

Handout for Study Group on Virtual Currency Exchange Business etc.

✂ Provisional translation version

# The Outline of Self-Regulation on Virtual Currency Exchange Service

September 25, 2018

Japan Virtual Currency Exchange Association



# The Outline of Self-Regulation

# I. JVCEA's Outline

Name: Japan Virtual Currency Exchange Association

Location: 〒 102-0082

18th Ichibancho, Chiyoda-ku, Tokyo Kawakita Memorial Building 4th Floor

Purpose: The purpose of the Association is to ensure the appropriate provision of Virtual Currency Exchange Service as well as contributing to the sound development of these businesses and protection of the interests of the users.

Number of Members: 16 companies registered with JFSA

## History

- March 1st, 2018: 16 registered companies agreed to establish unified self-regulation
- March 29th, 2018: organizing registration
- April 23th, 2018: general meeting, all 16 registered companies joined in the association
- July 30th, 2018: the board meeting decided the interim self-regulations
- August 2nd, 2018 the association applied for the approval of self-regulatory institution

## 2. Businesses of JVCEA

- **Businesses as a Self-Regulatory Organization**

- (1) providing guidance, recommendation, etc. to Members for the purpose of causing Members to comply with provisions of Payment Services Act(PSA) and other laws and regulations and self-regulatory rules in carrying out Virtual Currency Exchange Service(VCES);
- (2) providing guidance, recommendation, etc. to Members in relation to VCES that is necessary for ensuring the appropriateness of the terms and conditions of contracts or otherwise protecting the interests of users of the VCES;
- (3) establishment of the rules that are necessary for the appropriate management of the VCES carried out by Members and information used in the businesses;
- (4) investigation of the status of compliance with PSA or an order issued pursuant to the Act or a disposition given pursuant thereto, or the self-regulatory rules;
- (5) collection, arrangement, and provision of information necessary for the protection of the interests of users of the VCES ;
- (6) handling of complaints from users related to the VCES carried out by Members;
- (7) provision of information to users for VCES that contribute to the protection of users
- (8) ) publicity to the users of the VCES and other businesses necessary for the achievement of the purposes of the Certified Association for Payment Service Providers;
- (9) beyond what is set forth in the preceding items, businesses that contribute to the sound development of the VCES and the protection of the users of VCES; and
- (10) Investigation and research on information technology such as virtual currency and VCES and block-chain, holding workshops, etc.

- **Approach to the adjacent businesses**

Respond to businesses that does not fall under the Virtual Currency Exchange Service under the Payment Services Act and which is operated by Members as a Self-regulatory organization

ex. Virtual Currency CFD and other derivative transactions, wallet services of virtual currency etc.

