

Report
from Study Group
on Virtual Currency Exchange Services

December 21, 2018

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Members of the Study Group on the Virtual Currency Exchange Services

As of December 21, 2018

Chair	KANDA, Hideki	Professor, Law School, Gakushuin University
Members	FUKUDA, Shin-ichi	Professor, Graduate School of Economics, The University of Tokyo
	INOUE, Satoshi	Partner, NAGASHIMA OHNO & TSUNEMATSU
	IWASHITA, Naoyuki	Professor, Kyoto University School of Government
	KANSAKU, Hiroyuki	Professor of Graduate Schools for Law and Politics, The University of Tokyo
	KATO, Takahito	Professor of Graduate Schools for Law and Politics, The University of Tokyo
	KUSUNOKI, Masanori	Chief Technology Officer, Head of Technology and Design Division, Japan Digital Design, Inc.
	MIYAKE, Tsuneharu	Head, Financial Research Department, Mizuho Research Institute Ltd.
	MORISHITA, Tetsuo	Professor, Sophia University Law School
	NAGASAWA, Yumiko	Organizer, Foster Forum of Better Financial Services for Consumers
	NAKAJIMA, Masashi	Professor, Faculty of Economics and Business Administration, Reitaku University
	OKINA, Yuri	Chairperson of the Institute, The Japan Research Institute, Limited
SAKA, Yuichiro	Attorney at Law, Tokyo Godo Law Office	
Observers	FUKUMOTO, Takuya	Director, Industrial Finance Division, Economic and Industrial Policy Bureau, METI (Ministry of Economy, Trade and Industry)
	MOCHIZUKI, Akihito	Chairman of the Planning Committee, Japanese Bankers Association
	NAITO, Shigeo	Director for the Policy Planning Division, Consumer Affairs Agency
	NAKANO, Toshiaki	Chairman of the Business Committee, Trust Companies Association of Japan
	NAKAZAWA, Toru	Director, Financial System Stabilization Division, Minister's Secretariat, Ministry of Finance
	OKUYAMA, Taizen	Chairman, Japan Virtual Currency Exchange Association
	SOEJIMA, Yutaka	Head of FinTech Center, Payment and Settlement Systems Department, Bank of Japan
	TAKAHASHI, Toshiaki	Director, Japan Financial Intelligence Center, National Police Agency
	TAKEBAYASHI, Toshikazu	Counsellor, Minister's Secretariat, Ministry of Justice
	YAMAUCHI, Kimiaki	Executive Director, Chief Officer for Rules & Regulations, Japan Securities Dealers Association
	YAMAZAKI, Tetsuo	Secretary-General, The Financial Futures Association of Japan

(Alphabetical Order)

*In addition to its members, the Study Group invited the following persons to exchange opinions.

First Session (April 10, 2018)	Hisanori Ogawa	Director, Strategic Research Department, Mizuho Securities Co., Ltd.
Forth Session (June 15, 2018)	Joichi Ito	Director, MIT Media Lab
	Gary Gensler	Senior Advisor to the Director, MIT Media Lab
	Sagar Sarbhai	Head of Regulatory Relations for APAC and Middle East, Ripple

(Note) In the fourth session, opinions were exchanged through video calls.

Introduction

As regards virtual currency (crypto-assets),¹ in response to both; international requests regarding Anti-Money Laundering and Counter-Terrorism Financing,² and the occurrence of bankruptcy of the largest virtual currency exchange service provider (an “SP”) in Japan, Japan amended the Act on Prevention of Transfer of Criminal Proceeds as countermeasures against money laundering and terrorist financing which obligates SPs to identify customers, and established rules for customer protection by the amendment of Payment Services Act (the “PSA”) including accountabilities of the SPs to the customers. Both have taken effects since April 2017.

In January 2018, customer’s virtual currencies managed by an SP (“virtual currency under management”) were stolen due to illegal access.³ In addition to this incident, the Japan Financial Services Agency identified the inadequate internal management capabilities of many SPs through a series of on-site inspections. It was also pointed out that virtual currencies were highly fluctuating in price, which made virtual currencies subjects of speculative trading. Furthermore, new forms of virtual currency trading such as trading on margin and fund-raising using virtual currency have emerged.

Under those circumstances, the Study Group was established in March 2018 to discuss and deliberate on regulatory measures for various issues surrounding the virtual currency exchange services. The Study Group meeting was held eleven times⁴ including an interview with related parties such as an overseas operator. This report summarizes the outcomes of our studies.

¹ As described in this report, the term “virtual currency” as defined in the PSA may be changed to “crypto-assets”. Given the name of the Study Group and the fact that the members discussed various issues based on the current PSA, this report adopts “virtual currency” to avoid confusion.

² At the G7 Elmau Summit in June 2015, the summit declaration stated, “We will take further actions to ensure greater transparency of all financial flows, including through an appropriate regulation of virtual currencies and other new payment methods”. In the same month, FATF (Financial Action Task Force) also confirmed “The registration/licensing requirements of Recommendation 14 apply to domestic entities providing convertible VC (Virtual Currency) exchange services between VC and fiat currencies (i.e. VCPSP: VC payment products and services) in a jurisdiction.” in the guidance.

³ To be accurate, the private key managed by the SP, which was necessary to transfer virtual currency, was caught by the perpetrator through illegal access and the virtual currency was transferred from the SP’s address.

⁴ As described in this report, the Study Group discussed issues, such as SPs, unfair virtual currency spot trading, custodial services for virtual currencies, virtual currency CFDs and ICOs.

In September 2018, when the Study Group was ongoing, another incident of a virtual currency theft from an SP occurred. The outline of this case was also reported in the Study Group, and it was regarded as one of materials of discussion from that point. Since SPs are involved with various market participants through transactions related to virtual currency, it is desirable that they take measures thoroughly to protect users and ensure fair trading including prevention of recurrences of such incidents.

Also, in October 2018, the Japan Virtual Currency Exchange Association was certified as the certified association for payment service providers (a self-regulatory organization under the PSA, the “SRO”). Along with the changing environment surrounding virtual currency, from the viewpoint of user protection, it became possible for the SRO to set up and amend its self-regulation rules and carry out flexible monitoring of its members. It is expected that, in order to fulfill its self-regulative functions, the SRO works closely with the administrative authorities and brings its abilities and efforts to ensure its effective self-regulations, including the development of the enforcement system. Furthermore, in order to enable anyone to grasp the actual practices of various business operations related to virtual currency, it is desirable that the SRO should enhance the provision of necessary statistical surveys and information.

1. Addressing Issues with Virtual Currency Exchange Service Providers (SPs)

As mentioned above, SPs are subject to money laundering and terrorist financing regulations, such as the obligation to identify customers, to meet the international needs. On the other hand, from the viewpoint of user protection, a certain regulatory framework was established in the PSA, taking into account the balance with innovation.

