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Initial Coin Offerings (ICO) under Japanese laws

So Saito
So Law Office

Initial coin offerings ("**ICO**") have been one of the global hot topics followed with growing enthusiasm, but what regulations are applied to ICO is still unclear in most countries. Some issuers sell coins by way of ICO unknowing of regulations in the countries that may be relevant or even applicable, only to take serious regulatory risks. In Japan, most ICO coins are regulated under the so-called "Virtual Currency Act" (the provisions in the Payment Services Act concerning virtual currencies—"VC Act" or the "Act") which took effect in April 2017. Some coins might be regulated under other laws. Below are general guidance on regulations and laws which you would need to consider when you contemplate an ICO in Japan.

1. Conclusion

(A) VC Act

(a) If ICO coins are deemed "Virtual Currency" ("**VC**") as defined in the Act, only the registered Virtual Currency Exchange Business Operators ("**VC Exchange Business Operator**") are authorized to handle such an ICO.

(b) The Japanese Financial Services Agency (the "**JFSA**") presumes most ICO coins to fall under statutory "VC."

(c) Even a registered VC Exchange Business Operator cannot deal in all existing VCs. The VCs to be handled should be reported to and approved by the Japanese Financial Services Agency.

(e) ICO issuer has three choices when selling ICO coins. The first such choice is to get registered as VC Exchange Business Operator and sell tokens itself. The second is to delegate sales of ICO coins to a third party registered VC Exchange Business Operator. The last option is not to sell ICO tokens to Japanese residents.

(B) Financial Instrument Exchange Act (the "FIEA")

(a) The fund regulations pursuant to the FIEA (the "**FIEA Fund Regulations**") will apply, if ICO constitutes "collective investment schemes (fund)," i.e., a scheme that is (i) to collect money from others; (ii) to invest in a business; and (iii) to pay dividends

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to holders thereof.

(b) ICO coins which do not satisfy the test in (B)(a) above are not regulated by the FIEA Fund Regulations. We believe that the coins such as Bitcoin and Ether do not constitute "funds" under the FIEA.

(c) In principle, those funds that solicit not for "fiat," but for "VC" will not constitute "funds" under the FIEA.

(C) Consumer Protection Act and Civil Code

(a) From the general consumer protection point of view, appropriate explanation to the investors is required irrespective of whether such ICO coins are regulated by the VC Act, by the FIEA, or by neither thereof.

2. Virtual Currency Act

2.1 If ICO coins are deemed "VC" under the VC Act, only the registered VC Exchange Business Operator may sell VC on a regular basis

According to the VC Act, only such a VC Exchange Business Operator as has been registered pursuant to the Act may carry out any ICO, to the extent that (i) such ICO is in respect of the VC as defined in the Act; and (ii) the subscriptions solicited are paid in cash or other VC (which act of "sale and purchase of VC or exchange of a VC into another" "as carried out on a regular basis" is prescribed for the registered "VC Exchange Business Operators" by the Act).

2.2 Even the registered VC Exchange Business Operators may not be authorized to handle the entire universe of existing VCs. VCs to be dealt in should be reported to and approved by the JFSA.

The VC Act requires the registered VC Exchange Business Operator to report to the JFSA a list of coins it contemplates to deal in, which list is after that reviewed, with some coins possibly being screened out.

We are still discussing with the members of the self-regulatory organization and with the JFSA what coins are appropriate to be dealt by the registered VC Exchange Business Operators.

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2.3 Currently the JFSA deems most ICO coins to be VC

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VC Act defines "VC" as the first set of definitions Bitcoin most typically meets (such coins collectively are "**Type I VC**"). The second set of the VC definitions are characterized by the fact that such coins may be exchanged for the above-mentioned Type I VC "**with unspecified persons** as the other party" (such coins collectively are "**Type II VC**"). The VC Act excludes from its application coins that are linked to any fiat currency. The coins that are linked to any fiat currency are regulated by yet another regulation.

What this "unspecified person" means in the context of Type II VC definition is somewhat unclear. However, the FSA seems to think that (i) coins are deemed to be VCs if such coins have a possibility to be exchanged with Type I VC in the future and (ii) coins are deemed not to be VC, where, for example, such coins are structurally prevented from being exchanged with Type I VC. As most ICO coins are contemplated to be listed in the exchanges and to be exchanged with Bitcoin etc., we believe most coins would be deemed to constitute regulated VC from the JFSA's viewpoint.