# 3.Types of Membership / Organization of Executive Office

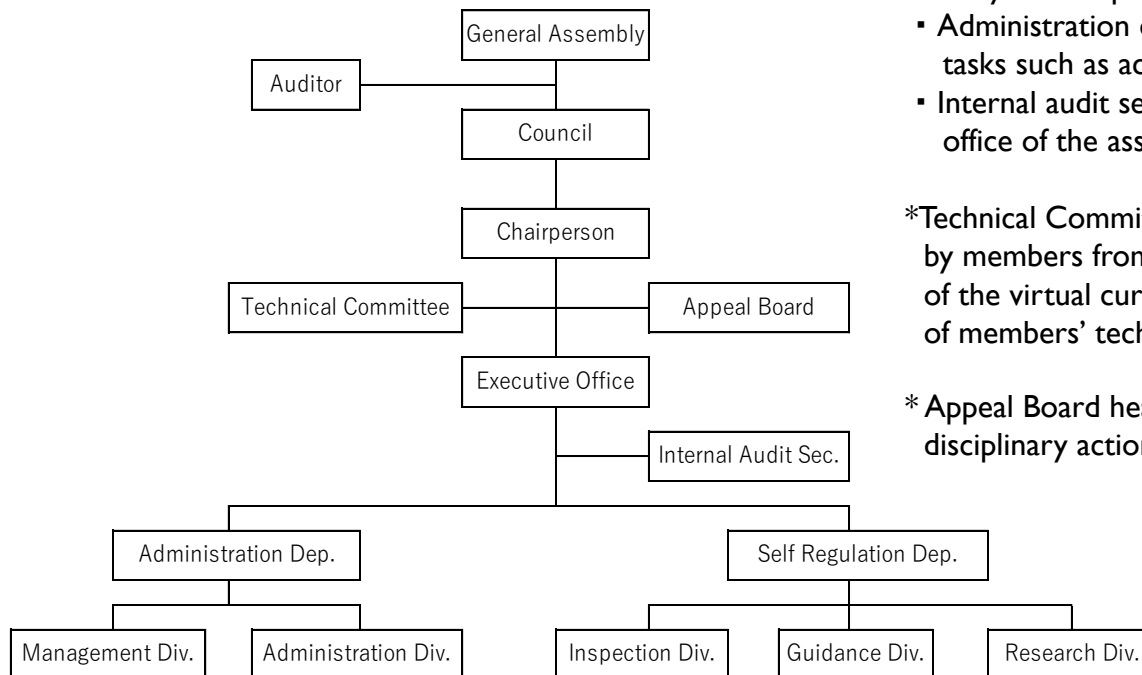
## • Types of Membership

Type I: Registered VCES Providers

Type2: Person under application for the registration of VCES or prospective applicant

Type3: It is planned to target those who agree with the purpose of the association, such as businesses conducting peripheral business of VCES

### 【Organization Chart】



## Organization of Executive Office

2 departments, 5 divisions, 1 section

\* Approx. 20 people will be assigned in October this year

- Inspection division inspects Type I members
- Guidance division guides Type I members in VCES and also supports Type II members' application for registration with JFSA
- Research division handles research on domestic and overseas trends of VCES
- Management division manages members' information and collaborates with relevant organizations such as Tokyo Metropolitan Police, consumer centers,
- Administration division handles general administrative tasks such as accounting and labor management
- Internal audit section conducts audits on executive office of the association

\*Technical Committee evaluates virtual currencies handled by members from technical viewpoints such as the safety of the virtual currency, etc. TC will be mainly composed of members' technology officials

\* Appeal Board hears appeal against self-regulatory disciplinary actions from members.

# 4. Intention of Self-Regulation

We aim to sound development of the VCES harmonising with users and society by securing and fostering fair and appropriate business practices and deterring fraudulent use of Virtual Currency with the ultimate objective of protecting users and public interests.