Nevertheless, while the number of the kinds of virtual currency has been increasing⁵ and the scale of their businesses has been rapidly expanding, inspection and monitoring by the administrative authorities revealed that the improvement of their internal management capabilities could not keep pace with the business growth. In addition, given the fact that two incidents of the thefts of virtual currency under management occurred within about one and a half years after the enforcement of the PSA, and that virtual currency is used as the subject of speculative trading, the Study Group examined issues that would be appropriate to solve by improving the regulatory framework in terms of user protection.

a. Tightening Management and Preservation of Customers' Assets

i. Addressing Risks of Leakage of Virtual Currency under Management

From the security perspective, SPs should store private keys which are necessary to transfer virtual currency under management⁶ with cold wallets (offline).

However, for a certain amount of virtual currency under management that is required to be available for daily transactions to respond to orders from customers quickly, private keys are sometimes stored with hot wallets (online), which would pose higher security risks than cold wallets.

⁵ At the first meeting of the Study Group (on April 10, 2018), the Japan Virtual Currency Exchange Association explained that there are more than 1,500 kinds of virtual currencies in circulation around the world.

⁶ In general, it is necessary to affix an electronic signature with a private key corresponding to the address to transfer virtual currency. Private keys are managed in wallets (software) on PCs or USB devices. Wallets that are not connected to an external network are generally called "Cold Wallets" and connected ones are called "Hot Wallets."

Through the actual cases in which private keys for stolen virtual currencies were managed in hot wallets and were hacked illegally, the risk of hot wallets has been revealed.⁷

As the first step to address these security risks, it is important for SPs to steadily implement security measures required by related acts and regulations. It is considered appropriate for the administrative authorities to continue intensive monitoring of the management system handling the security risks of SPs. Besides, in terms of the improvement of the security level of SPs, it would be effective that cyber-security specialists set guidelines focusing on technologies and skills.

On the other hand, and in addition to these security measures, it is also important in terms of user protection that the policy for customers in the event of leakage is clear in advance, and that the sufficient resources for reimbursement to customers are secured.

For this reason, it should be appropriate to require SPs to keep the amount of net assets⁸ and resource for reimbursement (consisting of the same kind of virtual currency⁹) both of which are equal to or more than the amount of virtual currency for which private keys are managed by hot wallets, as well as to develop and disclose policies in reaction to the leakage of virtual currency.

ii. Addressing Bankruptcy Risks of SPs

In general, a business operator who holds customers' assets in a part of its business is required to separately manage its own assets and the customers' assets in order to avoid

⁷ Coincheck, Inc., which was illegally hacked in January 2018, used a hot wallet to manage private keys for all of the stolen virtual currency (NEM) and the leaked virtual currency was equivalent to 58 billion JPY. In addition, Tech Bureau, Corp., which was also subject to illegal hacking in September 2018, managed private keys in hot wallets for most of the leaked virtual currencies (Bitcoin, etc.), and leaked them to the value of 7 billion JPY (including the customers' virtual currencies worth approximately 4.5 billion JPY).

⁸ In the Study Group meeting, there is an opinion that it might be necessary to increase the minimum capital (currently 10 million JPY), which is one of the registration requirements, in order to respond to business expansion of SPs, and to decrease administrative costs for the examination of application caused by easily entering into market. On the other hand, another member states that given the possibility of innovation, the government should not apply the strict regulations equally at the entry stage but should apply regulations corresponding to the risk level.

⁹ It is considered appropriate to request that the funds for reimbursement should be preserved separately from the company's assets and customers' assets. It is also conceivable that holding non-risk assets, such as cash, may be required as the funds for reimbursement. It is, however, necessary to take into consideration that SPs have an obligation to customers to return the virtual currency under management and that the face value of non-risk assets may become less than the required amount due to fluctuations in the virtual currency prices. Furthermore, even if virtual currency under management is leaked, the SP's obligation to return the virtual currency to the customers is not necessarily exempted. Therefore, it would be appropriate to require SPs to hold assets in the same kind of virtual currency as the funds for reimbursement.

misappropriation of the customers' assets and identify the customers' assets at the time of bankruptcy. The segregation obligations required by Japan's financial laws can be, in addition to distinguishing the operator's assets from customers' assets, divided broadly into the following two methods:¹⁰

- (i) Trusting the customers' assets with a customer as the beneficiary.
- (ii) Managing the asset of each customer in a way which enables the operator to identify it immediately.

1) Preservation of Virtual Currencies under Management

With regard to virtual currency, their legal status under private law is not clear, and to prevent misappropriation of customers' assets, as seen in past bankruptcy cases, SPs are required to manage the asset of each customer in a way which enables the SPs to identify it immediately under the PSA. In order to reinforce this regulation, SPs have to be audited on their segregation and financial statements by a certified public accountant or an auditing firm.

It has been, however, found through inspections and monitoring by the administrative authorities that the employees of SPs misappropriated virtual currencies under management for personal purposes, and therefore the first step is to ensure thorough compliance by each SP.

On the other hand, it is not clear whether bankruptcy remoteness works effectively for virtual currency under management even if the SPs properly segregate it.

When it comes to bankruptcy remoteness, it is conceivable to impose a trust obligation on SPs with customers as the beneficiary.¹¹ However, given the needs to improve

¹⁰ For example, Financial Instruments Business Operators under the Financial Instruments and Exchange Act have a duty to trust; they have to trust money deposited through contracts of bailment of cash for consumption with the rights of ownership and the beneficiary of the trust should be the customers. At the same time, securities deposited through contracts of bailment without the rights of ownership need to be managed in a way which enables them to identify each customer's property immediately.

As long as the Financial Instruments Business Operators keep an appropriate segregation, then even if they go bankrupt, the customers can receive preferential payment for money as beneficiaries and for securities by exercising a right of recovery based on ownership.

¹¹ Further examination of the legal status of virtual currency under private law, including the treatment under the Trust Act, is expected.

security risk management systems of trust banks and trust companies in response to the increases in the varieties of virtual currencies and the volume of virtual currencies under management, it would be difficult to require a trust of all amounts and all kinds of virtual currency under management at present.¹²

In the future, if trust banks and others could get fully prepared for virtual currency trust; it would be desirable for SPs to set up trusts of virtual currency under management as far as reasonably possible.

Furthermore, in light of the current situation in which it is impossible to trust all virtual currencies under management, it is considered appropriate to require SPs to disclose financial documents, such as balance sheets and profit and loss statements, in order to enable customers to recognize the financial soundness of the SPs when the customers use those exchanges.

In order to refund virtual currency under management without any interruption to the customer even in the event of the bankruptcy of SPs, it would be also possible to have customer's rights to demand restitution of virtual currencies under management¹³ secured by the statutory lien.¹⁴

2) Preservation of Deposited Cash

As for the customers' cash managed by SPs ("deposit") under the PSA, it is required to manage deposits in a saving account or a money trust separated from their own funds. However, the amount of deposit has become higher than when the amended PSA was enacted, and some cases of the misappropriation of money by SPs have been found through inspection and monitoring by the administrative authorities.

