

FINANCIAL REGULATION BULLETIN

April 2017

FinTech Newsletter

- Japanese Virtual Currency Regulations take effect in April 2017 -

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I. Japan's Virtual Currency regulations coming into effect

In the FinTech industry, virtual currency has recently drawn much attention due to the recent coming into effect of Japan's first virtual currency law. The revised Payment Services Act of Japan (the "**PSA**", or (as revised) the so-called "**Virtual Currency Law**"), together with the relevant regulations¹ and the Guidelines² (collectively with the Virtual Currency Law, the "**VC Regulations**"), came into effect on April 1, 2017.

The VC Regulations, the very first set of legal regulations on virtual currency under the Japanese legal system, are a significant legal development in Japan for three important reasons. One, they define "**Virtual Currency**". Two, they require providers of "Virtual Currency Exchange Services" ("**VCE Services**") such as virtual currency exchanges to register with the Financial Services Agency of Japan (the "**FSA**") as "Virtual Currency Exchange Service Providers" ("**VCE Service Providers**"). Three, they require VCE Service Providers to comply with various obligations in order to protect users.

In particular, the Guidelines provide for interpretive guidelines on what constitute Virtual Currency and VCE Services and are important for those who are engaged not only in exchange operations but also in other businesses using Virtual Currency. This newsletter will discuss the key issues under the VC Regulations that those business operators should keep in mind.

¹ Revised Order for Enforcement of the Payment Services Act (the "**Order**") and the Cabinet Office Ordinance on Virtual Currency Exchange Service Providers (the "**Ordinance**").

² Guidelines relating to Virtual Currency Exchange Service Providers issued by the Financial Services Agency of Japan (the "**Guidelines**").

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II. Virtual Currency and VCE Services under the VC Regulations

1. “Virtual Currency”

Under the Virtual Currency Law, a “Virtual Currency” is a token which has all of the following features³:

Features of Virtual Currency

- (i) It can be (a) used to pay unspecified people in exchange for purchasing or leasing goods, or getting services, and (b) purchased from and sold to unspecified people;
 - (ii) It is an electrically recorded proprietary value that is transferred through a computer network; and
 - (iii) It is not classified as Japanese or foreign legal currencies, or currency denominated assets.
- * “Virtual Currency” also includes proprietary value which can be mutually exchanged for another Virtual Currency which has all the features listed above, with unspecified people.

The key element of the definition of “Virtual Currency” is whether feature (i) above is satisfied (*i.e.*, whether it is circulated). The Guidelines stress this point and take into particular account (a) whether the shops in which the token can be used for payments are limited by the contracts with the token issuer, and (b) whether the token can be exchanged for Japanese or foreign legal currencies in the market without any restriction by the issuer.⁴ Accordingly, Virtual Currency under the Virtual Currency Law does not include traditional electronic money, in-game money and free coupons because those are available only in specific stores or games.

Although Virtual Currency functions as a means of payment, the VC Regulations do not recognize Virtual Currency as a legal currency which is considered legal tender. Unlike legal currency which can be used to make valid payments which payees cannot refuse to accept, payments by Virtual Currency need the payees’ consent.

However, the law on consumption tax was recently revised to classify Virtual Currency as a “means of payment”.⁵ As a result, the purchase of Virtual Currency using legal currency is not subject to consumption tax in

³ PSA, Article 2, Paragraphs 5 and 6.

⁴ Guidelines, Section I-1-1.

⁵ Revised Order for the Enforcement of the Consumption Tax Act of Japan.

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Japan. The revision will become effective on July 1, 2017, thereby giving a boost to the Virtual Currency business.

2. Regulation of Virtual Currency businesses

The following services are VCE Services under the Virtual Currency Law:⁶

Virtual Currency Exchange Services

- (i) Purchase and sale of Virtual Currency, or exchange for another Virtual Currency;
- (ii) Intermediary, brokerage or agency for (i) above; and
- (iii) Management of users' funds (legal currency) or Virtual Currency in connection with (i) or (ii) above.

