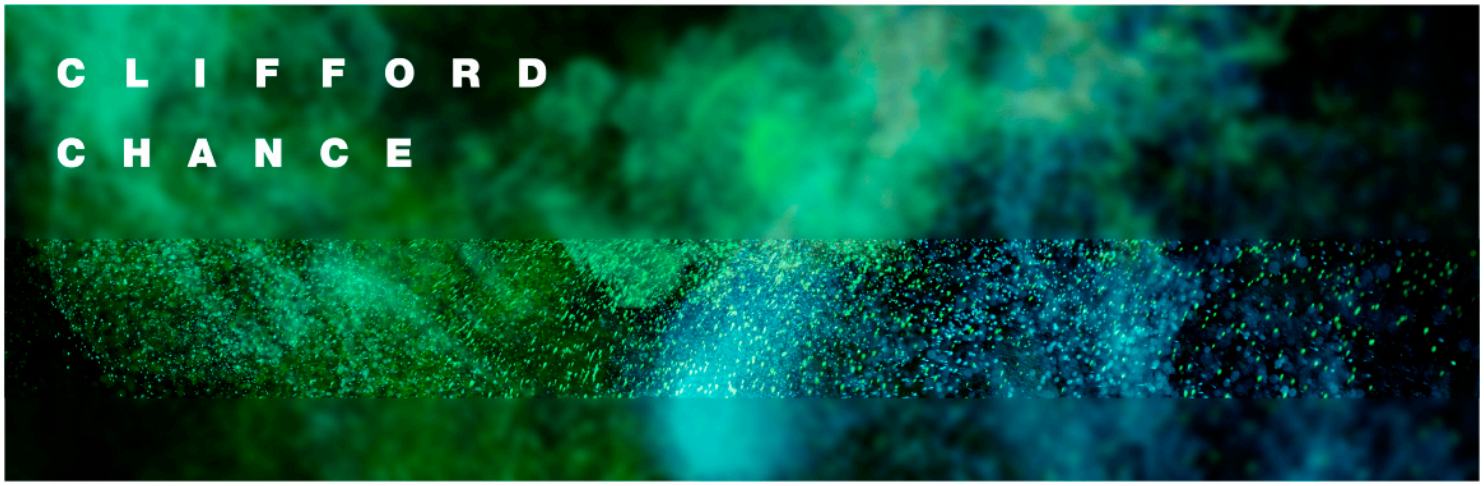


# NEW REGULATION OF INITIAL COIN OFFERINGS (ICOs) IN JAPAN

**The amendment to the Financial Instruments and Exchange Act of Japan (FIEA) is the first step towards introducing detailed regulation to ICOs in Japan. This represents a significant step forward and brings some helpful regulatory clarity to this emerging asset class.**

## ICOs AS OFFERING OF "SECURITIES"

Until recently, cryptocurrencies have been lightly regulated in Japan – primarily pursuant to the Payment Services Act (which only regulates their transfer and payment thereby). A number of market participants are of the view that more comprehensive regulation is needed, particularly given high cryptocurrency transaction volumes. In response to these concerns, an amendment to the FIEA (the Amendment) was passed by the Diet on 31 May 2019 and enacted on 7 June 2019.

In the context of collective investment schemes, the Amendment recognises cryptocurrencies as "money" and, accordingly, when cryptocurrencies are contributed to collective investment schemes (e.g. subscribers paying cryptocurrencies as consideration in return for tokens issued under an ICO), the interests (represented in the form of tokens in the context of an ICO) in the collective investment scheme are deemed to be Type II Securities under the FIEA.

As a result, ICOs for investment business purposes (involving a collective investment scheme) will be regulated as an offering of "securities" under the FIEA.

**What are "Token Securities"?**

The Amendment also introduces a new definition of "Token Securities" (*denshi kiroku iten kenri*). When interests in collective investment schemes raised by way of an ICO for investment business purposes are transferrable through an electronic information processing system (i.e. when they are represented in the form of tokens), such interests will fall within the definition of "Token Securities"[1]. The amended Payment Services Act also now expressly carves Token Securities out of its scope.