¹² There is an opinion that if it was difficult to require a trust of the same kinds and the same amount of virtual currencies as those under management, it might be appropriate to require a trust of money equivalent to virtual currencies under management. For these measures, retaining funds for reimbursement more than the amount of the virtual currency for which private keys are managed in hot wallets (outlined in 1.a.i.) or the statutory lien for customers (described later) may be effective as well. Therefore, it is important not to add up all these measures, but to combine them appropriately in consideration of feasibility.

¹³ There is an opinion that it would be desirable to clarify such rights that SPs owe their customers by law.

¹⁴ There is an opinion that it is necessary to consider the relationship with other creditors when the right to demand restitution is secured by the statutory lien. Given this opinion, the subject to the statutory lien would not be whole property of the SPs. For example, one of the possible approaches is to put a limit on the range of the subject; restrict to virtual currency under management, which is only for their customers, and the funds for reimbursement mentioned in 1.a.i.

Therefore, it is considered proper to impose a trust obligation of deposit on SPs for the purpose of preventing misappropriation and ensuring bankruptcy remoteness.

b. Ensuring Proper Business Operation by SPs

i. Ensuring Transparency of Trading Prices and Preventing Conflicts of Interest

In general, since there are no assets to support the value of virtual currency, it is difficult to identify its fundamental value, and although its price is determined mainly by the balance between supply and demand, the mechanism of its price formation has not been identified clearly yet, and there is a risk that prices will fluctuate significantly.

Under such circumstances, it is important to increase the transparency of trading prices and to prevent conflicts of interest by SPs because customers may trade virtual currencies at unreasonable prices. For those purposes, SPs may be required to take the following actions:

- To disclose the following information concerning trading with their customers
 - (i) OTC prices (bid price and ask price) and spread (a gap between bid price and ask price) provided by the SPs, or agreed price and quotation in a “board” where the exchange bring customers’ bid and ask together, and a gap between the agreed price and the OTC price.
 - (ii) Reference prices calculated by the SRO¹⁵ and a gap between those prices and the OTC prices.
- In cases where an SP provides multiple channels of trading including OTC, the board, and brokerage for other SPs, the SP has to develop and announce its policy to avoid the conflict of interests and to execute orders for its customers under the best terms and conditions and prepare a system to enforce that policy properly and surely.
- When an SP receives an order from a customer on the board and the SP executes that order as the counterparty of trade instead of bringing the order to the board, the SP

¹⁵ It would be necessary for the SRO to calculate and disclose reference prices of each virtual currency dealt by SPs, which should be based on at least the agreed prices of member-SPs, in order to enhance approaches for transparency in the trading prices.

has to explain to the customer the facts and the reason why that trading is favorable for the customer.

- In cases where an SP may participate in its own board to supply liquidity, the SP has to explain to the customers the fact and the reasons for this.

ii. Addressing Excessive Advertisements and Solicitations

It has been pointed out that aggressive advertisements by SPs have contributed to speculative trading, which is expected to benefit from capital gain, and some customers who conduct such trading have insufficient understanding of the risks of virtual currencies.

In light of these circumstances, it is considered appropriate to require SPs not to do the following acts from the viewpoint of preventing customers from misunderstanding risks and encouraging speculative trading:

- Misleading advertising, false announcements, provisions of conclusive judgments, uninvited solicitation;
- Solicitation that is inappropriate in light of the customer's knowledge; and
- Advertisements and solicitations to encourage speculative trading.¹⁶

iii. Cooperating with Self-regulatory Rules

In the field of virtual currency, there is a possibility that technological innovation makes the service of SPs change rapidly. In order to ensure the proper and reliable operation of their business, the cooperation between the regulations by law (that enable the authorities to act on the basis of the right to supervise) and the SRO rules (that enable the SRO to take flexible actions in response to changes in the circumstances) would be important.

¹⁶ SPs sometimes use targeted advertisements to attract customers who are not interested in virtual currency trading by advertisements displayed on other websites automatically. In addition, there are some cases of affiliate marketing; some non-SP persons take customers to SPs' trading websites and earn referral fees. These practices are also seen in the provision of financial services apart from virtual currency trading, but they may differ from the traditional "solicitation" and require cross-sectoral review in the future. The following contents are provided in the self-regulation rules of the SRO:

- Banners, etc., (display that is attached to web pages or e-mails managed by a third party and guides the users to websites designated by a member-SP) shall be regarded as advertisements.
- The members shall not grant excessive incentives that may induce or encourage affiliate program participants to solicit virtual currency trading.

Therefore, to promote becoming a member of the SRO and to require non-members to prepare the system equivalent to the standard of SRO rules, it is considered appropriate to establish the following grounds to refuse and cancel the SP registration under the PSA:

- Non-SRO members that have not established internal rules equivalent to the SRO rules; or
- Non-SRO members that have not prepared a system to comply with the above internal rules

c. Restricting Problematic Virtual Currencies

Each virtual currency has its own unique design and specification, and there are some virtual currencies that are difficult to trace and therefore likely to be used for money laundering due to non-disclosure of their transfer records, and others are vulnerable when maintaining and updating their transfer records.

Therefore, it would be necessary for SPs to take measures to prevent themselves from dealing in problematic virtual currencies in light of user protection, and proper and reliable business operation.

On the other hand, the security of virtual currency may vary depending on the discussion of those who are involved in forming or changing technical specifications and the conditions of mining. Technological innovation may also lead to new problems that have not previously been anticipated. These changes may also occur rapidly.

In light of these characteristics, it would be difficult to clearly identify problematic virtual currencies in advance through laws and regulations; thus, it is important that the administrative authorities and the SRO cooperate to take flexible and prompt measures.

To be concrete, it is considered appropriate that each change of a line of virtual currencies dealt in by SPs, which is currently subject to an *ex post facto* notification to the administrative authorities, should be subject to an *ex ante* notification so that the

administrative authorities can take necessary measures flexibly and rapidly in cooperation with the SRO.¹⁷

¹⁷ The following are stipulated in the self-regulatory rules of the SRO. It is expected that appropriate measures will be taken based on the rules for virtual currencies dealt in by SPs:

- The members have to notify the SRO of the commencement of dealing any new virtual currency in advance.
- If the SRO objects to the dealing, the member must not begin to deal in that virtual currency.
- The SRO shall publish an explanation of the virtual currency that is permitted for the members to deal in.
- The members shall reexamine the risks of the virtual currency they deal in regularly or as necessary and shall suspend or abolish dealing of the virtual currency if they find it inappropriate.

2. Addressing Unfair Acts in Virtual Currency Spot Trading

a. Current Situation of Unfair Acts in Virtual Currency Spot Trading and Needs of Regulation

Regarding virtual currency spot trading¹⁸, the following unfair trade cases have been recognized:

- Undisclosed information regarding an SP (e.g., adding new virtual currencies to its service) has leaked and the person who obtained the information gained profits.
- A private group of speculators sent pump messages that encourage their followers to buy a specific virtual currency at a specific time on a specific exchange on a social networking service to raise its price while the group was selling the overvalued virtual currency for profit.