User protection / Public interest

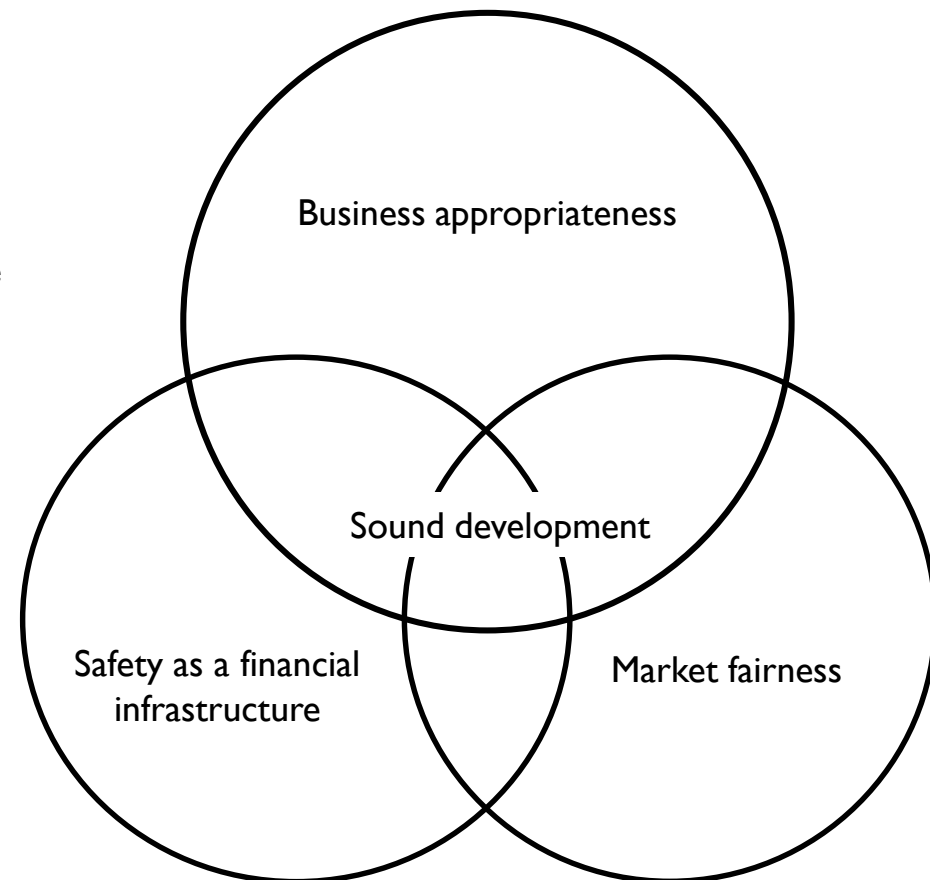
## Challenges of VCES

- Responding to rapid market expansion
- Improve consciousness as a financial industry and strengthen governance
- Correct inappropriate sales method
- Strengthen risk management system
- Responding to external threats such as cyber attacks
- AML / CFT
- Dealing with new transaction types such as derivative transactions and ICO etc.

## Solutions by self-regulation

We formulated self-regulatory rules using other financial regulations such as Financial Instruments and Exchange Act, etc. based on the risks peculiar to the Virtual Currency.

From now on, we ensure the effectiveness of self-regulatory rules by encouraging members to comply with those rules and flexibly operating and revising those rules based on changes in social situations, amendments of laws and technological innovation.



# 5. Outline of Self-regulatory rules

In addition to formulating self-regulatory rules related to existing regulations such as PSA and Act on Prevention of Transfer of Criminal Proceeds, we drew up a set of self-regulatory rules fitting reality of VCES on necessary matters from the viewpoint of user protection.

## General provision

### ① Basic rules on Virtual Currency related transactions

## Rules on specific issues

### ② Rules and guidelines on the handling of Virtual Currencies

### ③ Rules and guidelines on management of user property

### ④ System related rules

- Rules and guidelines on the safety management of information
- Rules and guidelines on system risk management
- Rules and guidelines on emergency action

### ⑤ AML / CFT related rule

- Rules and guidelines on AML / CFT
- Rules on eliminating relations with antisocial forces

### ⑥ Rules on complaints management and dispute resolution

### ⑦ Rules on sales activity

- Rules and guidelines on solicitation and advertisement etc.
- Rules and guidelines on user management and explanation

### ⑧ Rules on transaction management

- Rules and guidelines on the improvement of order management system
- Rules and guidelines on the establishment of transaction monitoring system to prevent inappropriate transactions
- Rules and guidelines on the establishment of information management system

### ⑨ Rules and guidelines on margin trading

### ⑩ Rules on financial management

### ⑪ Business Ethics / Disciplinary Actions related Rules

- Rules on establishment and compliance of ethics codes
- Rules on employee management etc.
- Rules on procedures of self-regulatory disciplinary actions
- Appeal Board Rules
- Rules on investigation in members

### ⑫ Rules and guidelines on ICOs

\* Please note that these self-regulatory rules are under review.

# 5 - ①. Basic rules on Virtual Currency related transactions

In order to secure business appropriateness and thus to protect users, formulate basic policy to be observed regarding Virtual Currency related transaction.

Clearly stating that the management of members must place the highest priority not only on the business performance, but also on the improvement of the internal organization and the management must act in good faith and take initiative to establish and disseminate concrete policies for the improvement to officers and employees.