VCE Services include (a) the operation of exchanges where users may trade Virtual Currency and (b) conversion services between legal currency and Virtual Currency, and between different Virtual Currencies. But they do not include wallet services for Virtual Currency unless the service provider offers services (i) or (ii) above.

While the range of businesses using Virtual Currency is expanding, it remains difficult to determine the status of some kinds of services under the VC Regulations and the regulations on other financial services. Therefore, the Guidelines mentioned some notable points, such as applicability of other financial regulations, concerning Virtual Currency businesses.

For example, Virtual Currency can be used in remittances or as a means of settlement. Because Virtual Currency makes overseas remittance cheaper than the traditional form of remitting money, some VCE Service Providers offer overseas remittance to and from foreign employees and students. The Guidelines note that "Remittance Services", which are regulated by the Banking Act and other rules of the PSA, refer to a money transfer, at the remitting party's request, from the remitting party to the receiving party in a different location without the direct delivery of money.⁷ If remittance services using Virtual Currency are considered "Remittance Services", then these services require either (i) a license under the Banking Act or (ii) if the amount of each remittance never exceeds JPY 1 million, registration as a "Funds Transfer Service Provider" under the PSA.

⁶ PSA, Article 2, Paragraph 7.

⁷ Guidelines, Section I-1-2.

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In addition, in practice, some exchanges offer margin trading in Virtual Currency. This is similar to foreign exchange margin trading that is considerably popular among Japanese individual traders. Under the Guidelines, within derivative trading in Virtual Currency, VCE Services do not include difference trading, which never ends with physical delivery.⁸ For the purpose of protecting users, however, the Guidelines suggest that VCE Service Providers offering margin trading should set appropriate rules of leverage ratio and loss cut,⁹ and should inform users of the risks related to margin trading.¹⁰ At the same time, service providers should keep in mind that the business of lending money is subject to the Money Lending Business Act and other regulations. If exchange services involve lending money to users who trade in Virtual Currency in the form of margin purchases, it is arguable that the service provider must be registered as a money lender under these regulations.¹¹

Lastly, the Virtual Currency Law does not restrict VCE Service Providers from engaging in other kinds of businesses or allowing their officers to become officers in other companies. This would help alliances between different kinds of businesses.

III. Key points of the VC Regulations

1. Application for registration

Service providers who intend to start VCE Services are required to register under the Virtual Currency Law.¹² In the meantime, operators which are already providing VCE Services as of April 1, 2017 have a grace period of six months to file their applications for registration.¹³ Even during the grace period, however, they are subject to the same regulations applicable to registered service providers as if they were already registered as VCE Service Providers.¹⁴ The VC Regulations provide that the formal application process generally takes about two months.¹⁵ However, in practice, it would probably take another couple of months to prepare for the application including conducting preliminary discussions with the FSA regarding

⁸ *Id.*

⁹ Ordinance, Article 18; and Guidelines, Section II-2-2-1-2(5).

¹⁰ Ordinance, Article 17; and Guidelines, Section II-2-2-1-2(2)①.

¹¹ Guidelines, Section I-1-2.

¹² PSA, Article 63-2

¹³ Amendment Act revising the PSA as the Virtual Currency Law, Supplementary Provision Article 8, Paragraph 1.

¹⁴ *Id.*, Supplementary Provision Article 8, Paragraph 2

¹⁵ Ordinance, Article 36, Paragraph 1.

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registration requirements.

(a) Application materials

The application requirements include a description of the services and other matters specified under the VC Regulations¹⁶ and the submission of required attachments detailed by the regulations.¹⁷

In particular, the applicant must provide an “outline of the Virtual Currency used for the service”¹⁸ and attach materials describing the outline to the application form.¹⁹ The outline must include the name, the unit, the system (including the process of issuing and transferring Virtual Currency), whether there is an issuer, the risks, and other features that make that Virtual Currency recognizable to users.²⁰ Applicants would prepare their applications based on descriptions appearing in white papers which are available to the public if the Virtual Currency that will be used for the services is a major currency and is already being circulated.

