

Japan Newsletter | Volume 2



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Is Japan Poised for a New Era of Financial Innovation? Understanding the Latest Legislative Changes in 2024

Japan is on the brink of a transformative period in its financial landscape, driven by recent legislative changes aimed at fostering innovation and supporting economic growth. Despite facing challenges such as a brief recession in late 2023 and subdued domestic demand, Japan's economy is showing signs of resilience and recovery. The country has successfully navigated the complexities of the COVID-19 pandemic and regional geopolitical tensions, emerging as a stable and attractive destination for foreign investment. In addition, Japan offers a transparent and predictable business environment that upholds the rule of law and intellectual property rights.

In August 2024, the Japanese stock market experienced significant volatility, initially crashing due to a surprising rate hike by the Bank of Japan, which led to a sharp appreciation of the yen. However, the market quickly rebounded, demonstrating its underlying strength and investor confidence. This period of turbulence underscores the dynamic nature of Japan's financial markets and the country's ability to adapt to global economic shifts. The recent uptick in inflation, spurred by global inflationary pressures in 2022 and 2023, indicates robust demand and a departure from decades of deflation. Rising stock prices over the long term despite the recent volatility, increasing land values, and higher wages further underscore the positive economic outlook.

To capitalize on this favorable macroeconomic environment, it is crucial for market participants to understand the new laws and government initiatives that will impact both Japanese companies and foreign investors. This newsletter delves into two significant legislative developments:

- *Act on the Promotion of Cash Flow-Based Lending*: This act introduces a new security interest, known as the “enterprise value security interest,” designed to facilitate financing for startups and business operators lacking tangible assets.
- *AI Guideline for Business ver. 1.0*: Released by the Ministry of Internal Affairs and Communications and the Ministry of Economy, Trade and Industry, this guideline aims to promote innovation while mitigating the risks associated with AI throughout its lifecycle.

By examining these legislative changes, we aim to provide a comprehensive understanding of how they will shape the future of business and innovation in Japan.

The Act on the Promotion of Cash Flow-Based Lending

The Act on the Promotion of Cash Flow-Based Lending (Act No. 52 of 2024) was enacted on June 7, 2024.

This law creates the new enterprise value security interest. Unlike conventional security interests, an enterprise value security interest is a security interest in the total properties of the company, not in individual properties such as land or buildings, and was created to facilitate financing for startups that lack tangible assets such as land or buildings, or for business operators that are hesitant to take over or expand their business due to management guarantees.

1. Enterprise value security interest overview

Key Concepts	Explanation
Property subject to the collateral	Total properties (including the company’s future property) (Article 7, paragraph 1)
Secured claim	Specified secured claims and unspecified secured claims (Article 6, paragraphs 4 and 5 and Article 21, paragraph 1)
Borrower (debtor/settlor)	Only stock companies and membership companies under the Companies Act (Article 2, paragraph 2 and Article 6, paragraph 1)
Lender (specified secured creditor/unspecified secured creditor)	Open to anyone
Holder of an enterprise value security interest	Enterprise value security interest trust company (Article 6, paragraph 2 and Article 32)
Requirement for becoming effective and requirement for perfection	Registration in the commercial register (Article 15)
Priority relationship between other collaterals and enterprise value security interest	<ul style="list-style-type: none"> • The mutual priority relationship between enterprise value security interest is determined before and after registration (Article 16). • The priority relationship between a pledge, a mortgage, a lien on the sale of real estate, and an enterprise value security interest is determined by the fulfillment of the respective countervailing

Key Concepts	Explanation
	requirements and the registration of the enterprise value security interest before and after the registration of the enterprise value security interest (Article 18, paragraph 1).
Use, profit from, and dispose of the property subject to the collateral	<p>Borrower may use, profit from, and dispose of the property even after establishing the enterprise value security interest (Article 20, paragraph 1).</p> <p>However, transactions that exceed the scope of normal business activities are, in principle, invalid (Article 20, paragraphs 2 and 3).</p>

2. Key elements of enterprise value security interest

2.1 Property subject to the collateral

The property subject to the collateral of the enterprise value security interest is the “total properties,” including future cash flows (Article 7, paragraph 1).