Although the Financial Instruments and Exchange Act (the “FIEA”) prohibits anyone from the following acts with penalties¹⁹ on securities trading, for which there are markets for customers as is the case with virtual currency spot trading, for investor protection and fair price formation through the full utilization of function of the capital markets operation, there are no such restrictions on virtual currency spot markets:

- Wrongful acts (use of wrongful means, schemes and techniques, trade with misrepresentation, and false quotations);
- Spreading of rumors, fraudulent means, and assault or intimidation;
- Market manipulation (fake trading, collusive trading, and market manipulation through real trading, spreading information or misrepresentation); and
- Insider trading.

Given the difference of the economic significance and importance of virtual currency spot trading compared to securities trading and the administrative costs involved in imposing

¹⁸ That is to say- buying-selling and exchange of virtual currencies to others.

¹⁹ Under the FIEA, although all securities trading is subject to the regulations of wrongful acts and spreading rumors, the prohibition of market manipulation applies to only listed security trading and the regulations of insider trading is for stocks and bonds of listed companies respectively.

unfair trade regulations, the necessity of imposing regulations similar to those for securities trading and establishing an equivalent supervisory system are not recognized. On the other hand, it is considered necessary to take certain measures to prevent unfair spot trading for user protection and as a deterrent to gaining unfair profits.²⁰

b. Details of Regulations on Unfair Spot Trading of Virtual Currencies

In order to prevent damage to the other customers and unfair profits for the violators through unfair spot trading, first of all, it is considered proper to require SPs to screen transactions whether or not there are any improper conducts. Then, when improper conduct is recognized, SPs should take strict measures including suspension of trading to those who conducted such acts.²¹

Since it is also assumed that it is not SPs who engage in unfair acts, in order to ensure effectiveness of unfair act regulations, it is considered effective to prohibit unfair acts with criminal penalty provisions regardless of SPs or not, similar to the unfair trade regulations of securities trading.

Specifically, concerning the fact that virtual currency trading also has a “board”, the prohibition of acts equivalent to market manipulation of securities trading should be imposed in addition to the prohibition of wrongful acts and spreading rumors (which are applied to all securities trading under the FIEA).²²

On the other hand, when it comes to insider trading regulations, it is considered difficult to clearly define the acts that should be prohibited by laws at present for the following reasons²³:

²⁰ For instance, the FIEA prohibits unfair acts with administrative monetary penalties and the Securities and Exchange Surveillance Commission’s rights of investigation of criminal cases as well as criminal penalties irrespective of the attribute of actors, while the Commodity Derivatives Act also prohibits unfair acts with criminal penalties regardless of actors but does not have any prescription of any surcharge or criminal investigation rights.

²¹ In order to make these measures possible, it is important to ensure transparency in prices of virtual currencies and to accumulate trading records.

²² With regard to virtual currencies, each SP has its own “board” (a place for matching customers’ bid and ask) and it is not always clear what the market price is. Therefore, an act equivalent to market manipulation may be called, for example, “unfair price manipulation”.

²³ Under the FIEA, persons concerned with a listed company who have come to know undisclosed significant information relating to the company are prohibited from buying and selling securities (shares, bonds, etc.) of that company, etc., before the

- Many virtual currencies do not have issuers, and even if they do, the issuers may be scattered around the world and be difficult to identify.
- In the absence of certain factors in price volatility, it is difficult to identify in advance which kind of undisclosed facts have a significant impact on customers' decisions for trade.

Regarding trading similar to insider trading, to at least prevent unfair trading that can be grasped by SPs and unfair acts by SPs themselves, it would be appropriate for SPs to properly manage the undisclosed information about virtual currency dealt in by the SPs and not trade for the purpose of the benefit of themselves or others based on the information, as well as to screen transactions mentioned above.

information is released. Also, the scope of "persons concerned with the company" and "significant information" is clearly specified by laws and regulations.

3. Addressing Custodial Services for Virtual Currencies

a. Current Circumstances of Custodial Services for Virtual Currency and Needs of Regulations

Under the PSA, the management of customers' virtual currencies pertaining to buying/selling and exchange of virtual currencies (including intermediation, brokerage and agency of these transactions) falls under the category of Virtual Currency Exchange Service. On the other hand, there are some operators running the business of managing customers' virtual currencies and transferring the virtual currency to the address specified by the customer as instructed (a “custodial service²⁴”)²⁵ without regard to the purchase or sale of any virtual currency. This service does not fall under the category of Virtual Currency Exchange Service because it does not relate to the buying/selling and exchange of virtual currencies.

Nevertheless, the custodial service manages virtual currencies as a means of payment and settlement, and transfers them to the person specified by the customer. Given the following points, it is considered necessary to ensure the proper and reliable business operation as a service related to payment and settlement by establishing certain regulations:

- The custodial service is considered to have risks in common with SPs such as the risk of leakage of customers' virtual currency due to cyber-attacks in addition to the risk of bankruptcy and money laundering/terrorist financing.
- Since virtual currency can be transferred across borders easily via the Internet, it is important to respond with international cooperation. In October 2018, the revised FATF Recommendation was adopted, which requires each country to make virtual currency custodians subject to the money laundering/terrorist financing regulations.²⁶

²⁴ It is sometimes referred as a “wallet service”. Methods of managing the customers' virtual currency are, for example, as follows:

- Managing private keys (necessary to transfer of virtual currency) corresponding to customers' virtual currency addresses.
- Managing customers' virtual currencies transferred from customers' address to a custodian's address whose private key is managed by the custodian itself.

²⁵ There are some foreign business operators who widely provide custodial service. At present, no specialized domestic custodial service providers are recognized in Japan but some SPs provide customers a wallet services that cannot be used for virtual currency trading.

²⁶ The FATF Recommendation states that “safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets” should also be subject to regulation.

b. Details of Regulations Pertaining to Custodial Services for Virtual Currencies

In view of the risks of custodial services and the needs for international cooperation, it is considered proper to impose the following same measures as those required for the management of customers' virtual currencies among the measures imposed on SPs:²⁷

- A registration requirement;
- Preparing an internal management system;
- Segregation of operators' and customers' virtual currencies;
- Audit of segregation and financial statements;
- Disclosure of policies in reaction to virtual currencies leakage and preservation of financial resources for reimbursement;
- Entitling customers to statutory lien that secures their claim to refund virtual currency;
- Not dealing in problematic virtual currencies that could interfere with user protection or proper and reliable business operation; and
- Customer identification and reporting suspicious transactions to the administrative authorities.

²⁷ Given that custodial services for virtual currency vary, there is an opinion that clarifying which business would be a subject to regulations is important for imposing appropriate regulations according to different risk levels.

