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Libra and other stable coins under Japanese regulations

Speaker's biography

So Saito

Attorney-at-law admitted in Japan and in NY

- 1999 Joined Nishimura & Asahi (there he handled securitization, derivatives, etc.).
- 2013 First professional encounter with bitcoin.
- 2015 Established an independent law firm specializing in crypto, blockchain, FinTech, etc.

- (Other) Graduated from the Faculty of Law of the University of Tokyo and the New York University, School of Law. Worked at a major law firm in New York.

Serving as the legal advisor to the Japan Blockchain Association (JBA), the secretariat of the Capital Markets Working Group of the FinTech Association of Japan, the supervisory officer of Mitsubishi Estate Logistics REIT Investment Corporation and ex-external director of bitFlyer Inc.

THE ISSUANCE OF LIBRA TOKENS

Initial issuance

- Libra Association sells investment tokens to founding members in a private placement
- proceeds from the token sale will be used as a reserve
- Libra Association pays out incentives in Libra coins to founding members to encourage adoption by users, merchants, and developers

Later issuance

- users have to purchase Libra coins for fiat and transfer the fiat to the reserve
- for efficiency reasons users will not directly interface with the reserve, instead authorized resellers interact with the reserve (similar to ETFs in Japan)

THE LIBRA RESERVE

- diversified investment in low-volatility assets (e.g. bank deposits, government securities)
- revenue from interests will be used to fund operations and the development of the Libra ecosystem
- profits will be distributed as dividends to investment token holders (returns will only materialize if the ecosystem grows substantially in size)
- users of Libra coins do not receive any profits

THE LIBRA REIMBURSEMENT MECHANISM

- authorized resellers may return Libra coins to the Libra Association and receive the same amount of fiat currency (it is unclear how the amount will be calculated)
- returned Libra coins will be destroyed

TRADING LIBRA

- users can buy and sell Libra coins on virtual currency exchanges etc.
- trading Libra coins on virtual currency exchanges provides arbitrage opportunities for investors and ensures that the market price remains stable compared to the reserve (structure seems to be similar to ETFs)

STABLE COINS

Stable coins are not a homogenous group of tokens. Instead there are different models which must be assessed carefully on a case-by-base basis for the legal classification.

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IOU Models

A dark blue square containing the text "On-chain Collateralized Models" in white, centered.

On-chain
Collateralized
Models

A dark blue square containing the text "Seigniorage Models" in white, centered.

Seigniorage
Models

STABLE COIN MODELS

IOU models

- issuer promises token holder to redeem token at a fixed rate
- generally fully backed by fiat currencies or other assets
- TrueUSD, USDTether, JPYZ, Libra

On-chain collateralized models

- requires a complex system of smart contracts, different kinds of tokens, oracles and external actors to ensure stability
- MakerDAO

STABLE COIN MODELS

Seigniorage models

- based on the quantity theory of money
- token supply adjusted continuously depending on demand and supply to stabilize token price relative to a reference currency or other benchmarks
- Basis

REGULATION – VIRTUAL CURRENCY

Definition of virtual currency

Electronically-recorded property value, excluding currency-denominated assets, that

Type I (i) can be used for payment to unspecified persons,
(ii) can be purchased from and sold to unspecified persons, and
(iii) can be transferred electronically.

Type II that can be mutually exchanged for Type I virtual currencies with unspecified persons and which can be transferred electronically.



CURRENCY-DENOMINATED ASSETS ARE EXPLICITLY EXCLUDED AND THUS AN IMPORTANT FACTOR FOR THE REGULATORY CLASSIFICATION OF STABLE COINS.

REGULATION – VIRTUAL CURRENCY

Definition of currency denominated assets

Assets denominated in JPY or a foreign currency, or for which performance of obligations, refund, or anything equivalent thereto is made in JPY or a foreign currency.

Example

TrueUSD and USDTether seem to be currency denominated assets, since the issuer promises to redeem 1 coin : 1 USD.

JPYZ is not a currency denominated asset, since the issuer only promises to buy 1 JPYZ : 1 JPY.

REGULATION – VIRTUAL CURRENCY

LIBRA

- backed by a basket of currencies (not linked to a particular currency)
- authorized resellers can redeem LIBRA tokens based on the value of the reserve at the time of request

Does that make LIBRA a currency denominated asset?

We do **not** think that LIBRA is a currency denominated asset. Libra coins can therefore be classified as a virtual currency under Japanese laws. The Financial Services Agency (JFSA) seems to be of a different opinion although they admit that a further analysis is necessary.



A FURTHER ANALYSIS CONSIDERING ALL FACTS AND CIRCUMSTANCES IS NECESSARY.