Business management: Comprehensive verification of financial and business risks with due consideration to the characteristics of Virtual Currencies and business model etc.

- Formulation and update of management plan to appropriately respond to financial and managerial risk

- Secure human and physical resources necessary for carrying out management plan

Internal audit: Internal audit section established as an organization that is independent from sales department and internal control division.

- Formulation and implementation of an effective internal audit plan according to the type and degree of risk in the audited department

- Important matters pointed out in the internal audit to be reported to the internal control division and the Board of Directors without delay

Compliance: Formulation and practice Compliance programs and codes of conduct as part of business management

- Establishment of educational system for fostering and improving compliance awareness among executives and employees

Respond to irregularity: the following measures to be taken promptly in case of irregularities

- Report to the internal management department and board of directors, report to the association

- In case that there is a possibility of violating the criminal law, report to the police etc

- Investigation and elucidation by the internal audit section, formulation of improvement measures to prevent reoccurrence, pursuit of responsibility of those involved

- Implementation of necessary measures to protect users who have been affected by irregularities



# 5 - ②. Rules on the handling of Virtual Currencies

Internal review and prior notification to the association is required to handle a new Virtual Currency.  
If the Association expresses objections the member cannot handle it.

- Modeling review items in a report form

Review items: status of issuance / transactions, technical matters, conditions of managers / recorders / holders,  
management capacity of the member

- Information disclosure: disclose the outline document of the Virtual Currency permitted by the Association

\*I The Association prohibited handling of Virtual Currencies that has problems in protecting users or public interest

- ① Virtual currencies which serious obstacles or concerns are found in updating/retaining of transfer records and holding records
- ② Virtual currencies which proper auditing by a certified public accountant or an auditing corporation can not be carried out
- ③ Virtual currencies which the member can not securely store, accept or deliver due to systemic problem etc.
- ④ Virtual currencies which the member can not fulfill obligations under the PSA properly and reliably

\*2 Regarding the Virtual Currencies that can not be traced of transfer records (so-called anonymous virtual currencies), the Association prohibits those because there are problems from the viewpoint of ensuring AML / CFT and appropriate audits unless these problems are solved.

## 5 - ③. Rules on the management of user property

In order to protect the user property, in compliance with the separation management obligation and the administrative guidelines under the PSA, setting additional rules such as measures concerning margin trading of Virtual Currency

Development of control environment: Establishment of separation management department,  
educational training / business instruction, prohibition of concurrently serving as a cashier and a person in charge of collation, Measures such as regular replacement of each person in charge to prevent accidents, frauds, etc.

Management of money: Calculate and record Individual User Segregated Management Amount (the amount calculated for each user on deposit from the user based on trading of virtual currency etc.) and the Necessary Amount of User Segregated Management (the total amount of Individual User Segregated Amount) every business day.

When calculating Individual User Segregated Management Amount of a user who conduct margin tradings, calculate and reflect the valuation gains and losses of the positions held by the user.

The amount required to prevent the situation that the balance of the account that separately manages deposits (Segregated Management Deposit) runs short of the Necessary Amount of User Segregated Management must be determined by members' internal rules, and it must be managed in the Segregated Management Deposit together with the deposit of users

Management of virtual currency: Calculate and record Individual User Segregated Management Amount (the amount calculated for each user for the virtual currency deposited by the user based on trading of virtual currency etc.) and Necessary Amount of User Segregated Management (the total amount of Individual User Segregated Amount) every business day

Setting maximum limit of virtual currency managed online (set according to remittance quantity per unit time)

Notify the user of private key storage environment (by on-line / off-line basis) and storage policy on the company's website etc. (as long as the disclosure not threatening user protection)

Measures necessary to prevent illegal diversion by receipt and payment personnel such as multisig

# 5 - ④. System related rules

- Rules and Guidelines on system risk management
- Rules and Guidelines on the safety management of information
- Rules and Guidelines on Emergency Response

In order to achieve user protection, based on the recognition that it is an urgent task to strengthen the foundation of the overall system risk management in the industry as a whole, in addition to the provisions in compliance with the PSA and JFSA guidelines, setting additional rules to develop risk management system.