The applicant must also detail the VCE Services, including information on the service name, the name of the Virtual Currency, the contents of the services, how to determine exchange rates between legal currency and Virtual Currency and between different Virtual Currencies, operating days and hours, and the fees and costs that users will pay.²¹ The required attachments to the application include the applicant’s organizational chart, financial documents, pro-forma income statements for the coming three years, internal rules and forms of contracts with users.²² Applicants may refer to the application requirements for the registration of Funds Transfer Service Providers since the required attachments partly overlap.

(b) Requirements for registration

Applicants for registration as VCE Service Providers must:²³

- (i) be either (a) a stock corporation formed in Japan or (b) a foreign company which legally operates VCE Services abroad, and has an office and a resident representative in Japan;
- (ii) have a capital of at least JPY 10 million and a positive net asset worth;²⁴
- (iii) have an internal system to ensure that it complies with the relevant

¹⁶ PSA, Article 63-3, Paragraph 1; Ordinance, Article 5.

¹⁷ Ordinance, Article 6.

¹⁸ *Id.*, Article 5, Item (i).

¹⁹ *Id.*, Article 6, Item (xi).

²⁰ *Id.*, Form I, Section 7.

²¹ *Id.*, Form I, Section 4.

²² *Id.*, Article 6.

²³ PSA, Article 63-5, Paragraph 1.

²⁴ Ordinance, Article 9.

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regulations and offers the services properly and reliably (please see Section 2 below);

- (iv) not use a company name which may be confused with the names of existing VCE Service Providers;
- (v) not engage in another business that is contrary to public interest; and
- (vi) not fall under any disqualification applicable to the applicant and its officers.

2. Internal system of VCE Service Providers

VCE Service Providers must have an internal system for ensuring that they comply with the relevant regulations and offer their services properly and reliably. The following, some of which are unique to VCE Service Providers, are the main things that an internal system must cover:

The main things to be covered by the internal system of VCE Service Providers

- (i) management governance
- (ii) compliance
- (iii) elimination of ties with antisocial groups
- (iv) system and security management
- (v) management of users' information
- (vi) segregation of users' funds and Virtual Currency
- (vii) supervision of outsourcing contractors
- (viii) provision of information to users
- (ix) other actions for protecting users
- (x) complaint handling process and financial ADR system
- (xi) measures for disabled people
- (xii) actions relating to supervision by regulators
- (xiii) AML/CFT (anti-money laundering and combating the financing of terrorism)

(a) Segregation of users' funds and Virtual Currency

When users deposit their funds and Virtual Currency into a VCE Service Provider, that provider must manage the users' assets separately from its own assets in the following manner.²⁵

²⁵ PSA, Article 63-11; Ordinance, Article 20.

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Segregation of users' assets

Users' funds must be managed by either:

- (i) depositing the funds into a deposit account held at banks or other financial institutions, provided that (a) the account is in a name indicating that the deposited funds belong to the users and (b) the VCE Service Provider checks the account balance daily and makes up for any deficiency within two business days if the actual balance in the bank account is insufficient for the amount of money recorded on the VCE Service Provider's own books;²⁶ or
- (ii) setting a money trust with trust banks which satisfy certain requirements (such as guarantee of the principal) imposed by the VC Regulations.²⁷

Users' Virtual Currency must be managed by implementing the following:

- (i) If the VCE Service Provider itself manages users' Virtual Currency, then it must:
 - (a) clearly separate the users' Virtual Currency from its own Virtual Currency; and
 - (b) manage each user's Virtual Currency such that one can identify the amount of Virtual Currency belonging to each user (including through the keeping of records).
- (ii) If the VCE Service Provider outsources the management of users' Virtual Currency, it must cause the outsourcing contractor to undertake the same measures described in the preceding paragraph (i).

Audit on segregation

A VCE Service Provider must be subject to a yearly external audit on the segregation by a certified public accountant or an audit corporation.²⁸

While a VCE Service Provider is required to make a clear distinction between its own and the users' Virtual Currency, the VC Regulations do not require that each user's Virtual Currency be managed in a different individual wallet since the identification through records would be sufficient to manage each user's Virtual Currency. However, a VCE Service Provider must cross-check the total outstanding amount of users' Virtual Currency recorded on its own book with that on the network such as blockchains. If there is a

²⁶ Guidelines, Section II-2-2-2(1)④.