When establishing an enterprise value security interest, an entity’s entire business may be collateralized. Not only tangible assets such as land and buildings, but also intangible assets including intellectual property rights, know-how, customer base, etc., and goodwill may be collateralized.

2.2 Establishment of enterprise value security interest

To establish an enterprise value security interest, involved parties must conclude an enterprise value security interest trust agreement with the borrower (debtor/settlor) as trustee, the enterprise value security interest trust company (Article 6, paragraph 2) as trustee, and specified secured creditor (Article 6, paragraphs 4 and 6)/unspecified secured creditor (Article 6, paragraphs 5 and 7) as beneficiary.

Only stock companies and membership companies under the Companies Act can become borrowers.

To become an enterprise value security interest trust company, parties must obtain a license from the Prime Minister (Article 32). A deemed license system has been established for enterprise value security interest trust companies, and when a bank or other financial institution announces it will engage in trust business related to enterprise value security interests, it is deemed to have obtained a license (Article 33).

Specified secured creditors are mainly expected to be lenders, while unspecified secured creditors are the debtor’s general creditors.

2.3 Requirement for becoming effective and requirement for perfection

The requirement for an enterprise security interest to be effective and for perfection of an enterprise value security interest is its registration in the commercial register (Article 15).

The mutual priority relationship between enterprise value security interest is determined before and after registration. The priority relationship between a pledge, a mortgage, a lien on the sale of real estate, and an enterprise value security interest is determined by the fulfillment of the respective countervailing requirements and the registration of the enterprise value security interest before and after the registration of the enterprise value security interest.

2.4 Use, profit from, and dispose of the property subject to the collateral

Borrower may use, profit from, and dispose of the property subject to the collateral of the enterprise value security interest even after the establishment of the enterprise value security interest (Article 20, paragraph 1).

However, transactions that exceed the scope of normal business activities, such as the disposal of important assets or the transfer of entire or significant part of the business, etc., require the consent of the holder of an enterprise value security interest (Article 20, paragraph 2), and transactions conducted without such consent are in principle invalid. Nevertheless, this protection cannot be asserted against a third party who had good faith and did not have gross negligence (Article 20, paragraph 3).

2.5 Enforcement of enterprise value security interest

If a specified secured claim is not repaid when due, or if the debtor dissolves (except by merger) without completing repayment of the specified secured claim, the security interest holder (enterprise value security interest trust company) shall, upon the instruction of all the holders of the specified secured claims, take necessary measures, including the exercise of enterprise value security interests (Article 61). The holder of the enterprise value security interest shall make such execution upon the filing of a petition for commencement of execution proceedings.

Once the petition is filed and the commencement of execution proceedings is decided, the court appoints a trustee, who obtains the right to manage the business and dispose of the property.

Next, the trustee, with the court's permission, conducts a realization of the property subject to the security interest. Generally, the realization of the enterprise value security interest shall take the form of transfer of the operation or business (Article 157, paragraph 1).

After completing the realization of the property subject to the security interest, the trustee shall implement the distribution of dividends without delay (Article 169).

The procedure for enforcing an enterprise value security interest shall be terminated upon the conclusion of the dividend (Article 191, paragraph 1), and the enterprise value security interest shall be extinguished after the court decides to terminate enforcement (Article 191, paragraph 3).

3. Conclusion

Japan has traditionally been considered a difficult environment for startups because it is challenging for startups to raise funds from Japanese banks. In many cases, startups cannot provide collateral (real estate, machinery, and equipment, etc.) that would satisfy a bank or other financial institutions.