System risk management: Appointment of system supervisor, appointment of system administrator for each department,

Introduction of a multi-layered defence system against cyberattacks, measures to prevent damage from expanding when cyberattacks occur, appropriate authentication methods in line with the risks associated with transactions

Verification and planned improvement of risks inherent in the system, formulation of quality control program,

Certain execution of quality assessment at system development and pre-introduction test, operational state monitoring,

Periodic system audits, outsourcing management including cloud services etc.

Information security: Establishment of information security policy and disclosure of its outline, formulation of information security committee and appointment of chief information security officer, appointment of information management officer for each department

Formulation of risk standards related to information security, identification, analysis, evaluation and response of risks

Identification of important user information, formulation of management rules, prevention of unauthorized access and information leaks

Periodic checkout of vulnerability etc. against intrusion into the virtual currency management system etc.

\* The provisions concerning the management of virtual currency are the immediate measures and will be revised in a timely manner based on discussions on the security management of virtual currency among both in Japan and overseas.

Emergency response: Formulation and renewal of contingency plan, establishment of liaison system with related organizations, implementation of training

Improvement of business continuity system related to important systems, installation of backup system, Report on system troubles affecting transactions with users

# 5 - ⑤.AML / CFT · anti counter measure related regulation

- Regulations and guidelines on money laundering and countermeasures against terrorism financing (AML / CFT)
- Regulations on interruption of relations with antisocial forces

Provisions of the AML / CFT procedures required by virtual currency exchange companies in compliance with the FSA AML / CFT guidelines

Risk-based approach: We must properly identify and evaluate the risks we face and take measures to reduce them according to risk

KYC · CDD: Regardless of the provisions of the criminal law, even at the time of providing Wallet, etc., it is subject to confirmation at the time of dealing  
Continue to screen new and existing users utilizing sanctions list, PEPs list, etc. as well as anti-company information  
In addition to ongoing user management, management of business partners etc. is also carried out

Transaction management: Detect suspicious transactions by monitoring transactions taking account of user attributes, information on the situation at the time of dealing, thorough reporting to the authorities

Data management: Confirmation record · Implement accurate database of transaction records, evaluate risk using database and verify effectiveness of reduction measures  
Establishment of detection, monitoring and analysis of suspicious transactions, etc. according to business content or · business type.

Management involvement: We position AML / CFT as one of the important tasks in the management strategy, etc., the management team is actively involved and maintains this as a priority.  
Establishment of responsible person: AML / CFT, establishing the person responsible for anti-countermeasure s, establishment of information transmission rules to responsible persons procedure

Securing and training staff: Confirmation of the suitability of staff involved in AML / CFT through recruitment, training, etc.

# 5 - ⑥. Rules related to grievance and dispute resolution

Preliminary explanation (information disclosure):

Basic policy on complaint handling etc., department in charge or name of responsible person, address of department in charge, reception phone number, e-mail address etc, reception time, name of ADR and communication method, complaint to association Consultation method

\* For the explanation to the user concerning the above matters, it is stipulated in "Rules on management and explanation of users".

Construction of Complaint Handling System:

Enhancement of complaints window, etc. so that users can make complaints and other requests easily and efficiently, Sharing information among necessary stakeholders such as reporting serious cases to the internal audit division · management team

Storage of Complaints Records :

Regulations to record and save actions on each complaint until record processing is completed.

