering new IT based financial services and solutions. The JFSA's current efforts are intended to address this issue and strengthen the competitiveness of Japan's FIs and financial markets.

Although the draft revisions to the Banking Act are yet to be finalized, in order to avoid any increase in risk at the level of licensed banks, it is expected that the revisions will expand the scope of activities that non-bank subsidiaries of bank holding companies can conduct, thereby facilitating the ability of banking groups to acquire / invest in tech businesses.

Tips and traps for acquiring a tech business

Banks and other financial institutions or financial services companies contemplating acquiring or investing in a technology-driven business should acquaint themselves as early as possible with the specific issues associated with such transactions in order to avoid surprises and maximize value.

Customary issues include:

Securing ownership of the technology

The technology fundamental to the target company will be a combination of assets, which may include databases, platforms, proprietary code, licensed third party software or assets and "open source" software. A purchaser must understand exactly what elements the target owns - as opposed to what it is entitled to use - and the purchaser should have the vendor substantiate claims of ownership.

For example, if the technology was developed by the founder of the business prior to the incorporation of the target company, a purchaser should look for evidence that the technology has been transferred from the individual to the target company.

Identify the risks associated with the assets

Technology that is used but not owned by the target company creates exposure for the purchaser. In the case of third party licensed software, this exposure is in the form of changes to license fees, and limitations on the use of the software. In relation to open source software components, the purchaser may find itself subject to compulsory license obligations.

If third party software has not been properly licensed by the target company, there is also exposure to a third party intellectual property infringement claim.

Understand what is on offer

Small technology companies - especially start ups - are often unwilling to give assurances as to ownership of the intellectual property driving the technology, or that use of the technology will not infringe the rights of third parties. A purchaser should establish this early in the process and negotiate the price accordingly, rather than risk identifying the issue after substantial commitments have been given.

Securing the brains of the operation

The value of the technology can be heavily impacted if the individuals with special knowledge of, or expertise in, the acquired technology leave the target company. Identifying and securing the services of key personnel, as well as embedding 'knowledge transfer' provisions for staff who will not transfer with the target company, are important to secure the full value of the technology.

Identifying potential claims against the technology

Be aware that even technology that is owned by the target company may be subject to claims by an employee. In a number of countries employee inventors may be entitled to additional remuneration for 'outstanding contributions' to inventions that are patented and used by their employer. A purchaser should seek warranty protection against these types of claims.

Multi-national protection of technology

If the technology is protected by patents as well as copyright, purchasers should identify what countries are covered by patent filings and be aware that developments that are capable of patent protection in one country may not be patentable in other countries.

Impact on regulatory obligations

If a financial services company acquires a technology company, the regulatory obligations that apply to the acquirer may flow through to the technology company. If the tech company continues to provide services to other

www.bakermckenzie.co.jp

For further information please contact

Gavin Raftery
Partner
+81 3 6271 9454
gavin.raftery@bakermckenzie.com

Chris Hodgens
Partner
+81 3 6271 9442
chris.hodgens@bakermckenzie.com

Masato Honma
Associate
+81 3 6271 9505
masato.honma@bakermckenzie.com

Baker & McKenzie
(Gaikokuho Joint Enterprise)

Ark Hills Sengokuyama
Mori Tower 28F
1-9-10, Roppongi, Minato-ku
Tokyo 106-0032, Japan
Tel + 81 3 6271 9900
Fax + 81 3 5549 7720
www.bakermckenzie.co.jp

customers, it may have regulatory compliance obligations that are broader than the purchaser's existing obligations.

Ongoing contracts

If the target company will continue to provide services to other companies after its acquisition, the purchaser will need to ensure its acquisition does not give existing customers a right to terminate their agreements.

Strict segregation of data and services will need to be in place to ensure that there is no conflict between the services that the company provides to the purchaser and those it provides to other customers after acquisition.

Think about the infrastructure

A purchaser should identify the scope and location of the target company's infrastructure. If its data centers are located overseas, or if it stores data in a co-located data center or in the cloud, this could affect the security of the data and create compliance issues for the purchaser.

Privacy issues

A target company that will continue to provide services to other customers after its acquisition, will cause the purchaser to have access to personal information of other customers. This personal information may be subject to different privacy obligations which the purchaser will need to comply with.

* * * * *

Baker & McKenzie Tokyo has a multi-disciplinary team of legal professionals focusing on issues and opportunities in the FinTech sector. These professionals cover financial services regulatory issues, technology and data privacy issues, tax and transfer pricing issues, competition issues and venture capital, private equity and general M&A issues.