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Japan: Trends & Developments

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Trends and Developments

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Amendments to the Payment Services Act, etc (Introduction of Regulations on Stablecoins)

Overview

On 11 January 2022, the Payment Services Working Group of the Financial System Council published a report (the “Report”) on the clarification and introduction of the regulations on stablecoins. In response to the Report, the “Bill for partial amendment to the Payment Services Act, etc, for the purpose of establishing a stable and efficient payment and settlement system” (the “Amended Act”) was promulgated on 10 June 2022. The Amended Act is expected to come into effect in the first half of 2023.

The Amended Act is essentially based on the contents of the Report and mainly focuses on:

- the establishment of a definition of “Electronic Payment Instruments”, the goal of which is to define stablecoins;
- a statutory system for trust companies that issue stablecoins in the form of trust beneficial rights;
- the determination of the scope of an “electronic payment instruments exchange service” and an “electronic payments handling service”, meaning an intermediary business for stablecoins and existing electronic money; and
- the establishment of registration procedures and codes of conduct imposed on Electronic Payment Instruments Exchange Service Providers and Electronic Payments Handling Service Providers.

While the definition of electronic payment instruments and the code of conducts seem to be mostly based on the existing regulations under the Payment Services Act (the PSA) pertaining to crypto-assets and crypto-asset exchange services, due attention should be paid to the differences in the regulations arising from the fact that electronic payment instruments are currency-denominated assets.

Generally, Japanese financial regulatory systems have a three-tiered structure consisting of legislation, subordinate legislation (government ordinances and cabinet office ordinances), and supervisory policies and administrative guidelines (“Supervisory Policies”), which often function as de facto rules despite their original function as indicators of the viewpoints of the competent administrative authorities. The current legislation concerning stablecoins is also expected to follow this structure, but only the top-level legislation has been disclosed at the time of writing (as of December 6, 2022). Therefore, it is necessary to pay close attention to the progress of the development of subordinate legislation and Supervisory Policies.

Definition of “Electronic Payment Instruments”

The Amended Act newly defines “Electronic Payment Instruments” as referring only to digital-money type stablecoins – ie, those issued at a price linked to the value of a legal currency (eg, one coin = JPY1) and promised to be redeemed in the same amount as its issue price (and those equivalent to the same). Article 2,

Paragraph 5 of the Amended PSA states that the term “Electronic Payment Instruments” used therein means:

- “(i) property value (limited to currency-denominated assets which are recorded on an electronic device or any other object by electronic means, and excluding securities, electronically recorded monetary claims specified in Article 2, Paragraph 1 of the Electronically Recorded Monetary Claims Act (Act No 102 of 2007), pre-paid payment instruments and other instruments specified in cabinet office ordinances as being equivalent to the foregoing items (except those specified in the cabinet office ordinances taking into account their transferability and other factors) which can be used in relation to unspecified persons for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services, and can also be purchased from and sold to unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system (except those that fall under item (iii));
- (ii) property value which can be mutually exchanged with what is set forth in the preceding item with unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system (except those that fall under the next item);
- (iii) specified trust beneficial interests; and
- (iv) those specified by cabinet office ordinances as being equivalent to those listed in the preceding three items.”

Electronic Payment Instrument I

Electronic Payment Instruments specified in item (i) (“Electronic Payment Instrument I”) are currency-denominated assets that are recorded and transferred electronically and that can be used for paying consideration to unspecified

persons, and can also be purchased from or sold to unspecified persons. Currency-denominated assets are assets that are denominated in a legal currency, or for which the performance of obligations, refunds or anything equivalent thereto is supposed to be made in Japanese currency or a foreign currency (Article 2, Paragraph 7 of the Amended PSA).

The definition of Electronic Payment Instrument I is similar to that of crypto-assets (Article 2, Paragraph 14, Item (i) of the Amended PSA), except for the fact that crypto-assets do not include currency-denominated assets whereas Electronic Payment Instruments are, in principle, limited to currency-denominated assets. This means that USDT (tether) and USDC (USD coin), for example, meet the definition in general (please note that, as described under *Whether handling of USDC or Tether will be permitted*, below, the definition being met does not necessarily mean that it is practically possible to circulate such assets in Japan). For the avoidance of doubt, Electronic Payment Instrument I is not limited to tokens using blockchain (distributed ledger technology) and, even when managed on a specific server, any property value could fall under the category of Electronic Payment Instruments as long as it meets the definition outlined above.

Furthermore, the phrase “except those specified in the cabinet office ordinances taking into account their transferability and other factors” provides that, in exceptional cases, certain securities, electronically recorded monetary claims, prepaid payment instruments, etc, can be classified as Electronic Payment Instruments, even though they are generally not classified as Electronic Payment Instruments (a double negative provision to “exclude” from “exceptions”).