However, the creation of enterprise value security interest may ease startups’ abilities to raise funds, even if they do not have properties like real estate, machinery, equipment, etc.

Establishing the Act on the Promotion of Cash Flow-Based Lending may facilitate startup growth and new businesses development in Japan.

AI Guideline for Business ver 1.0

On April 19, 2024, the Ministry of Internal Affairs and Communications and the Ministry of Economy, Trade and Industry released “AI Guideline for Business ver 1.0¹.”

This guideline encourages those involved in AI to properly recognize risks in light of international trends and stakeholder concerns, and to voluntarily implement necessary countermeasures throughout the lifecycle, with the aim of actively creating a framework with stakeholders that both promotes innovation and mitigates risks.

1. Subjects of the AI Guideline for Business ver 1.0

Subjects of the AI Guideline for Business ver 1.0 are as follows:

Subject	Explanation
AI Developer	<p>Business operators that develop AI systems (including those that research and develop AI).</p> <p>AI Developers design and build AI systems, encompassing AI models, system infrastructure, and input/output functions. Their work involves developing AI models and algorithms, collecting and preprocessing data (including purchasing data), training AI models, and verifying their performance.</p>
AI Provider	<p>Businesses operators that provide AI systems as services embedded in applications, products, existing systems, business processes, etc. to AI Business Users and, in some cases, to non-business users.</p> <p>AI Providers verify AI systems, integrate AI systems with other systems, and provide AI systems and services, as well as operational support for AI systems for normal operation on the AI Business User side or for the AI service operation itself. In some cases, communication with various stakeholders may be required as AI services are provided.</p>

¹ See Guidelines in [Japanese](#) and [English](#). See Appendix in [Japanese](#) and [English](#).

Subject	Explanation
AI Business User	<p>Businesses operators that use AI systems or AI services in their business activities.</p> <p>AI Business Users use AI systems or AI services appropriately as intended by AI Providers, sharing information on environmental changes with AI Providers to continue normal operation, or operating AI systems provided as necessary. If there is any possible impact on non-business users in the use of AI, the AI Business Users are required to avoid any unintended disadvantages of AI for such users and maximize the benefits of AI.</p>

2. Structure of the AI Guideline for Business ver 1.0

AI Guideline for Business ver 1.0 is divided into a main body and Appendix.

The main body of the guideline presents “what kind of society we are aiming for (basic principles = why)” and “what we should do (guidelines = what),” which are important for business operators seeking to use AI safely and securely while maximizing its benefits. The Appendix presents “what specific approaches we should take (practices = how)” and is intended to lead to concrete actions by business operators. In addition, the descriptions in the Appendix correspond to those in the main body and support the reading of the main body and considerations and actions based on it.

3. Basic principles and guidelines

The AI Guideline for Business ver 1.0 lists basic principles that should be respected: (1) a society where human dignity is respected (Dignity), (2) a society where people of diverse backgrounds can pursue diverse happiness (Diversity and Inclusion), and (3) a sustainable society (Sustainability).

To realize the three basic principles, the AI Guideline for Business ver 1.0 stipulates (a) common guidelines and (b) other important issues for each subject (i.e., AI Developer, AI Provider and AI Business User) in addition to the common guidelines. Particularly, (a) is important because it targets all AI Developers, AI Providers, and AI Business Users. Its overview is as follows:

Category of Matters	Theme	Explanation
Matters to be addressed by each subject (i.e., AI Developer, AI Provider and AI Business User)	1) Human-centered	<ul style="list-style-type: none"> • AI shall act to extend people’s capabilities and enable diverse people to pursue diverse happiness (well-being). • Take necessary measures against risk of AI-generated false information, misinformation, and biased information destabilizing and disrupting society based on the recognition that said risk is growing. • Facilitate the use of AI by the socially vulnerable so that more people can enjoy the benefits of AI

