

Role of Crypto-currency Exchange and Japanese VC Act

SO SAITO

FOUNDER AND REPRESENTATIVE LAWYER

SO LAW OFFICE

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Speaker's biography

Admitted to the bar in Japan (1999-) and in the State of New York (2005-)

Founder and representative lawyer of So Law Office (2015-)

Legal Advisor to Japan Blockchain Association (JBA) (2014-)

Specialized in Crypto-related law since 2013

Today's lecture content

- The role of the virtual currency (VC) exchanges
- Japanese VC Act and regulations
- Impact on regulations by the Coincheck incident
- Future of Regulation

I Role of Exchange

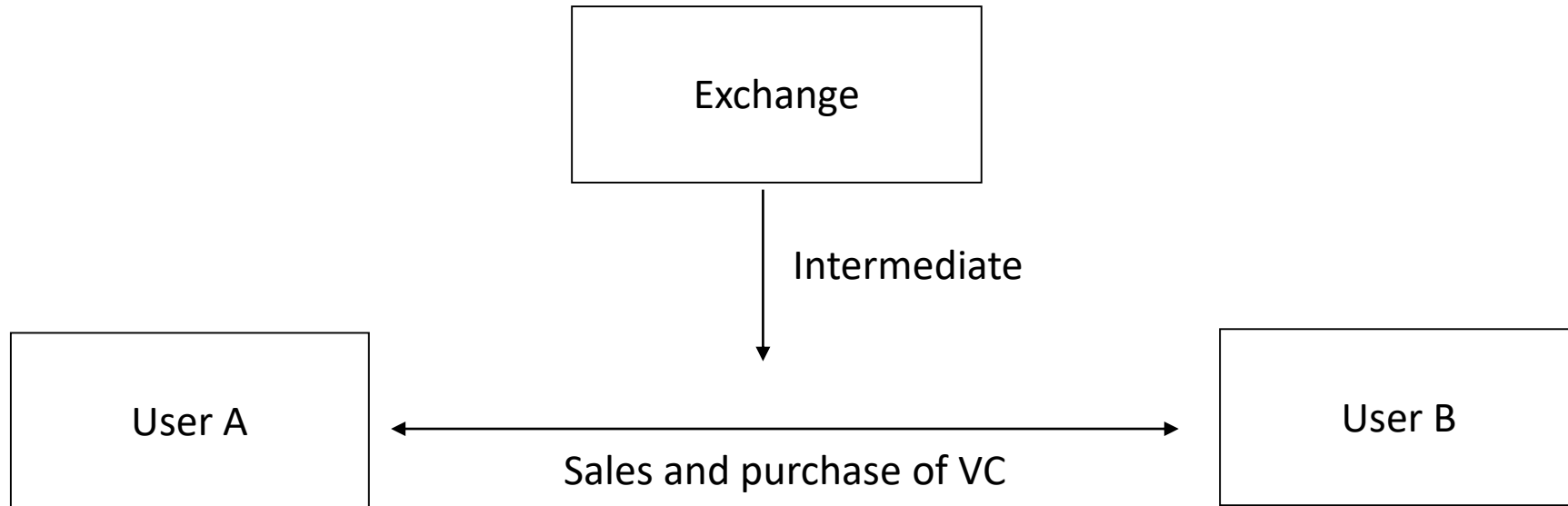
There are mainly two type exchanges

(i) Exchange-type exchange (It matchs sales and purchase order between users)

(ii) Shop-type exchange (It itself sells and purchases crypto)