4. Addressing Virtual Currency Derivative Trading

a. Current Circumstances of Virtual Currency Derivative Trading and the Needs of Regulations

Currently, nearly half of all SPs provide virtual currency CFDs²⁸ trading service. This is a form of derivative trading based on virtual currencies, and further new types of derivative transactions may appear in the future.

In 2017, virtual currency derivative trading accounted for approximately 80% of all domestic virtual currency trading volume through SPs, and the FSA received a considerable number of inquiries from users due to system deficiencies and unclear services.

In addition, while virtual currency derivative trading falls under financial regulations in most major countries, it is still not subject to financial regulation in Japan. On the other hand, under the FIEA, there is a framework in which any CFDs trading can be subject to the regulations regardless of the underlying assets.

As to virtual currency derivative trading, it is pointed out that the appreciation of virtual currency as the underlying asset has been unclear, and the trading is solely promoting speculative fever of virtual currency at present. Thus, it is difficult to find any positive social significance in the trading.

However, considering that a sizable amount of virtual currency derivative trading has already been conducted in Japan and that the FSA has received a significant amount of inquiries from users, the trading should not be prohibited, but instead be subject to certain regulations to ensure user protection and appropriate trade while requiring fair self-responsibility.

²⁸ This is trading in which a customer deposits money or virtual currency to derivative trading service providers as a margin, buy or sell in currency pairs using leverage whose maximum limit is set by the service providers, and then do the cross-trading. The user will gain or lose the difference between the first and cross-trading prices and the difference is settled in the margin.

b. Details of Regulations Applying to Virtual Currency Derivative Trading

i. Measures Based on Attributes of Derivatives

Since all derivative trading would have similar economic functions and risks regardless of the underlying assets, it would be necessary that the same conduct regulations should be imposed on virtual currency derivative trading as well as other derivative trading.²⁹

As for the leverage limits for virtual currency CFDs, some service providers currently adopt 25:1 as a maximum leverage limit. Given that the fluctuation in virtual currency prices is larger than that of fiat currencies, it is considered suitable to set the appropriate maximum leverage limits based on actual conditions.³⁰

As described above, it is difficult to find a positive social significance for virtual currency derivative trading. Therefore, the necessity to deal in virtual currency derivative trade in a place where many participants can carry out that trade (such as financial instruments exchanges), is not recognized at present.

ii. Additional Measures in light of Characteristics of Virtual Currency

Virtual currency derivative trading has problems in common with virtual currency spot trading, for example, the lack of customer understanding about the characteristics of virtual currencies and the possibility of dealing in problematic virtual currencies.

Therefore, it is considered appropriate to require business operators who conduct virtual currency derivative trading to take the same measures as those imposed on SPs in consideration of the characteristics of virtual currencies.

²⁹ For example, a business operator dealing in Forex trading, as a Type I Financial Instruments Business Operator, is subject to minimum capital and net assets requirements, an obligation to establish a business management system, advertising regulation, prohibition of false announcements and uninvited solicitation, an obligation to provide customers' pre-contract documents and accountability, segregated management requirements of customers' assets, and regulation of margin ratio and loss-cut, etc.

³⁰ There is an opinion that the maximum leverage limit should be 2:1, which is adopted in EU regulations and the self-regulatory rules of Chicago Mercantile Exchange (CME) and the Chicago Board Options Exchange (CBOE) (as of December 2017) where bitcoin futures are traded. While there is an opinion that each appropriate leverage limit should depend on the volatility of each virtual currency, other members argue that a uniform limit should be adopted to avoid complicated regulations. The self-regulatory rule of the SRO stipulates that the uniform limit is set at 4:1 in general; however, within one year from the enforcement date of the self-regulatory rule (October 24, 2018), it is allowed to set each member's original limit which is calculated based on the occurrence of losses by users and which enables to prevent the occurrence of uncollected fees from users.

Moreover, because it is difficult to find the positive social significance of virtual currency derivative trading and such trade may bring excessive speculation, it would be reasonable to require service providers to take the following measures in order to prevent such harm from coming to individuals with insufficient financial resources or knowledge:

- Establishment of minimum margin (criteria to participate in the trade);
- Restricting persons who are not appropriate to be involved in such trading in light of their financial resources³¹ from the trading; and
- Thorough warning towards customers.

c. Addressing Virtual Currency Margin Trading

Currently, although a few SPs provide virtual currency margin trade³² and buying/selling and exchange of virtual currencies as a business is subject to the PSA, there is no financial regulation on virtual currency margin trading per se.

On the other hand, although there are differences between spot trading and trading on notional amounts, virtual currency margin trading is considered to have the same economic function and risk as virtual currency CFDs in respect to the trading on leveraged seed money (margin).

Therefore, virtual currency margin trading should be subject to regulations equivalent to ones on virtual currency CFDs.

³¹ Regarding financial resources, there is an opinion that it might be necessary to set standards such as annual income criteria so that persons without any income including students cannot participate in trading. The SRO's self-regulatory rules prescribe that members cannot conduct CFDs trading with minors except in special circumstances.

³² This is a trading in which a customer deposits money or virtual currency to an SP as a margin, borrows virtual currency from the SP within a maximum amount specified by the SP's rate and finally buys or exchanges other virtual currency or fiat currency on the borrowed virtual currency.

5. Addressing ICOs (Initial Coin Offerings)

a. Current Circumstances and Future Direction of ICOs

i. Current Circumstances of ICO Financing

Although there is no clear definition of ICOs (Initial Coin Offerings), it is largely regarded as a general term that refers to an act in which a company issues tokens to the public electronically and procures fiat or virtual currency.³³

There are few cases of ICOs in Japan, and there is no official data on the amount of ICOs financing in Japan or abroad; however, according to one private information website,³⁴ ICOs raised about \$5.5 billion worldwide in 2017 and about \$16.7 billion from January to October 2018.³⁵

While some have evaluated that such ICOs may be a promising way of fund-raising in which can enable small and medium-sized companies to raise fund globally at low cost and bring higher liquidity compared to the existing financing means, others have pointed out:

- There are few examples that ICOs were used effectively.
- User protection is insufficient given that there are many cases of fraud and faulty project plans.
- There are many unclear points in the rights of token holders, including the relationship with the rights of stakeholders including shareholders and other creditors.
- In many cases, token purchasers want only to resell tokens, while the issuers want to just raise money, which leads to a lack of discipline and moral hazards.

³³ There is no clear definition of ICOs. Therefore, it is difficult to predict what will happen in the future including the possibility that other names such as STOs (Security Token Offerings) will become common for those with investment potential. However, irrespective of the name, the discussion in the Study Group can be applied to all types of fund-raising activities where the token is issued electronically.

³⁴ There are such private information websites, for example, Coindesk.

³⁵ Source: coindesk.com. In 2017, the global IPOs (Initial Public offerings) raised about \$188 billion (Source: EY Global IPO Trends 2017 4Q).