In light of the content of the Report, it is expected that, among prepaid payment instruments, at least “those issued by the issuer in a permissionless distributed ledger with specifications that can be distributed to unspecified persons and used as a means of remittance and settlement to unspecified persons” (ie, not limited to the settlement to the issuer or member stores) would be included in such exceptions specified in the cabinet office ordinances.

Electronic Payment Instrument II

The Electronic Payment Instruments specified in item (ii) (“Electronic Payment Instrument II”) are almost identical to the crypto-assets II specified in Article 2, Paragraph 5, Item (ii) of the current PSA. However, since existing well-known stablecoins meet the definition of Electronic Payment Instrument I, none of them is likely to be classified as Electronic Payment Instrument II. Rather, it seems that Electronic Payment Instrument II is introduced in conjunction with Electronic Payment Instrument I from the viewpoint of the prevention of the circumvention of regulations.

Electronic Payment Instrument III (specified trust beneficial rights)

The Electronic Payment Instruments specified in item (iii) (“Electronic Payment Instrument III”) are defined as “specified trust beneficial rights”, which are separately defined in Article 2, Paragraph 9 of the Amended PSA as trust beneficial rights that are electronically recorded and transferred and meet certain requirements – eg, that a trustee manages the entire amount of money constituting the trust property by bank deposits. This is considered to take into account the scheme that uses trust beneficial rights among the schemes of “electronic payment instruments” exemplified in the Report and under which the customers’ right to claim redemption against issuers are clearly secured, and under

which the customers’ rights to claim redemption are properly protected in the event of the default of issuers or intermediaries.

The issuance of stablecoins that use trust beneficial rights may also be classified as a fund transfer because it follows a scheme that enables a fund transfer between remitters and recipients. Thus, in order to enable trust companies to issue stablecoins that use trust beneficial rights, the Amended Act newly defines “specified trust fund transfer” as a means of issuing specified trust beneficial rights (Article 2, Paragraph 28 of the Amended PSA), and permits trust companies that issue specified trust beneficial rights (defined as “specified trust companies” under Article 2, Paragraph 27 of the Amended PSA) to conduct only “specified trust fund transfers” among fund transfers (Article 37-2 of the Amended PSA).

Electronic Payment Instrument IV

Under Article 2, Paragraph 5, Item (iv) of the Amended PSA, “those specified by cabinet office ordinances as being equivalent to those listed in the preceding three items” are also classified as Electronic Payment Instruments (“Electronic Payment Instrument IV”). The details of Electronic Payment Instrument IV are not clear at present. However, considering that “Electronic Payment Instruments (excluding currency-denominated assets)” is excluded in the definition of crypto-assets under Article 2, Paragraph 14 of said Act, it can be said that it indicates a possibility that Electronic Payment Instruments that are not currency-denominated assets (ie, certain crypto-asset type stablecoins that aim to stabilise value by algorithms) will be specified as Electronic Payment Instrument IV in the future.

“Electronic Payment Instruments Exchange Service” and “Electronic Payments Handling Service”

Correspondence between definitions in the Report and the Amended Act

The Report indicated the intention to impose new business regulations on intermediaries of electronic payment instruments, and identified the following three acts as being subject to the regulations:

- (I) creating or extinguishing deposit claims on behalf of a bank;
- (II) creating or extinguishing claims pertaining to outstanding obligations in the process of a fund transfer on behalf of a fund transfer service provider; and
- (III) the sale, purchase and exchange of – and custody and brokerage for the sale, purchase and exchange of – electronic payment instruments for trust beneficiary rights, with a specification that the trustee manages the entire amount of money constituting the trust property by bank deposits.

As an equivalent to these acts, the Amended Act has established a definition of an “Electronic Payment Instruments Exchange Service” in the Amended PSA and a definition of an “Electronic Payments Handling Service” in the Amended Banking Act as follows:

- Article 2, Paragraph 10 of the Amended PSA:

“The term “Electronic Payment Instruments Exchange Service” as used herein means engaging in any of the following acts in the course of trade. The term “Exchange of Electronic Payment Instruments” means the acts specified in Item (i) or (ii), and the term “Management of Electronic Payment Instruments” means the acts specified in Item (iii):

- (i) the sale and purchase of an electronic payment instrument, or the exchange thereof with another electronic payment instrument;
- (ii) serving as intermediary, brokerage, or agency for the acts specified in the preceding item;
- (iii) the act of managing electronic payment instruments for others (except those specified by cabinet office ordinances as not giving rise to a risk of insufficient protection for customers, taking into account their details and other factors); or
- (iv) the act of making an agreement, under entrustment from a fund transfer service provider, with a customer (limited to those who have concluded a contract with the fund transfer service provider under which fund transfers are to be carried out on a continuous or recurring basis) on behalf of the fund transfer service provider, to carry out any of the following acts by a means that uses an electronic data processing system, and by increasing or reducing the amount of claims pertaining to obligations relating to fund transfers based on said agreement:
 - (a) transferring funds based on said contract and reducing the amount of the claim pertaining to the obligation relating to the fund transfer that is equivalent to the amount of said funds; or
 - (b) increasing the amount of the claim pertaining to the obligation relating to the fund transfer that is equivalent to the amount of funds received by the fund transfer.”