WE ANALYZE BOTH CASES THAT LIBRA IS DEEMED A VIRTUAL CURRENCY AND A MONEY ORDER.

REGULATION – VIRTUAL CURRENCY

Registration and Notification

Where tokens constitute virtual currencies, issuers must register as virtual currency exchange or sell their tokens through one of the registered exchanges.

Tokens must further be approved by the JFSA prior to offering the tokens to Japanese residents. This requires considerable efforts (liaising with registered exchanges, self-regulatory organizations and the JFSA).

JPYZ has been listed since 2017.

Since the Coincheck incident in January 2018, no new tokens have been approved for listing. This might change in the future.

REGULATION – MONEY ORDER

Definition of a money order

Accepting, or fulfilling a request from a customer that involves transfer of funds between persons in remote locations using a mechanism for transferring funds, i.e. by bank transfers, without physically transporting cash (by armored truck, etc.).

Depending on the transaction amount the required license differs.

JPY >1M banking license required

JPY ≤1M fund transfer license is sufficient

REGULATION – MONEY ORDER

Issuer of stablecoins

Deeming a so-called bank coin (e.g. MUFG) as money order has no impact on bank issuers.

Non-bank issuers must either obtain a banking license or a fund transfer business license, if their coins are deemed money orders.

- Banking License

For general companies it is generally unrealistic to obtain a banking license.

- Fund transfer business license

It is easier to obtain a fund transfer business license, but it might be difficult to ensure the JPY 1M limit and to deposit the entire amount of unused funds (especially in case of global operations).

REGULATION – MONEY ORDER

Transactions in crypto exchanges

Money orders do not constitute virtual currencies. The sale of money-order-type stable coins is therefore not considered a virtual currency exchange transaction.

The sale of money-order-type stable coins by crypto exchanges might be deemed an agent activity for a bank or fund transmitter. In the former case, crypto exchanges might be required to have a bank agent license. In the latter case, no license is required but the exchanges are subject to supervision of a fund transmitter.

REGULATION – MONEY ORDER

Transactions in crypto exchanges

The transfer of stable coins from customer A's account to customer B's account may be deemed a transfer of money order and require a license.

The exchange of virtual currencies and money-order-type stable coins is likely to be deemed as virtual currency exchange business.

REGULATION – PREPAID PAYMENT INSTRUMENTS

Theoretically, stable coins may be issued expressly as prepaid payment instruments.

Definition of prepaid payment instruments

Prepaid payment instruments are defined as a

- record of value,
- which is issued in exchange for consideration, and
- which can be used for the purchase of goods and services from the issuer or a member store of the issuer.

Prepaid Payment Instruments are issued for the purchase of goods and services and thus not considered as transfer of funds. Except for a few cases, it is not permitted to refund outstanding amounts to holders of prepaid payment instruments. This is prohibited deliberately to avoid conflicts with the transfer of funds which is only allowed to licensed banks and licensed fund transmitters.

REGULATION – PREPAID PAYMENT INSTRUMENTS

Issuer of stable coins

The issuer of prepaid payment instruments for third-party business must be registered in Japan.

The design of such stable coins would differ from existing stable coins, primarily due to non-refundability.

Half of the unused balance must be deposited in Japan.
(particularly challenging for businesses operating globally)

REGULATION – PREPAID PAYMENT INSTRUMENTS

Transactions in Crypto Exchanges

It seems that crypto exchanges can sell prepaid-payment-instrument-type stable coins as an agent of an issuer as an ancillary business.

The transfer of prepaid-payment-instrument-type stable coins between customers does not seem to constitute transfers of a money order.

It is uncertain whether the exchange of prepaid-payment-instrument-type stable coins for virtual currencies constitute a virtual currency exchange business (e.g. buying virtual currencies with SUICA), but probably the answer is Yes.

REGULATION – SECURITY ACT / COLLECTIVE INVESTMENT SCHEME

Definition of collective investment scheme

- an investment of money or money equivalent
- business using the money
- right to participate in the profits arising from the business

Libra tokens

- unlike the holders of investment tokens, users of Libra coins do participate in profits generated by the reserve
- fluctuations in price of Libra coins are not the result of an active monetary policy but of fluctuations in the price of currencies and bonds in the reserve (from our point of view Libra tokens are therefore no interests in a collective investment scheme)

SUMMARY

There are various kinds of stable coins.

Each stable coin requires a careful case-by-case analysis.

Libra, JPYZ, MakerDAO, basis

Virtual Currency

TrueUSD, USDTether

Money Order

For Libra it would be the easiest, if it was classified as a virtual currency in Japan.

DISCLAIMER

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