Use of financial ADR:

Partnership with financial ADR operated by Tokyo Three Bar Association  
Information exchange on complaints and conflict situations, consultation on how to deal with problems common to the industry

Acceptance of complaint by our association: We accept complaints to members through association website and telephone

We promptly deploy the received information to the target member and ask for explanation of situation and action

Follow the members' handling of the situation until resolution and urge response in case of delay

# 5 - ⑦. Rules related to business conduct

- Regulations on solicitation and advertisement etc. · Guidelines
- Rules on management and explanation of users · Guidelines

Solicitation / advertisement: In view of the price fluctuation situation of the virtual currency, refer to the Financial Instruments and Exchange Act

Criteria for starting recruitment (compliance principle, limitation on solicitation for elderly and minors)

Prohibition of invitation without user's consent, prohibition of recruitment to users who refused solicitation

Prohibited acts at the solicitation (offering of profits, false announcements, provision of judgmental judgment, mass-sale recommended sales, insider information transaction etc.)

Display obligations in advertisements (essential items, font sizes etc.), prohibition of hype

Prohibition of advertisement aimed at fueling emargy heart or competitive spirit

Affiliate advertising regulation, SNS usage regulation

Establish advertisement review personnel, save review record

Information disclosure and explanation obligation: In addition to the explanation based on the fund settlement law, disclosure matters are added with reference to the financial and commercial law

Transaction type

- ① buying and selling or exchanging virtual currency or ② intermediary, intermediary or substitute for the act ①, management of user property concerning ① or ② action

Transaction method

① Competitive sales transaction / ② Market making type transaction / ③ OTC over-the-counter transaction

In the transaction method of ① or ②, when the member deals with the user as a market maker etc., the fact and reason

Explanation about transaction fee etc. (Including explanation on spread)

Compensation policy when virtual currency leaks by cyber attack

Business report, content of the most recent financial documents · audit report

Measures to prevent conflicts of interest with transactions with users, risk of damage to user assets at the time of membership failure

Provide annual report to contribute to taxpayers' support

Explicit prohibited items of users (counterfeit, camouflage, intimidation, etc., market maneuver, dissemination of rumor, pseudonym / borrow name, insider trading, false declaration etc)

# 5 - ⑧. Transaction business related rules

· Regulations on the improvement of the order management system · Guidelines · Regulations on the development of the trading examination system to prevent inappropriate transactions · Guidelines · Regulations on the development of the management system for virtual currency related information · Guidelines

To raise the reliability of virtual currency transactions through fair prices, orders and contracts, regulations referring to the Kommunal Code and others.

Order management system: stipulate obligations to maintain order reception and contract processing

Prevention of detachment from benchmark price, measures to cope with sudden price changes such as circuit breakers

Reporting and announcement when the order acceptance or contract processing has stopped and delayed for more than 1 minute is recognized as a system failure

Prohibition of transactions that you do as opponent without obtaining prior consent from the user

Provision of benefits, settlement etc. delayed act, short sale, prohibition of nominal lending

Preventing inappropriate transactions: Improvement in the establishment of transaction review division etc.

Specific contents of improper transaction

· Certain actions (such as the dissemination of rumor, etc.) that are done for the purpose of price fluctuation, market manipulation, transactions by fictitious name

· Transactions using "virtual currency relationship information" by insiders

Mandatory transaction review for inappropriate transactions and reporting to our association

Virtual currency relation information: important information on undisclosed members and other virtual currency handlers and insiders (issuers and administrators of the virtual currency or related parties) and is used for transaction judgment on the virtual currency Information recognized as having significant influence

Appropriate management of virtual currency relation information (establishment of information management department, preparation and storage of register, release to users)

Prohibition of transmission by executives and employees, prohibition of solicitation, etc. using virtual currency related information, prohibition on own trading

Report to the transaction detection department of transactions by insiders, refusal of transaction etc. in certain cases

# 5 - ⑨. Margin trading rules

In order to suppress loss risk and excessive speculative transactions of users in leveraged transactions using virtual currency, the margin ratio is stipulated with reference to the method of determining the margin rate in derivative transactions, and other margin trading operations need to be stipulated.

Margin multiplier: selective use of the level specified by association itself = 4 times (margin rate 25%) or the level determined by the members themselves (provisional measures for one year)

Considering the occurrence of receivables from members within one year, unified to the level specified by the association

\* When a member decides the magnification ratio himself / herself generates a receivable within one year, the member shall stipulate that the member must promptly devalue the magnification to a level at which the receivable will not occur.

