

Client Alert

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FinTech Client Alert No. 2

1. Introduction

In response to the changing FinTech landscape, which combines finance with new technologies to bring about innovative financial services, the Japanese Diet enacted "An Act to Partially Amend the Banking Act, etc. for the Purpose of Responding to the Changing Environment Due to the Development of Information and Communication Technologies" (the "**Amendments**"), as of 25 May 2016.

While the Amendments implement changes to several related laws, it is fair to say that in relation to FinTech, the primary substance of the Amendments involves: (i) amendments to the Banking Act in order to facilitate the entry of banking groups into the FinTech space, (ii) amendments to the Payment Services Act and the Act on Prevention of Transfer of Criminal Proceeds in order to prevent money laundering and the funding of terrorism in relation to, and to protect the users of, virtual currencies and (iii) amendments to the Payment Services Act in order to streamline regulations in connection with services utilizing payment mechanisms based on prepayment ("**Prepaid Payment Instruments**").

2. Facilitation of Investment by Banks into Finance-related IT Businesses (Amendment of the Banking Act)

Under the Banking Act, banks (and bank holding companies) are permitted to hold subsidiary companies in finance-related fields, but the scope of operations available to such subsidiaries are generally regulated on the same strict basis as applicable to their parent banks—such that they have not been able to engage in "other business" (such constraints, the "**Regulations on Scope of Operations of Subsidiaries**"). Furthermore, banks (and their subsidiaries) have been prohibited from holding more than a total of 5% of the voting rights of any company in Japan which is not in compliance with the Regulations on Scope of Operations of Subsidiaries, and the same regulations have applied to bank holding companies to a level of 15% of such voting rights (such regulations, the "**Regulations on Voting Rights Ownership**"). Under such regulations, even where banks and bank holding companies have moved to acquire or invest in FinTech ventures for the development of new financial services, they have been prevented from making more than a 5% investment (15% in the case of bank holding companies).

Under the Amendments, the Regulations on Scope of Operations of Subsidiaries and the Regulations on Voting Rights Ownership have been relaxed in order to facilitate the entry of banks and banking groups into the FinTech space. In other words, it is now possible for banks and bank holding companies to receive permission, on a case-by-case basis, to acquire and hold more than the stipulated level of voting rights (up to and including 100%

of such voting rights) in finance-related IT businesses, etc. (that is, including companies engaged in, or which have the expectation of becoming engaged in, (i) the advancement of banking business using communications technologies or other technologies, or (ii) the improvement of user experiences). Although the Amendments do not elaborate on the approval criteria for such permission, it may be presumed that they will include such considerations as the impact on the soundness of the relevant group's financial condition, familiarity with the risks to the banking business, the degree to which the risks could affect the bank, the possibility of abuse of superior bargaining positions and of conflicts of interest, and the potential for contribution to the expansion of financial services, etc.

In addition, the Amendments have relaxed the requirement for revenue dependency (50% or more) in respect of the parent banking group, as was required for subsidiaries operating as dependent businesses (e.g. as in the case of IT businesses in the payments-related sector).

3. New Regulations for Virtual Currencies in Japan (Amendments to the Payment Services Act and the Act on Prevention of Transfer of Criminal Proceeds)

Virtual currencies, which allow for rapid and easy transferability as well as anonymity, carry with them the risk of them being exploited—whether in connection with money laundering or the funding of terrorism—and this risk has become an issue of international concern. At the same time, recent bankruptcies of Bitcoin exchanges have brought awareness that there is a greater need for the protection of virtual currency users/holders.

In order to address these considerations, the Japanese government has implemented new amendments to the Payment Services Act and the Act on Prevention of Transfer of Criminal Proceeds which are centered around the establishment of a registration system for businesses involved in the exchange of virtual currencies ("**Virtual Currency Exchange Services**").

A) Definition of Virtual Currency

Broadly speaking,¹ virtual currency has been classified as valuable property which can be used as a medium of exchange in connection with the payment of consideration between parties, which can be transferred by means of electronic data processing systems. This classification includes virtual currencies which can be exchanged for other virtual currencies.

B) Introduction of a Registration System for Virtual Currency Exchange Services

The Amendments establish (i) provisions mandating that Virtual Currency Exchange Services may not be provided unless the provider of such services

¹ The definition of "virtual currency" under Article 2(5) of the Payment Services Act is as follows:
1) any thing having value as property which, in the event of a purchase of goods, a borrowing, or a receiving of the provision of services, can be used for the purpose of the payment of consideration in respect thereof to an unspecified person, which can be sold to or purchased from an unspecified person (excluding the currency of Japan or of any other country to the extent that such are recorded on electronic devices or by any other electronic method; the same shall apply to the next item), which can be transferred by means of electronic data processing systems, or
2) any thing having value as property that can be exchanged with an unspecified person in respect [a virtual currency described by] the preceding item, which can be transferred by means of electronic data processing systems.

For further information please contact



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



Masato Honma
Partner
+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

is registered to do so (as a "Virtual Currency Exchange Service Provider") and (ii) requirements and procedures applicable in connection with such registration.

C) Ensuring Confidence

In order to promote confidence in the use of virtual currencies, the Amendments provide regulations for (i) sharing of information regarding users of virtual currencies, (ii) management of the safety of the related systems, (iii) management of the segregation of user deposits as made in the form of money and virtual currencies, respectively, (iv) rules relating to minimum capital and net assets, (v) external audits regarding deposit segregation management and financial statements, (vi) the implementation by relevant authorities of reports, inspections and business-improvement orders and (vii) self-regulation mechanisms.

D) Measures Against Money Laundering and Funding of Terrorism

By adding Virtual Currency Exchange Service Providers to the list of "specified business operators" under the Act on Prevention of Transfer of Criminal Proceeds, the Amendments oblige Virtual Currency Exchange Service Providers to comply with several duties under such Act, including know-your-customer procedures at the time of the opening of new accounts, the creation and maintenance of records regarding identifications and transactions, reporting to the relevant authorities of suspicious transactions and the establishment of internal compliance systems.

4. Regulations for the Streamlining of Prepaid Payment Instruments (Amendment of the Payment Services Act)

The Amendments also implement the below changes with a view to streamlining the regulations related to services utilizing Prepaid Payment Instruments, which are commonly used in connection with FinTech innovations.

A) Interfacing with Network-enabled Prepaid Cards

With respect to the sharing of information regarding Prepaid Payment Instruments (including, for example, prepaid cards), certain regulations previously mandated that information (i.e., regarding available balances, etc.) could only be displayed directly by means of such Prepaid Payment Instrument. These regulations are being revised, and more flexible methods of information sharing will be permitted (including the provision of such information over the internet).

B) Complaint Processing System for Prepaid Cards

Corresponding to the growing popularity of prepaid cards, the Amendments provide new regulations relating to (i) public notice requirements related to withdrawals from Prepaid Payment Instruments, (ii) regulations in relation to complaint processing systems for Issuers of Prepaid Payment Instruments and (iii) flexibility with respect to calculation reference dates applicable to amounts deposited on Prepaid Payment Instruments.