Role of Exchange – Exchange-Type Exchange

Exchange type exchanges



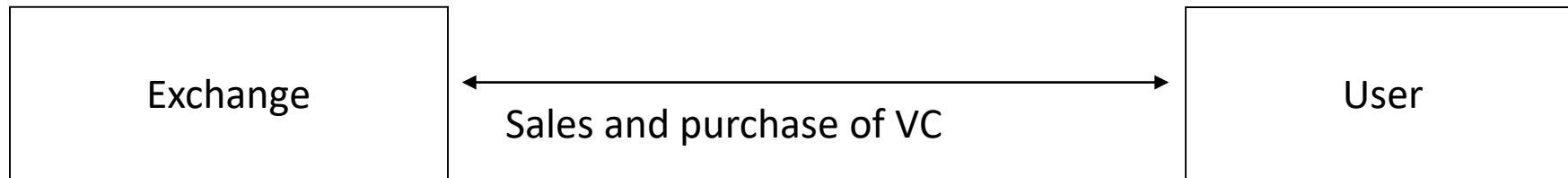
Role of Exchange – Exchange-Type Exchange

Exchange-Type exchange

- (i) Keeping users' fiat and VC under custody
- (ii) Matching of buying and selling of VC between users
- (iii) Settlement of trading

Role of Exchange – Shop-Type Exchange

Shop-Type Exchange



Role of Exchange – Shop-Type Exchange

Shop-Type Exchange

- (i) shop itself becomes a counterparty and trades with users
- (ii) Often keep users' fiat and VC in custody

Role of Exchange - Differences

Differences between Two Types

(Exchange-Type)

- Matching
- Fee is cheaper / More volume

(Shop-Type)

- Direct sale
- More user-friendly (easier to use)
- More alt-coins in Japan

Role of Exchange – Outside of Blockchain

Exchanges are outside of blockchain

Hacking to exchange is not a fault of Bitcoin system

However, exchanges play an important role in crypto industry

- Most users use exchanges and keep their VC in exchanges
- Criminal use exchanges for money-laundering

Risk of Exchange

Hacking risk

Money laundering risk

Regulators want to regulate exchanges

II Japanese Virtual Currency Act

The VC Act was enacted in April '16 and is enforced in April '17

Introducing "registration system"

Japanese Virtual Currency Act

VC exchanges are required to "register" with JFSA

Obligations: compliance officer, KYC/AML, cyber-security, segregation of exchange's asset and users' assets, internal audit, accounting audit, audit on segregation, explanation duty to users, etc.

6 months to 1 year

More than JPY100M cost?

Japanese Virtual Currency Act

16 companies have been registered including bitFlyer, Zaif, QUOINE, GMO Coin, DMM Bitcoin, SBI Virtual Currency

4 companies (including Coincheck) are operating under deemed registration (transitional measures)

More than 100 companies are applying

Market Entrants from Overseas

There are many applicants from overseas

They are from all over the world including the US, Europe, Russia and former Soviet Union, and China

Reasons for entry to Japan Market

Stability of the law

Large trading volume

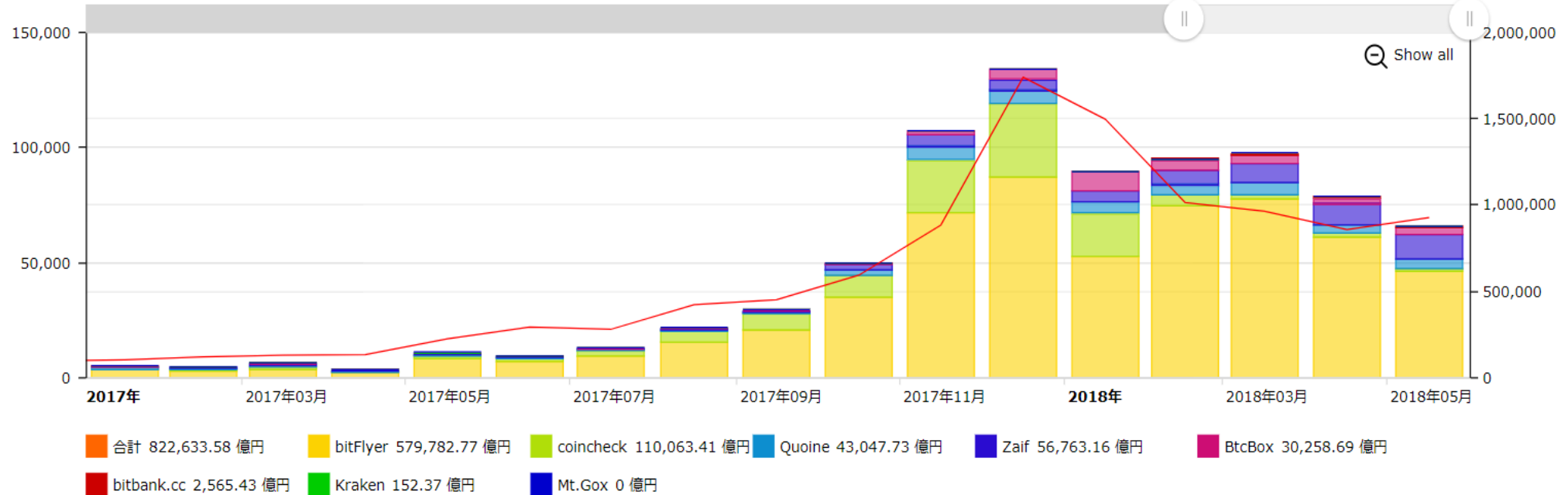
Bank accounts are relatively easier to open