※ Basis for Association designated level (4 times)

Starting from March 31, 2018, the daily price fluctuation rate of the bit coin which is the main virtual currency was taken as a sample, with the target period of 3 months, 1 year, 3 years as the sample. From the viewpoint of preventing the occurrence of accrued money, the line where 99.5% of the sample fits is taken as an appropriate value, and the value which fits in this line in any period is extracted. As a result, since the value of the variation rate of about 25% was obtained, the margin magnification was set to 4 times

Loss cut transaction: When introducing Loss cut transaction, if accrued receivable (loss exceeding margin) occurs, report to association

Prevent price discrimination: stipulate that measures to prevent deviation from benchmark price of margin trading price should be taken

Proprietary trading: In order to clarify the involvement of proprietary trading in margin trading, prohibit the publication of the proprietary trading result of each month, affecting the formation of other transaction prices, etc.



# 5 - ⑩. Rules on financial management

Under the understanding that market risk, supplier risk, operational risk, liquidity risk should be properly managed to maintain the financial soundness of virtual currency exchange operators involved in settlement systems, as a specific measure, Consideration of self-regulation rule on matters of.

- Self position management

To limit the self-position limit, taking into account the net asset value, and the price fluctuation risk caused by the self position and to operate within that range.

- Monitoring self-position risk

To monitor the market price and profit and loss amount of own virtual currency as appropriate and control the position so as not to cause serious damage of net assets.

- Cash management based on liquidity of self-holding virtual currency

When holding a virtual currency with low liquidity, manage positions and funds states so that they will not be caught quickly even in emergency situations such as market crashes.

- Financial statements · Business reports

To make it easier for users to verify the financial status of members, make regular announcements.

In addition, required to conduct financial management of the members through the financial soundness index (index indicating the soundness of the members' financial condition) calculated by the method specified by the association, and regularly publish the index. However, with regard to specific calculation methods and others, we will continue to consider important factors in calculations, such as counterparty risk, and decide on it.

## 5 - ⑪. Business Ethics / Disposal Related Rules

- Regulations concerning possession and compliance of ethics codes in members
- Rules and regulations on employee employment etc · Guidelines
- Regulations and procedures concerning dispositions etc. to members
- Appeals Board Rules
- Regulations concerning member survey

In addition, formulate the above-mentioned 5 rules / guidelines as self-regulation rules related to management ethics and disposition to members.

Among them, "Rules on Employee's Duties" stipulates the prohibition of transactions using internal information by executives and employees.

# 5 - ⑫. Rules on Handling of ICO

The members consider voluntary restrictions on cases where they conduct the following acts.

- (1) An act of a member issuing a virtual currency stipulated in the Payment Services Act itself and selling the virtual currency to the user or exchanging it with another virtual currency
- (2) An act of selling or exchanging virtual currency issued by a third party other than the members based on the request of the third party, or exchange with another virtual currency

Consider, for example, the following items to formulate self-regulation rules

Examination: Examination of eligibility, feasibility and feasibility of target project

Disclosure: Continuous information provision at the beginning of sales, at the end of sales, after sales

Safety assurance: Verify the safety of blockchains and smart contracts used for their own virtual currency, wallets that store the virtual currency, etc.

Procurement Fund: Prohibit from using procured funds for purposes other than the use of funds disclosed to users

Selling price: Review the appropriateness of the range of selling price etc. using a reasonably calculable method such as survey of investment demand as necessary when conducting sales operations

## 6. Date of enforcement

- In principle, it will be enforced at an early stage in order to acquire the certification of our association. However, since the range of self-regulatory rules varies and the members' business styles and operations also vary, based on the opinion of the member, for example, it is necessary to gradually enforce the part requiring a period for thoroughly notifying the user, the part requiring additional personnel securing, and the part requiring the system renovation, we plan to make adjustments such as establishing transitional measures.