2.4 Three Ways to sell ICO coins

ICO issuer can choose out of three ways to sell its ICO coins.

The first method is to get registered as VC Exchange Business Operator registration and sell tokens by itself. It takes about 6 months to get registered, and some costs are incurred. Please see our earlier memo, "[Guidance Note on the Japanese Virtual Currency Legislation and Overview on Registration Requirement thereunder](#)" for more details of the registration.

The second method is to delegate sales of ICO coins to a third party registered VC Exchange Business Operator. Currently, there are 15 registered exchanges in Japan. We understand that they are asked to treat ICO tokens every day, and they accept only tiny percent of such offers. Thus, to negotiate with the registered exchange might not be so easy. Since many new businesses are applying to the JFAS now, the situation may change in the future.

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The third method is not to sell ICO coins to Japanese residents. If you exclude Japanese residents from purchasing ICO tokens, we believe that you do not need to take the VC Exchange Operator license.

3. FIEA and the Fund Regulations

3.1 Bitcoin and Ether do not fall under the definitions of securities

For the FIEA to apply, the case must involve either "Negotiable Instruments/ Securities" or "Derivatives" as defined therein. These terms are defined by a fixed list of items, each of which is also defined. Common virtual currencies such as Bitcoin and Ether are included in neither "Negotiable Instruments/ Securities" nor "Derivatives." Hence, as a general rule, the act does not apply to the sale and purchase or exchange of a VC such as an ICO.

3.2 Collective Investment Scheme is regulated by the FIEA

Having said that, amongst the statutorily-defined items of Securities, the term "collective investment schemes (fund)" is a broad and diverse concept. Certain ICOs seem to fall under such "collective investment schemes," specifically, where an ICO is (i) to collect money from others, (ii) to invest in a business, and (iii) to pay dividends to holders. Such a structure most likely invites the application of the FIEA Fund Regulations. The FIEA Fund Regulations are generally stricter than the regulations on VC under the VC Act, and you should be careful with such possible applications to your ICO.

When coins are offered in exchange for payment in Bitcoin or Ether, the FIEA Fund Regulations are unlikely to come into play because Bitcoin and Ether are not "money" under Japanese law. However, if someone sells Bitcoin and Ether in exchange for cash to investors and then collect such Bitcoin and Ether from the investors as an investment to a fund, the chain of actions as a whole may be deemed to constitute collecting "money" and, thus, may be regulated¹.

¹ On October 27, 2017, the JFSA issued "Initial Coin Offerings (ICOs) - User and business operator warning about the risks of ICOs -".

http://www.fsa.go.jp/policy/virtual_currency/07.pdf

In there, the FSA states that "If an ICO has the characteristics of an investment and the purchase of a token by a virtual currency is practically deemed equivalent of that

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3.3 Certain funds such as real estate funds might still be regulated even if they collect investment solely in VC.

You need to consider yet another regulation if money or VC collected by way of ICO is invested in a certain specific asset class. For example, some ICOs that invests money or VC in real estate businesses might be regulated under the Act on Specified Joint Real Estate Ventures in Japan. Since the Act on Specified Joint Real Estate Ventures does not distinguish VC from money, ICO might be regulated even if the ICO collects investment via Bitcoin or Ether.

4. Consumer Contract Act and Civil Code

Where neither the VC Act nor the FIEA Fund Regulations reach, sellers are still not entirely at liberty to design an explanation of their products.

For instance, any consumer is entitled to rescind the manifestation of his/her intention to enter into a transaction in which a soliciting business operator has made misrepresentations as to the material facts, intentionally omitted an explanation of material facts, or provided conclusive evaluations. Accountability under the Civil Code (etc.) will also come into question. Any products offered, irrespective of whether they constitute VC, should without exception entail reasonable explanations.

From the consumer protection point of view, explanations made for most of the arguably fraudulent coins do not seem to amount to clear-cut "false statements" or "conclusive evaluations." However, there may still be room to argue that the "intentional omission of material facts" has been committed. It may justify further contemplations by the legislator or self-regulatory organization of the minimum disclosure standard, i.e., list of material facts/ important matters.

Should you contemplate ICO, we recommend that you get ready for adequate disclosure to the investors.

by a legal tender, the ICO becomes subject to regulations under the Financial Instruments and Exchange Act."

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