²⁷ Ordinance, Articles 21 and 22.

²⁸ *Id.*, Article 23.

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deficiency in users' Virtual Currency, the VCE Service Provider must make up for the shortage within five business days.²⁹

The Guidelines require VCE Service Providers to manage the secret key for users' Virtual Currency separately from the key for their own Virtual Currency.³⁰ In addition, VCE Service Providers are required to hold users' Virtual Currency in cold wallets which are not connected to the Internet unless it makes the services inconvenient for the users.³¹ To protect Virtual Currency from being attacked and stolen by hackers, cold wallets rather than hot wallets (connected to the Internet) are practically used to hold Virtual Currency which the holder is not trading. The Guidelines essentially follow current practice in ensuring the security of users' Virtual Currency.

When a VCE Service Provider informs users of its services, it must explain the segregation obligation of providers and the details of the segregation method adopted by that provider.³²

(b) Supervision of outsourcing contractors

Since the main players in the Virtual Currency industry are VCE Service Providers which are startup companies, they typically outsource parts of their services to outsourcing contractors. Accordingly, the registration application form requires the contractor's name and a description of the outsourced services.³³ The VC Regulations also require that, in supervising the outsourcing contractors, VCE Service Providers take measures to:³⁴

- (i) ensure that the outsourcing contractors have the ability to operate the outsourced services;
- (ii) ensure there is necessary and appropriate supervision over the outsourcing contractors, including inspecting the outsourced services regularly or as necessary and causing the contractors to remedy problems;
- (iii) respond to users' complaints in connection with the outsourced services;
- (iv) protect users, including by having a contingency plan to replace the outsourcing contractors with other contractors; and
- (v) be able to amend or terminate the outsourcing contracts to ensure that

²⁹ Guidelines, Section II-2-2-2(1)③.

³⁰ *Id.*, Section II-2-2-2(1)⑥.

³¹ *Id.*, Section II-2-2-2(1)⑦.

³² *Id.*, Section II-2-2-1-2(2)⑥.

³³ PSA, Article 63-3, Paragraph 1, Item (ix); and Ordinance, Article 6, Item (xvi).

³⁴ Ordinance, Article 15.

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the VCE Service Providers provide their services properly and reliably.

The VC Regulations do not limit the scope of the services that VCE Service Providers may outsource. In any case, the VCE Service Providers are not relieved of their obligations simply by outsourcing the services. For example, while a VCE Service Provider may outsource the segregation of users' Virtual Currency, the VCE Service Provider must cause the contractor to comply with the requirements of the VC Regulations and will remain liable as VCE Service Provider.³⁵

(c) Information provision to users

For the purpose of protecting users, the VC Regulations require VCE Service Providers to inform users regarding the services through written documents, e-mail or other appropriate manners.³⁶ A VCE Service Provider offering the services on the Internet may display the necessary information on its website and request the users who understand the information to click an acknowledgement button on the screen.³⁷

VCE Service Providers are required to provide to a user:³⁸

- (i) information to prevent the user from mistaking Virtual Currency for Japanese or foreign legal currencies – before providing the services;
- (ii) information on the contents of the services and the fees – before the user (a) makes a transaction or (b) enters into an agreement for repeating transactions (such as a contract for opening a wallet account) with the provider;
- (iii) a deposit receipt for the user's funds or Virtual Currency – at the time of the receipt of the funds or Virtual Currency; and
- (iv) a report on the user's transactions and the user's funds and Virtual Currency deposited in the VCE Service Provider – at least once a quarter (if it repeatedly transacts with the user).

The information under item (ii) above must include risks of loss that may result from changes in the value of the Virtual Currency and important factors that may influence users' decision on transactions.³⁹ Examples under the Guidelines include explaining the main feature of Virtual Currency (that is, it is an electrically recorded proprietary value that is transferred through a computer network) and risks of loss or decrease in the value of

³⁵ Guidelines, Section II-2-2-2(1)⑧.

³⁶ PSA, Article 63-10.

³⁷ Guidelines, Section II-2-2-1-2(1)①.

³⁸ Ordinance, Articles 16 and 17.