- Article 2, Paragraph 17 of the Amended Banking Act:

“The term “Electronic Payments Handling Service” as used herein means a business that carries out the following acts, and the term “Electronic Payments Related Deposit Intermediary Service” means the act specified in Item (ii):

- (i) the act of making an agreement, under entrustment from a bank, with a depositor who

has opened a deposit account with the bank on behalf of the bank to carry out any of the following acts by a means that use an electronic data processing system, and of increasing or reducing the amount of claims under a deposit contract (“Deposit Claim” in this item) based on said agreement:

- (a) transferring funds pertaining to the said account and reducing an amount of Deposit Claims that is equivalent to the amount of said funds; or
- (b) increasing an amount of Deposit Claims that is equivalent to the amount of funds received by the fund transfer;
- (ii) acting as an intermediary for the conclusion of a contract for acceptance of deposits on behalf of the bank referred to in the preceding item (“Entrusting Bank”) in connection with the act in the same item that is performed.”

First of all, the acts in Items (i) through (iii) of Article 2, Paragraph 10 of the Amended PSA are the sale, purchase and exchange (Item (i)), serving as intermediary, brokerage or agency providers for the sale, purchase and exchange (Item (ii)), and custody (Item (iii)) of Electronic Payment Instruments, all of which correspond to the acts described in (III) above. However, this is provided that not only the handling of specified trust beneficial rights as assumed in 2(3) above is classified as this type of act, but also an intermediary’s handling of overseas issued stablecoins, which will thus require a licence as an Electronic Payment Instruments Exchange Service Provider.

Secondly, the act specified in Article 2, Paragraph 10, Item (iv) of the Amended PSA corresponds to the act described in (II) above because it is described as an act of an Electronic Payment Instruments Exchange Service Provider to agree with customers to transfer funds between their accounts on the assumption that it is author-

ised to act as an agent based on the contractual relationship with a fund transfer service provider, and to generate the resulting effect of increasing (in relation to the recipient, Item (iv) (b)) and decreasing (in relation to the remitter, Item (iv) (a)) outstanding obligations in the process of a fund transfer in relation to the fund transfer service provider based on such authority to act as an agent.

Furthermore, the acts described in Article 2, Paragraph 17 of the Amended Banking Act are basically equivalent to Article 2, Paragraph 10, Item (iv) of the Amended PSA – namely, whereby an Electronic Payments Handling Service Provider agrees with customers to transfer funds to other customers on the assumption that it is authorised to act as an agent based on the contractual relationship with a bank, and it generates the resulting effect of increasing (in relation to the recipient, Article 2, Paragraph 17, Item (i)(b) of the Amended Banking Act) and decreasing (in relation to the remitter, Article 2, Paragraph 17, Item (i)(a) of the Amended Banking Act) deposit claims in relation to the bank based on such authority to act as an agent.

Codes of conduct

Following the completion of registration, Electronic Payment Instruments Exchange Service Providers are subject to the following codes of conduct in general.

- Measures to Protect Customers – Electronic Payment Instruments Exchange Service Providers must provide explanations to prevent misidentification with an issuer of stablecoins, provide information on fees and other contract details, and take other necessary measures to protect customers and ensure the proper and reliable performance of service.