[1] There may be some exceptions to the scope of Token Securities, which will become clearer when the ordinances implementing the Amendment are released.

**Key issues**

- ICOs regulated under the FIEA as offering of "securities"
- Disclosure and licensing requirements imposed on ICOs
- ICOs online require careful consideration

**Terminology**

- An **ICO** is a fundraising event in which an issuer offers tokens to participants or investors in return for consideration (e.g. other cryptocurrency, fiat currency, or as a reward for marketing / referral activities).
- **Tokens** are electronic records generated by a smart contract system that is based on a cryptocurrency with separate blockchain.

"It is interesting to see Japan taking a different approach in providing regulatory clarity towards cryptocurrencies through legislative amendments when compared to some other APAC jurisdictions, such as Hong Kong, where ICOs are yet to be expressly governed by legislation and are instead subject largely to ad hoc regulatory guidance."
**Rocky Mui, Partner Hong Kong**

As a consequence of such an interest being a Token Security, the stricter disclosure and licensing requirements set out below will be imposed on ICOs.

## CONDITIONS FOR PRIVATE PLACEMENT

As an ICO for investment business purposes will be regulated as an offering of "securities" under the FIEA, unless it complies with the conditions for relying on a private placement exemption, a securities registration will also be required.

The conditions for relying on the private placement exemption available to Token Securities are strict. Like Type I Securities' private placement, the offerees must be limited to qualified institutional investors or a very limited number of investors (fewer than 50). Careful consideration will therefore be needed (particularly given ICOs will ordinarily be conducted via the internet) to ensure that such solicitations are limited to qualified institutional investors or such limited number of investors.

**Background to disclosure regulations**

In principle, Token Securities fall within the category of Type II Securities (i.e. the category of fund securities in general). However, in the context of disclosure regulations, Token Securities are treated as Type I Securities (i.e. the category of traditional securities such as shares and bonds in general), and the conditions for relying on a private placement exemption available for Type I Securities are stricter than those for Type II Securities.

## LICENSING REQUIREMENTS

Given the regulation of ICOs for investment business purposes as an offering of "securities" (as mentioned above), such ICOs must also be handled by securities companies licensed under the FIEA.

A Type I Financial Instruments Business Operator (FIBO) licence will be necessary to process an ICO (whether it is a private placement or public offering) and to broker the Token Securities.

Issuers of tokens of ICOs will also be required to be registered as Type II FIBOs to conduct marketing activities in respect of the ICOs by themselves (as the tokens fall within the category of Type II Securities). In addition, the operator of the ICO (which will likely also be the issuer) will be required to be registered as an Investment Manager to manage the funds raised by way of an ICO. To be exempted from these licensing requirements, the operator may be able to seek to rely upon Article 63 registration - although this will only become clear once the ordinances implementing the Amendment are released.

"US regulators and US courts have been grappling with the threshold issue of whether a particular digital asset is a security for over two years with little in the way of consensus or clarity. The US approach to date has been reactive, essentially considering any asset issued in an ICO to be a security, and then requiring that the asset be regulated within the existing securities offering, trading, and operational regulatory framework. Japan's new amendment is refreshing in that it recognizes the existence of this new asset class and attempts to facilitate capital formation while protecting investors."
**Steven Gatti, Partner Washington D.C.**

## EXTRATERRITORIAL APPLICATION?

Financial regulation inevitably raises the question of extraterritorial application. As long as a Japanese resident can possibly access the ICO, extraterritorial application of the FIEA arises - even if the ICO is based in another jurisdiction and is in a language other than Japanese. As Japanese residents can be solicited in these circumstances, the FIEA would apply, as would the relevant regulatory regime(s) in other jurisdictions where the ICO is based.

## TIMELINE

The Amendment will come into force no later than 7 June 2020. The drafts of the ordinances implementing the Amendment are expected to be released by the end of this year and to be finalised around the first quarter of 2020.

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