It is said that there are various types of ICOs because of flexibility in their design, but from the token purchasers' standpoint, it is possible to classify them as follows:

- A type that an issuer is said to have obligations to distribute future business profits (Investment-type tokens).
- A type that an issuer is said to have obligations other than those described above, such as providing goods and services (Utility-type tokens).
- A type that an issuer is said to have no obligation (Tokens with no rights).

ii. Present Status of ICOs Regulations

While some countries banned ICOs, other major countries have clarified that ICOs classified as an investment-type could be subject to existing securities regulations and the authorities take administrative actions including warnings based on these regulations.³⁶

In Japan, in October 2017, administrative authorities alerted users to the risks of ICOs, and indicated to business operators that depending on the ICOs structure they could be subject to the FIEA and/or the PSA. To be more specific, they can be applied as follows:

- Under the FIEA, if a purchaser of a token expects the distribution from the issuer and the token satisfies the following (i) or (ii), such rights which are given to the holder of the token (the “rights attached to token” or “RATs”) are regarded as interests in collective investment schemes:³⁷
 - (i) To be purchased by fiat currency.
 - (ii) To be purchased by virtual currency, but substantially regarded as a token purchased by fiat currency.

³⁶ In addition to these measures, some countries are considering specific regulations for non-investment type ICOs.

³⁷ The FIEA prescribes interests in collective investment schemes as rights for which the holders can receive distribution of profits arising from the business run by money invested or contributed by holders or distribution of property of the business.

- In relation to the PSA, if tokens issued on the ICOs process satisfy the following (i) or (ii) and are not denominated in fiat currency,³⁸ such tokens are considered to be Virtual Currencies under the PSA:

- (i) To be usable for payment to unspecified parties and exchangeable for fiat currency with unspecified parties.
- (ii) To be mutually exchangeable with another Virtual Currency with unspecified parties.

iii. Direction for Addressing ICOs

Although various issues related to ICOs are pointed out, the FSA should not decide to prohibit ICOs at the moment because ICOs would have an established value and their potential would be recognized. It is appropriate to hammer out a basic direction to ensure user protection and fair trading by clarifying the contents of the regulation while requiring the users' proper self-responsibility.

In addition, one of the characteristics of ICOs is that their tokens are easy to circulate with their technology. It is, however, important to establish regulations which consist of the similar regulations as ones applied to other trading having similar economic functions and risks and unique regulations suitable to the functions and risks of the ICOs.

To be more precise, depending on the characteristics of each ICO, it would be appropriate to take the necessary measures. Regulations on the ICOs considered as the sale of investment products should be developed using financial instruments regulations for reference, and ones on the ICOs considered as the sale of payment methods should be developed using payment service regulations for reference.

³⁸ Under the PSA, "Currency-Denominated Assets" (which are denominated in the Japanese currency or a foreign currency, or for which performance of obligations, refund, or anything equivalent thereto is supposed to be made in the Japanese currency or a foreign currency) are excluded from the definition of Virtual Currency. For example, the Prepaid Payment Instruments under the PSA fall under the category of "Currency-Denominated Assets" because they need to be refunded in money in certain cases. Furthermore, there is an opinion which suggests a question whether "stable coins", guaranteed to be exchanged to the fixed value of fiat currency, is not regarded as "Currency-Denominated Assets" and also which suggests that the relationship with regulations of the Funds Transfer Service (exchange transaction) should be discussed further.

b. Details of ICO Regulations

i. Details of Regulations on Investment-type ICOs

The investment-type ICOs³⁹ are considered to have the following characteristics:

- The RATs are considered to be electronically transferable with the token and have high liquidity.
- Because of flexibility in their design, there tends to be information asymmetry between the issuers and the investors both at the time and after the tokens are issued.
- Because investors are solicited through the Internet instead of face-to-face sales, it is easy for token issuers and sellers to approach investors, and it is difficult for the investors to identify fraud.

All of these characteristics lead to risks for investors, so the following frameworks would be necessary:

- A framework of continuous information disclosure to mitigate information asymmetry between issuers and investors.
- A framework in which a third party can screen the business and financial status of the issuer in order to prevent fraud.
- A framework to ensure fair trading in the distribution channel of tokens including the prevention of unfair acts.
- A framework to make a difference to the range of distribution channel of tokens depending on the degree of information asymmetry between the issuers and the investors.

As mentioned in 5.a., if an RAT is purchased with virtual currency, it does not always fall within the scope of the regulation of the current FIEA.

³⁹ There is an opinion that debt-type schemes (the token purchasers expect the payment of fixed interest and the redemption of principal) as well as equity-type schemes (the token purchasers expect the distribution of business profits) should be subject to regulations relating to investment as well.

There is, however, no difference in the economic effect between a purchase with fiat currency and one with virtual currency.⁴⁰ It is therefore considered appropriate to apply the same regulation on all tokens purchased with virtual currency. This is a reasonable consideration not only when it comes to RATs but also when it comes to interests in collective investment schemes.⁴¹

1) Frameworks of Information Provision/Disclosure

The FIEA stipulates which kinds of securities need to disclose related information, and they are categorized into two types; high-liquidity type securities (Paragraph (1) Securities) and low-liquidity type securities (Paragraph (2) Securities). Since RATs can be distributed among a multitude of investors, it is considered appropriate to classify them into the same type as high-liquidity type securities (Paragraph (1) Securities).

Under the FIEA, the rules of public disclosure which includes a Securities Registration Statement (for offering disclosure) and an Annual Securities Report (for continuous disclosure) are imposed on the Public Offerings of Securities.⁴² On the other hand, those rules are not imposed on Private Placement provided that the restriction of reselling is imposed on such securities. It would be appropriate that the RATs are classified in the same way as those securities.⁴³

RATs of tokens considered as an investment-type generally intends, so far, to share profits from the investments to a certain limited range of businesses or assets, but there might be RATs which intend to share profits from the investments to existing issuer's businesses. Therefore, the disclosure items of RATs should be classified depending on the character of the rights.

⁴⁰ There is an opinion that not only the purchase with virtual currency but also those with other nonmonetary instruments having the similar value to fiat currency should be equally regulated.

⁴¹ The discussion will not end at collective investment schemes. From the viewpoint of the same regulations on the trading having the same functions and risks, it is necessary to examine based on the actual condition whether there is trading where virtual currency is used instead of fiat currency and it should be treated the same as when fiat currency is used.

⁴² There is an opinion that the accounting rules of ICOs would be also necessary.

⁴³ When RATs are sold in the Private Placement with qualified institutional investors, it is considered important to ensure the effectiveness of the restriction on resale including the prohibition by the system protocol.

2) Frameworks for Screening Project and Financial Conditions by Third Parties

In order for investors to make appropriate decisions, it is important to confirm the feasibility that the project may work and provide cash flow. In the case of the existing fund-raising methods, for example, the managing underwriter (Type I Financial Instruments Business Operator) for the IPO and the intermediary agent (Type I Small Amount Electronic Public Offering Service Provider, etc.) for the stock investment type crowdfunding have legal obligations of screening based on the examination items provided in self-regulatory rules.⁴⁴

Likewise, as for ICOs, it is considered appropriate to establish a framework in which a third party examines the issuer's project and financial condition to prevent fraud and prevent the issuance and distribution of ambiguous RATs.