³⁹ Ordinance, Article 17, Paragraph 2, Items (v) and (vi).

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Virtual Currency caused by cyber attacks.⁴⁰ Although existing exchanges had been informing users of the risk factors and other important information even before the Virtual Currency Law came into effect, they are now required to do so under the VC Regulations.

(d) Obligations to prepare, keep and report records

Under the VC Regulations, VCE Service Providers must prepare and keep the following records in the following manner:⁴¹

<i>Records</i>	<i>Retention Period</i>
(i) transaction records regarding VCE Services (ii) general ledger (iii) user ledger	10 years
(iv) records of the amount of users' funds and Virtual Currency (v) records of the amount of entrusted funds (if the VCE Service Provider manages users' funds by setting up a money trust) (vi) results of audit on segregation	5 years
<i>Manner</i>	
The VCE Service Providers must keep the records in writing in Japan, except that:	
(i) they can prepare the original records outside Japan but promptly prepare and keep copies of the records in Japan; or	
(ii) they can prepare the records in electric form and promptly make the recorded matters available for inspection in an office in Japan.	

In addition, VCE Service Providers are required to regularly submit the following documents to the FSA:⁴²

<i>Documents</i>	<i>Frequency; Deadline</i>
(i) Report on the VCE Services business and earnings,	Each fiscal year; within 3 months after the end of the fiscal year

⁴⁰ Guidelines, Section II-2-2-1-2(2)①.

⁴¹ PSA, Article 63-13; and Ordinance, Articles 26 to 28.

⁴² PSA, Article 63-14; and Ordinance, Articles 29 and 30.

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accompanied by a balance sheet, an income statement and an audit report	* The audit report is not required for the fiscal year during which the Virtual Currency Law took effect. ⁴³
(ii) Report on the management of users' assets, accompanied by a balance certificate and an audit report on segregation	Each quarter; within 1 month after the end of the quarter

3. AMT/CFT Regulations

The revised AML/CFT regulations,⁴⁴ which became effective on April 1, 2017, apply to registered VCE Service Providers as well as existing but yet-to-be-registered service providers. In general, the regulations require financial institutions to (i) verify and record the identity of customers when conducting certain transactions (that is, a KYC process),⁴⁵ (ii) record transactions with customers,⁴⁶ (iii) report suspicious transactions to the FSA,⁴⁷ and (iv) take measures to keep information regarding customer verification up-to-date, provide education and training for employees, and develop other necessary systems for properly conducting the processes described in the preceding clauses (i) to (iii).⁴⁸

VCE Service Providers must conduct a KYC process⁴⁹ when:

- (i) they enter into an agreement (such as a contract to open a wallet account) with a user to repeatedly provide VCE Services or to manage the user's funds or Virtual Currency;
- (ii) they provide VCE Services in an amount exceeding JPY 2 million; or
- (iii) at a user's request, they transfer to a third party the user's Virtual Currency managed by them in an amount exceeding JPY 100,000.

Although transaction (iii) above does not fall within the scope of VCE Services as defined in the Virtual Currency Law, VCE Service Providers should keep records of the transaction in order to comply with the AML/CFT regulations.

If VCE Service Providers had conducted a KYC process prior to the

⁴³ Ordinance, Supplementary Provision Article 3.

⁴⁴ Act on the Prevention of Transfer of Criminal Proceeds (the "APTCP") and the relevant laws.

⁴⁵ APTCP, Articles 4 and 6.

⁴⁶ *Id.*, Article 7.

⁴⁷ *Id.*, Article 8.

⁴⁸ *Id.*, Article 11.

⁴⁹ Order for Enforcement of the APTCP, Article 7, Paragraph 1, Item (i).

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effective date of the new regulations, they do not have to go through another KYC process as long as the requirements of the new regulations are satisfied.⁵⁰

NEWS

➤ Chandler MHM Limited Starts Operations

Mori Hamada & Matsumoto is pleased to announce that it has, through its Bangkok Office, integrated its business with that of a leading law firm in Thailand, Chandler & Thong-ek Law Offices Limited (“CTLO”), and CTLO has changed its name to Chandler MHM Limited (“CMHM”). CMHM started operations on January 4, 2017.