However, it is in question if the said perceived advantages still remain

Trading Volume of Japanese Exchanges

国内取引所(JPY-BTC)の総月間出来高(日本円換算、単位:億円)

※差金決済/先物取引を含む



<https://jpbitcoin.com/market/volume>

III Coincheck incident and afterwards

On January 26, '18, NEM equivalent of approximately JPY58 billion was hacked from Coincheck

Coincheck kept all NEM in hot wallet

Coincheck incident and afterwards

Coincheck has repaid all stolen loss to its users with JPY (1 NEM=JPY88.5, total 46 billion) from its own asset

Many were surprised to find the scale of profitability of exchanges

Monex, a leading online security company, purchased Coincheck

Coincheck incident and afterwards

The FSA's Examination after the Coincheck incident

- On 1st February, all registered exchanges and deemed registered exchanges were ordered to report on system risks
- On-site inspection is being conducted first on Coincheck, thereafter on each registered and deemed registered exchange
- Business improvement order, business suspension order, refusal of registration were issued to exchanges

Virtual Currency Act – Review becomes Stricter

Original intention at the time of legislation in '16

→ Enabling the startups to engage in VC business

Review became stricter in mid 2017 because of surge in VC prices and hardfork of Bitcoin

- FSA's special monitoring team was formed
- Hundreds of questions are being asked when applying for registration

Virtual Currency Act – Review becomes Stricter

Review becomes far stricter after the Coincheck incidents

Security, Advertisement, Operation, Internal Management, Insider, Anti-money laundering, Market Maneuvering

There are no new exchanges nor new coins admitted since last December

Coincheck incident and afterwards

JFSA Workshop on Virtual Currency Exchange Business (April 2018 -)

- FSA's Research group of experts

Japan Virtual Currency Exchange Association (April 2018 -)

- Established as voluntary self-regulatory organization, but aiming to be legally-mandated SRO. 16 registered exchanges currently join. Scope of self-regulation is being discussed including, security, AML, market manipulation, etc.

IV ICO Regulation

ICO is abbreviation of “Initial Coin Offering”
Fund-raising by selling so-called “coins” or
“tokens”

Still remains global hot topics being followed
with growing enthusiasm

ICO Regulation

In December `17 JFSA revealed its view to relevant parties that ICO tokens constitute, to the extent they have the probability of being listed later, "virtual currency"

ICO Regulation

"Registration of virtual currency exchange business" + "notification of coins" are required for ICO in Japan.

December `17 onwards no ICO was being launched as unequivocally in compliance of the laws.

VI Future Japanese virtual currency exchange industry

The VC Act in Japan was perceived as advanced and forward-looking when published

A lot has happened in one year thus the act started to lag behind the fast-changing reality

Future Japanese virtual currency exchange industry

As drafted, the law was meant to promote innovation, but as currently operated it is to further regulate the industry

Balance between innovation and regulation

No conclusion yet, should discuss