For example, under the FIEA, Financial Instruments Business Operators dealing in securities are divided into two types; Type I Financial Instruments Business Operators and Type II Financial Instruments Business Operators, depending on the liquidity of securities dealt in, and each different registration requirement is applied to Type I Operators and Type II Operators respectively.

To deal in RATs is equal to dealing in rights that may be circulated among many investors. Therefore, it would be proper to categorize the business operator dealing in such RATs into Type I Financial Instruments Business Operator and to require appropriate examinations of the project and the issuer's financial condition.

It is said that, in the majority of ICO cases, the issuers float the RATs by themselves ("self-offering"). Considering the necessity to prevent fraud, it is desirable to have a third-party examination. However, when it comes to collective investments schemes, self-offering is acceptable if the issuers are registered as Type II Financial Instruments Business Operators. Therefore, self-offering of RATs should also not be prohibited but regulated in a proper way.

Specifically, it is considered appropriate to require ICO issuers to be registered in the same way as interests of collective investment schemes, and to impose such conduct

⁴⁴ When it comes to stock investment type crowdfunding, the existence of the issuer and the business, and the appropriateness of the project are also examined, in light of the characteristics of non-face-to-face financing via the Internet.

regulations as advertising and soliciting regulations and the duty to explain details of the RATs for the purpose of investor protection.⁴⁵

3) Frameworks to Realize Fair Trading

Due to, for example, the flexible regulatory structure including self-regulations, there are multiple places and forms in which stocks are bought and sold; the Financial Instruments Exchanges, the Proprietary Trading Systems (the “PTs”),⁴⁶ the Specified Exchange Financial Instruments Markets (so-called professional markets), Over-the-Counter Transactions of the issues of the Shareholder Community based on the SRO of the Japan Securities Dealers Association (JSDA) which is an Authorized Financial Instruments Firms Association, and other Over-the-Counter Transactions by securities companies (Type I Financial Instruments Business Operator).⁴⁷

There are no specific reasons to provide a tailored place or form for RATs in addition to these places or forms above in advance, even if considering their characteristics. Also, there are no reasons why RATs should be banned from using some of these distribution channels or forms (such as institutional prohibition of Listing⁴⁸).⁴⁹

In addition, the need to prevent unfair trading of RATs for fair trading is not different from that of securities trading. For that reason, it is considered appropriate that the unfair trading regulations which are imposed on securities trading should be applied to trading of RATs.⁵⁰

⁴⁵ By making the self-offerings of RATs a subject to the regulation, it is possible for administrative authorities to take supervisory actions as necessary.

⁴⁶ Currently, the PTs do not allow dealing in unlisted shares.

⁴⁷ In addition, there are technically Over-the-Counter Securities Market by the JSDA (ex. the old JASDAQ which no longer exists) and Treatable Securities (Phoenix brand, no stock is currently listed) based on the self-regulatory rules of the JSDA.

⁴⁸ In general, it is sometimes called as “listing” that SPs begin to deal in the tokens issued by ICOs, however, it should be noted that it is completely different from “Listing” on a Financial Instruments Exchange under the FIEA.

⁴⁹ Although the issuance of RATs listed on a Financial Instruments Exchange is unlikely to be found for the time being, it is possible that new forms of distribution will emerge in the future, thus it is necessary to closely monitor the practices of transactions.

⁵⁰ There is an opinion that even regarding an RAT which is not listed on a financial instruments exchange, the action equivalent to market manipulation (unfair price manipulation) may be banned because it has high liquidity and its price is formed through trading.

With regard to insider trading regulations, however, what are the material facts are prescribed in laws and regulations and the disclosure of those facts is regulated presupposing the timely disclosure system based on the self-regulation rules of Financial Instruments Exchanges.⁵¹ On the other hand, with respect to RATs, currently it is not clear what constitutes material facts having a significant influence on investors' decisions due to the flexibility of their design.

Therefore, it would be appropriate to review the application of insider trading regulations to those rights trading after an accumulation of related cases and enhancement of timely disclosure have developed.

4) Frameworks to Make Differences in the Range of Distribution of ICO Tokens

Unlisted stocks, which have been sometimes used in fraud and that become an issue of public concern, have been restricted in their solicitations to investors, apart from qualified institutional investors, by the JSDA rules.⁵² They are not expected to be distributed widely among retail investors.

In light of the fact that ICOs have been pointed out to have many fraudulent cases, it would be necessary to restrict their solicitations⁵³ to control the range of their distribution among retail investors at a certain level, similarly to unlisted stocks, unless special measures are taken to protect investors, such as an appropriate examination by a third party in the same way as listed stocks.⁵⁴ Given the high liquidity of RATs, it is considered appropriate to restrict solicitation in their self-offerings as well.

⁵¹ As illustrated in footnote 23, the insider trading regulations of the FIEA prohibit Company Insiders who have come to know undisclosed material facts about the listed company from purchase and sale of that company's securities (shares, bonds, etc.) prior to the disclosure of the information, and clearly stipulate the scope of "Company Insider" and "material facts" in laws and regulations.

⁵² The JSDA states that the aims of the restriction are that unlisted companies do not have obligations of disclosure and accounting audits, and information, which is necessary for investment decisions, is not appropriately provided. The JSDA therefore prohibits securities companies from soliciting investors to invest in unlisted shares. On the other hand, the following solicitation cases are not restricted:

- Solicitation of Over-the-Counter Traded Securities (Phoenix Brands) based on the JSDA self-regulatory rules.
- Solicitation of issuance of Shareholder Community Stocks to participants of that community based on the JSDA self-regulation rules.
- Solicitation of equity investment type crowdfunding in its offering.

⁵³ As in the case of virtual currency trading mentioned in footnote 16, there are cases in which issuers and sellers attract investors through targeted and affiliate advertising with regard to ICOs.

⁵⁴ There is an opinion that if the regulations equivalent to those on Type I Financial Instruments Business Operators are applied to a person who brokers RAT trading between an issuer and a purchaser and the regulations equivalent to those on Type II

ii. Details of Regulations on ICOs Requiring Financial Regulation for Settlements

As described in 1.c., it would be necessary for SPs to take measures in order not to deal in virtual currencies that have the risks of interrupting user protection and proper and reliable business operation. This need shall apply to tokens regarded as virtual currency.