The firm first opened its Bangkok Office, operated under the name of Mori Hamada & Matsumoto (Thailand) Co., Ltd., in April 2015. Prior to its integration with CTLO, Mori Hamada & Matsumoto (Thailand) Co., Ltd. was staffed with four Japanese lawyers and one Thai lawyer. After this business integration, CMHM will have a significantly larger support structure, thereby establishing a stronger presence in the Thai legal market and increasing the firm’s ability to meet the growing and varied demands for legal services throughout the Southeast Asian region.

Satoshi Kawai, a partner of the firm with abundant experience in cross-border M&A and other commercial transactions, has taken the position of Managing Partner of CMHM with the current managing partner of CTLO, Niwes Phanchaoenworak. Three Japanese lawyers from Tokyo, Singapore and Jakarta have also transferred to CMHM, reinforcing the support structure in Bangkok and providing CMHM with a staff of more than 50 lawyers, including the Thai and U.S. lawyers who have joined from CTLO. Mori Hamada & Matsumoto stands out among Japanese law firms having bases in Thailand and throughout the Southeast Asian region.

MHM will continue to encourage all its lawyers throughout the firms’ offices in Tokyo, Osaka, Nagoya, Fukuoka, Beijing, Shanghai, Singapore, and Yangon, as well as the Jakarta Desk and the newly-opened Chandler

⁵⁰ Amendment Act revising the Order for the Enforcement of the APTCP, Supplementary Provision Article 8.

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MHM Limited, to work seamlessly together to provide the best possible legal services for its clients.

➤ [29 new lawyers joined Mori Hamada & Matsumoto](#)

➤ [Ryuichi Shitara joins Mori Hamada & Matsumoto](#)

Ryuichi Shitara, who retired as the Chief Judge of the Intellectual Property High Court in January 2017, joined Mori Hamada & Matsumoto on February 15, 2017 in the role of special counsel.

Mr. Shitara has been involved in the practice of intellectual property right litigation at the Intellectual Property Division of the Tokyo District Court, the Intellectual Property High Court, and other courts. He also performed a central role in international activities related to intellectual property right litigation as the Chief Judge of the Intellectual Property High Court.

By welcoming Mr. Shitara as a special counsel, Mori Hamada & Matsumoto will further endeavor to provide our clients with even higher levels of quality in legal services related to intellectual property right disputes.

➤ [Four new partners and three new of counsels](#)

As of January 1, 2017, four lawyers became partners of the firm.

Partners:

Mitsue Tanaka, Susumu Hanawa, Kunihiro Watanabe and Fuyuki Kojima

Also, three lawyers became of counsels as of January 1, 2016.

Of Counsels:

Hisashi Shibata, Jie Yuan and Yan Sun

The firm appreciates your continued support.

➤ [Hirotaka Murakami, a certified public accountant and a licensed tax accountant joined Mori Hamada & Matsumoto and MHM Tax Advisory Services](#)

Hirotaka Murakami, a certified public accountant and a licensed tax accountant, joined Mori Hamada & Matsumoto and MHM Tax Advisory

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Services on March 1, 2017.

After working at the Tokyo Regional Taxation Bureau, he worked at Deloitte Touche Tohmatsu LLC. At the Tokyo Regional Taxation Bureau, he oversaw tax investigations in relation to corporate income tax, consumption tax, withholding tax, stamp tax, and the like and at Deloitte Touche Tohmatsu LLC, he audited accounts and provided various accounting support services.

With the addition of Mr. Murakami to our teams, our ability to provide tax services integrated with legal services will further improve.

- [Top rankings received from Best Lawyers in the Eighth edition of "The Best Lawyers in Japan"](#)

Hideki Matsui, Daisuke Oda and Akira Ehira were selected as "best lawyers" in the practice area of Financial Institution Regulatory Law in the eighth edition of "The Best Lawyers in Japan" by the Best Lawyers survey.

- [Top rankings received from Chambers Global 2017](#)

Toru Ishiguro was evaluated highly in the practice area of Banking & Finance: Financial Services Regulation, by Chambers Global 2017.

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