	<p>2) Safety</p>	<ul style="list-style-type: none"> • Conduct appropriate risk analysis and take measures to address risks. • Avoid harm due to provision or use that deviates from the original purpose of use within the control of the subject. • Based on the characteristics and purpose of use of AI systems and services, consider the accuracy of data used for learning, etc., as well as support data transparency, comply with legal frameworks, update AI models, etc., as appropriate to a reasonable extent.
	<p>3) Fairness</p>	<ul style="list-style-type: none"> • Endeavor to eliminate unfair and harmful prejudice and discrimination against specific individuals or groups based on their race, gender, nationality, age, political beliefs, religion, or other diverse backgrounds. • Develop, provide, and use AI, paying attention to unconsciousness and potential bias, after considering the use of intervening human judgment at appropriate times, in addition to letting AI make judgments on its own, to ensure that AI output results will not lack fairness.
	<p>4) Privacy protection</p>	<ul style="list-style-type: none"> • Comply with relevant laws and regulations, such as the Act on the Protection of Personal Information. • Develop and publish a privacy policy for each entity to ensure stakeholders' privacy is respected and protected. • Consider the social context and people's reasonable expectations.
	<p>5) Ensuring security</p>	<ul style="list-style-type: none"> • Take reasonable measures considering the level of technology currently available to maintain the confidentiality, integrity, and availability of AI systems and services, and to ensure the secure use of AI at all times. • Review the considerations for dealing with risks of external attacks on AI systems and services because new methods of such attacks are created every day.
	<p>6) Transparency</p>	<ul style="list-style-type: none"> • Provide appropriate information to stakeholders to the extent necessary and technically feasible and reasonable, taking into account the social context in which AI is used, while ensuring the verifiability of the AI system and service (e.g., fact that AI is being used, the

		extent to which it is being utilized, data collection and annotation methods, capabilities and limitations of the AI system and service, appropriate/inappropriate use at the provider, etc.)
	7) Accountability	<ul style="list-style-type: none"> • Provide information and explanations to stakeholders regarding traceability and the status of compliance with common guidelines. • Develop and publish a policy on AI governance for each subject, a privacy policy, etc. • Document and store relevant information for a period of time and make it available for reference when and where needed, in an accessible and usable form.
Matters expected to be addressed in cooperation with society	8) Education and literacy	<ul style="list-style-type: none"> • Take necessary measures to ensure that those involved in AI have a sufficient level of AI literacy. • Provide education to stakeholders that covers the characteristics of AI, such as complexity and misinformation, as well as the possibility of intentional misuse.
	9) Ensuring fair competition	<ul style="list-style-type: none"> • Maintain a fair, competitive AI environment so that new businesses and services can be created, sustainable economic growth will be maintained, and solutions to social issues will be provided.
	10) Innovation	<ul style="list-style-type: none"> • Promote internationalization and diversification, industry-academia-government collaboration, and open innovation. • Ensure interoperability and interconnectivity between companies' own AI systems and services and others'. • Comply with standard specifications, if any.

4. Building AI Governance

The AI Guideline for Business ver 1.0 emphasizes the importance of practicing ‘agile governance’ in building AI governance. This approach involves multiple stakeholders across various governance systems—such as corporations, laws and regulations, infrastructure, markets, and social norms—continuously and rapidly going through the cycle of ‘environment and risk analysis,’ ‘goal setting,’ ‘system design,’ ‘operation,’ and ‘evaluation.’ This is in contrast to practicing AI governance with fixed rules and procedures.

5. Conclusion

In recent years, the development of AI has been remarkable, and regardless of the industry or size of a company, it has been shown to improve business efficiency and development.

On the other hand, it is difficult to comprehensively understand and examine the risks associated with the use of AI, which continues to evolve at an ever-increasing pace.

As stated above, where AI is assumed to have both significant benefits and uncertain risks, these guidelines provide guidance for AI governance as a measure to the latter. Companies should consider establishing AI governance based on the contents of these guidelines and in consultation with legal experts.

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