When it comes to virtual currencies (including tokens regarded as virtual currencies) that have their own issuers, it is considered appropriate to require SPs⁵⁵ to provide information of the issuer, the existence (or non-existence) and contents of obligations which the issuer owes to holders, and the calculation basis of the flotation price for user protection.⁵⁶ In addition to those measures, for ICOs, it is considered appropriate to require them to provide information of the project plan prepared by the issuer, feasibility and progress of the project, and other information⁵⁷ while keeping in mind their objectivity and appropriateness.⁵⁸

Since it is pointed out that there are many fraudulent ICO cases and faulty project plans, SPs are required to take thorough measures not to deal in tokens that come under the category of virtual currency, except for those that are assessed to have no problems as a result of strict examinations.⁵⁹ In addition, it is important for administrative authorities to repeatedly call on token purchasers to remind them of their own responsibility for

Financial Instruments Business Operators are applied to a person who conducts self-offering, and certain measures, such as prohibition of small private placements (which are out the scope of disclosure regulations) are adopted, it is not necessary to restrict solicitation to retail investors.

⁵⁵ Regarding a virtual currency whose issuer exists, if the issuer sells the virtual currency as a business, it is considered to fall under the category of Virtual Currency Exchange Service. On the other hand, if an SP sells upon the issuer's request and the issuer does not sell at all, the act of the issuer would generally not fall under the category of Virtual Currency Exchange Service.

⁵⁶ Under the current PSA, SPs are required to provide customers the following information:

- When there is a risk of loss arising directly from significant causes that would affect the user's decision on their trading, the facts and the reason for this; and
- Other matters that are found to be useful for trading.

⁵⁷ There is an opinion that it is necessary to be careful not to give unsupported expectations to customers by providing information including feasibility and progress of the project.

⁵⁸ There is an opinion that it is necessary to remove a difference between the regulations on investment type ICOs and that on tokens regarded as virtual currency by improving the content of information to be provided with customers. On the other hand, another member argues that the right to demand goods and services to the issuer is regarded as payment in advance for purchase of goods and services, which is on a different standpoint of the protection of those who invest in securities, and that, although the minimum consumer protection will be necessary, an approach of applying the existing regulations strictly, dealing with individual cases and drawing attention from consumers would be enough to satisfy the consumer protection, instead of a radical reform of the system.

⁵⁹ The SRO is considering stipulating the obligation of an examination of the eligibility and feasibility of the project and the provision of information at the time of the commencement of the sale and the termination of it and after the termination, regardless of the content of the token regarded as virtual currency, in its self-regulatory rules relating to ICOs.

actions⁶⁰ and make them sufficiently careful. Moreover, as measures based on financial regulations alone might have limitations, it is expected that the parties concerned including consumer affairs organizations take appropriate actions to protect users depending on the details of each problem.

⁶⁰ Regarding ICOs, there are cases in which an issuer operating business in Japan issues tokens regarded as virtual currency and sells the tokens in Japan through unregistered foreigner dealers while publicizing the details of the tokens and how to buy for domestic residents. Appropriate measures against unregistered business are considered important for the authorities' supervision. There is also an opinion that it might be possible to develop provisions that invalidates the trading with unregistered business operators in principle and that allow a court to order the prohibition or suspension of the trading.

6. Appropriate Transitional Measures under Adoption of Regulations

Transitional measures⁶¹ which stipulated that service providers operating service subject to the PSA when it was enforced could continue their business after the enforcement (called “deemed operators”) for a certain period were applied because it would result in confusion and inconvenience among the customers if such service providers would not be allowed to operate any longer just after the enforcement.

However, it was indicated that during the period of transitional measures, the deemed operators actively advertised and rapidly expanded their business and many customers failed to recognize the fact that their counterparties were “deemed” (not registered yet) operators and what it means.

When the regulations of virtual currency derivative trading, etc., are introduced in line with this report and the transitional measures are provided, it is considered appropriate to require deemed operators to take the following measures:

- Not expanding new services or adding other virtual currencies;
- Not acquiring new customers (at least, not advertising or soliciting to acquire new customers); and
- Indicating on their website that they are not registered yet⁶² and will discontinue when its registration application is refused, in addition to not expressing the expectations to be registered.

Furthermore, a certain deadline until which the deemed operators could continue their business should be set to avoid too long of a transitional period and to improve the predictability for the registration.

⁶¹ Specifically, the following transitional measures were adopted:

- Service providers operating service which is subject to the PSA when it was enforced could continue to run the business without registration for six months after the enforcement (however, the service provider is deemed as a regulated service provider and is subject to conduct regulations.).
- If the application of registration is filed within the six months, the applicant would be deemed to be a regulated service provider and continue the said business even after the six months while being subject to the conduct regulations, as described above, until the application is approved or refused, or the abolition of business is ordered.

⁶² There is an opinion that indicating that this operator has not been registered yet should be done via methods which are easy for the public to understand clearly, such as by using a common logo or sticker.

7. Change Defined Term of Virtual Currency to Crypto-Asset

When the amended PSA imposed the regulations on Virtual Currency Exchange Service, the amended PSA adopted the term “Virtual Currency” for the following reasons:

- “Virtual currency” has been used in FATF and foreign laws and regulations; and
- The word “仮想通貨” (“virtual currency”) was generally used in Japan at that time.

On the other hand, the term “crypto-asset” has recently been used in international discussions⁶³. Moreover, the PSA requires SPs to provide an explanation to prevent misunderstanding that virtual currency is equivalent to fiat currency; however, it is still pointed out that the defined term “Virtual Currency” led to misunderstanding.

Considering these trends, it would be possible to change the name of the defined legal term from “Virtual Currency” to “Crypto-Asset”.

⁶³ For example, the G20 Buenos Aires Summit (November 30 and December 1, 2018) declaration uses the word “crypto-asset”; “We will regulate crypto-assets for anti-money laundering and countering the financing of terrorism in line with FATF standards and we will consider other responses as needed.”

Conclusion

This is the outcome of discussions by the Study Group. This report presents the direction of necessary regulatory frameworks to deal with various issues arising as the environment surrounding virtual currency changes continuously. It is expected that parties concerned will take prompt and appropriate responses based on the concepts presented in this report. Furthermore, the innovation in this field is expected to be promoted in an appropriate manner under the environment where the regulations of virtual currency trading are clarified.

In considering regulatory measures, it is important to design systems as flexibly as possible so that they can respond to environmental changes in the future. From this perspective, the Study Group has deliberated on as forward-looking approaches as possible based on the current circumstances of virtual currency trading.

It is, however, difficult to establish a system that can respond to all situations forecasting the future environmental changes in this industry where remarkable changes occur day by day. In addition, it may not be reasonably appropriate to determine regulatory measures in advance without evaluating the trends of virtual currency activities in the future because unexpected problems may happen and technological advances may enable us to take more effective measures that have not been expected.

Therefore, further assessment of the trading practices and taking actions including making regulation structure flexible depending on risks are important to ensure user protection as well as to consider the innovation.

From an international perspective, virtual currency trading is easily carried out across borders via the Internet and there is a limitation to how much a single country can handle alone, thus the international cooperation is also considered to be essential.

Users are expected to understand that the legal status of virtual currency under private law is still unclear and there are limitations on the user protection by laws and regulations. Besides, they are expected to recognize a certain level of self-responsibility in their trading.

It is desirable that government and parties concerned in this industry will continue their unremitting efforts to make virtual currency businesses fairer and safer.