- **Prohibition of Deposit of Property – Electronic Payment Instruments Exchange Service Providers** are, in principle, prohibited from accepting deposits of money or other property from customers in relation to the Electronic Payment Instruments Exchange Service. A proviso to said article provides for an exception – “cases specified by a cabinet office ordinance as those in which there exists no risk of resulting in insufficient customer protection”.
- **Obligation to Segregate Electronic Payment Instruments of Customers – Electronic Payment Instruments Exchange Service Providers** must manage electronic payment instruments of customers separately from their own electronic payment instruments, and must periodically undergo an audit by a certified public accountant or an audit firm with regard to the status of the management.
- **Obligation to Conclude a Contract with Issuers – Electronic Payment Instruments Exchange Service Providers** must conclude a contract with an issuer for the electronic payment instruments service that provides for the sharing of liability for damages, in the event that a customer incurs damages, and must conduct the electronic payment instruments service for said issuer in accordance with said contract. Matters to be provided for in the contract other than the sharing of liability for damages are delegated to cabinet office ordinances.
- **Application of the Financial Instruments and Exchange Act –** the provisions of this act shall apply mutatis mutandis to Electronic Payment Instruments Exchange Service Providers that engage in an electronic payment instruments-related service pertaining to Electronic Payment Instruments specified by cabinet office ordinances inasmuch as the price of said instruments may fluctuate due to a fluctuation in the value of currencies or other indicators.
- **Obligation for Confirmation at the time of Transaction –** as a result of the addition of Electronic Payment Instruments Exchange Service Providers to the category of specified business operators under the Amended Act on Prevention of Transfer of Criminal Proceeds (the APTCP), Electronic Payment Instruments Exchange Service Providers are now subject to various obligations imposed on specified business operators under the APTCP, including conducting “KYC” procedures on their clients at the time of a transaction and reporting suspicious transactions.
- **Travel Rules –** as obligations specific to Electronic Payment Instruments Exchange Service Providers rather than obligations for specified business operators in general, the APTCP imposes:
 - (a) measures to check the status of counterparties, including confirmation at the time of transaction in the case of repeated and continuous transfers of Electronic Payment Instruments with a person who exchanges or manages Electronic Payment Instruments in a foreign country (Article 10-2 of the Amended APTCP); and
 - (b) so-called travel rules (eg, the obligation to notify the receiving Electronic Payment Instruments Exchange Service Provider of client information at the time of a transfer of Electronic Payment Instruments). However, these obligations shall not apply to Electronic Payment Instruments that are specified trust beneficial rights.

The codes of conduct on Electronic Payment Instruments Exchange Service Providers seem to use the codes of conduct imposed on crypto-asset exchange service operators as a reference standard, except for:

- the prohibition of deposit of property;
- the obligation to conclude a contract with issuers;
- the application of the Financial Instruments and Exchange Act; and
- the travel rules, which are obligations specific to Electronic Payment Instruments Exchange Service Providers and are not imposed on crypto-asset exchange service providers.

Of such obligations, the prohibition of deposits of property will, in principle, prohibit a business model in which an Electronic Payment Instruments Exchange Service Provider temporarily receives money from clients and thereupon purchases stablecoins (Electronic Payment Instruments) using that money, as conducted on current crypto-asset exchanges (unless such business model falls under the exceptions that will be specified in a cabinet office ordinance in the future).

Since the existing major digital-money type stablecoins are all of the permission-less type and do not generally expect the conclusion of a contract between issuers and intermediaries, the obligation to conclude a contract with issuers may impede the circulation of these stablecoins in Japan.

Whether handling of USDC or Tether will be permitted

As discussed above, the definitions of “Electronic Payment Instruments Exchange Service” and “Electronic Payments Handling Service” under the Amended Act basically assume the three types of legal structures for the issuance and circulation of stablecoins where issuers and intermediaries are entities regulated in Japan.

What is of interest is whether the Amended Act permits the intermediation of stablecoins through

other business models. The business model whereby intermediaries handle permission-less stablecoins issued by foreign issuers that do not follow any of the above three legal structures (eg, USDC, Tether) (without contractual relationships with foreign issuers) (“Overseas Issued Stablecoin”) seems to be especially practical.

First of all, in relation to “Electronic Payment Instruments Exchange Service”, the definition of “Electronic Payment Instruments” that are subject to the types of acts in Article 2, Paragraph 10, Items (i) to (iii) of the Amended PSA is not necessarily limited to specified trust beneficial rights. Hence, such acts in relation to Overseas Issued Stablecoins will fall under the definition of an Electronic Payment Instruments Exchange Service as well.

Secondly, in relation to codes of conduct, the Report indicates the following prescriptions:

- issuers and intermediaries are required to take measures to prevent a transfer of permission-less stablecoins to customers whose identity has not been verified;
- intermediaries are only allowed to handle stablecoins issued overseas with respect to which assets are protected in Japan;
- intermediaries are required to conclude contracts with issuers with respect to stablecoins they handle;
- in principle, intermediaries are prohibited from receiving deposits of money from customers; and
- it is necessary to establish clear rules (procedures, timing) on a transfer of rights in stablecoins.

While it seems that the authority is reluctant to allow the business model described above, it appears that setting strict legal parameters has

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been avoided, as there is room for exceptions to be granted or for specific regulations to be delegated to address them in subordinate legislation (or Supervisory Policies). As such, whether the handling of any given existing well-known Overseas Issued Stablecoins will be permitted, in effect, will depend on upcoming subordinate legislation and Supervisory Policies, and attention should be paid to the progress made in the discussions being held on these matters.

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