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# Blockchain 2023

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## **Japan: Law & Practice**

Ken Kawai, Takeshi Nagase,  
Keisuke Hatano and Takato Fukui  
Anderson Mori & Tomotsune



# JAPAN

## Law and Practice

### Contributed by:

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## Contents

### 1. Blockchain Market and Business Model Overview p.6

- 1.1 Evolution of the Blockchain Market p.6
- 1.2 Business Models p.6
- 1.3 Decentralised Finance Environment p.7
- 1.4 Non-fungible Tokens p.7

### 2. Regulation in General p.8

- 2.1 Regulatory Overview p.8
- 2.2 International Standards p.9
- 2.3 Regulatory Bodies p.9
- 2.4 Self-Regulatory Organisations p.9
- 2.5 Judicial Decisions and Litigation p.9
- 2.6 Enforcement Actions p.9
- 2.7 Regulatory Sandbox p.10
- 2.8 Tax Regime p.10
- 2.9 Other Government Initiatives p.10

### 3. Cryptocurrencies and Other Digital Assets p.11

- 3.1 Ownership p.11
- 3.2 Categorisation p.11
- 3.3 Stablecoins p.11
- 3.4 Use of Digital Assets p.13
- 3.5 Non-fungible Tokens p.13

### 4. Exchanges, Markets and Wallet Providers p.13

- 4.1 Types of Markets p.13
- 4.2 On-Ramps and Off-Ramps p.13
- 4.3 KYC/AML/Sanctions p.14
- 4.4 Regulation of Markets p.15
- 4.5 Re-hypothecation of Assets p.15
- 4.6 Wallet Providers p.16

## **5. Capital Markets and Fundraising p.16**

- 5.1 Initial Coin Offerings p.16
- 5.2 Initial Exchange Offerings p.17
- 5.3 Other Token Launch Mechanisms p.17
- 5.4 Investment Funds p.17
- 5.5 Broker-Dealers and Other Financial Intermediaries p.17

## **6. Smart Contracts p.17**

- 6.1 Enforceability p.17
- 6.2 Developer Liability p.18

## **7. Lending, Custody and Secured Transactions p.18**

- 7.1 Decentralised Finance Platforms p.18
- 7.2 Security p.19
- 7.3 Custody p.19

## **8. Data Privacy and Protection p.20**

- 8.1 Data Privacy p.20
- 8.2 Data Protection p.20

## **9. Mining and Staking p.20**

- 9.1 Mining p.20
- 9.2 Staking p.20

## **10. Decentralised Autonomous Organisations (DAOs) p.21**

- 10.1 General p.21
- 10.2 DAO Governance p.21
- 10.3 Legal Entity Options p.21

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Anderson Mori & Tomotsune is one of the largest and most international Japanese law firms. It is best known for its long history of advising overseas companies doing business in Japan and in cross-border transactions. The main office in Tokyo is supported by two offices in Japan and seven overseas, and the firm has one of the leading fintech practices in Japan. With extensive experience across all areas of fintech, Anderson Mori & Tomotsune's skilled lawyers provide innovative, up-to-date legal advice to clients in this fast-growing and cut-

ting-edge industry. Because of the firm's long history of success and proven understanding of new technology, its advice is regularly sought in fintech-related matters, including applications for licences and regulatory approvals for start-ups; analysis of financial regulatory issues; development and marketing of innovative financial instruments, products and transactions; and consultations and negotiations with official regulatory authorities and self-regulatory organisations.

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# JAPAN LAW AND PRACTICE

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## 1. Blockchain Market and Business Model Overview

### 1.1 Evolution of the Blockchain Market

Japan was the first country to establish a regulatory framework for crypto-assets. Perhaps because of this head start, blockchain technology is now being increasingly adopted in the Japanese financial industry. For example, there are 30 licensed crypto-asset exchange service providers in Japan (“exchange providers”) as of 31 March 2023.

In line with this, the “Bill for Partial Amendment to the Payment Services Act, etc, for the Purpose of Establishing a Stable and Efficient Funds Settlement System” was submitted to the Diet (the “Amendment Bill”), where it was passed on 3 June 2022.

The Amendment Bill aims to establish a stable and efficient funds settlement system that can respond to the digitalisation of finance and other fields, against the backdrop of:

- the increasing issuance and circulation of so-called stablecoins overseas;
- the growing need to further improve the effectiveness of transaction monitoring by banks, etc; and
- the spread of prepayment instruments that enable payment by electronic means.

In addition, in response to the increasing issuance and circulation of so-called stablecoins overseas, the Amendment Bill also introduces the concept of “electronic payment instruments” (EPIs), which corresponds to the concept of stablecoins (see the items in Article 2, paragraph 5 of the Amended Payment Services Act (the “Amended PSA”).

The Amendment Bill also provides a new definition of intermediary activities in respect of the transfer and management of stablecoins that constitute EPIs. Specifically, under the Amendment Bill, such activities are defined as “electronic payment instruments exchange services” and “electronic payment handling services”. Furthermore, the Amendment Bill introduces a registration system in respect of businesses engaged in such activities.

The Amendment Bill will come into effect in June 2023.

### 1.2 Business Models

Since 2020, security tokens, sometimes referred to as digital securities, have been in the spotlight. As a result of recent amendments to the relevant laws and regulations, an increasing number of financial institutions are entering this new market, focusing mainly on digital corporate notes and tokenised equity interests in real estate funds. For instance, in August 2022, Kenedix, Inc, a real estate asset management company, announced the completion of a fundraising exercise, through a security token offering, with a total issue price of JPY6,915 million (and aggregate issue value of JPY6,631.48 million), backed by logistics facilities with an aggregate asset value of JPY14.6 billion.

In addition, since late 2020, non-fungible token (NFT)-related businesses have been gaining traction, particularly in the online gaming and art sectors, and a number of platforms for the issuance and trading of tokenised digital artworks have also recently emerged.

Furthermore, it was decided by way of the “Basic Policy on Economic and Fiscal Management and Reform 2022”, approved by the Cabinet in June 2022, that the Japanese government would fos-

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ter the development of an environment for the promotion of Web3, including the use of NFTs and decentralised autonomous organisations (DAOs) based on blockchain technology. More recently, in April 2023, the Liberal Democratic Party (LDP), the ruling party in Japan, released a “Web3 White Paper” that included a summary of issues needing immediate resolution for the promotion of Web3, as well as proposals for accompanying legislative revisions.

These developments demonstrate that Japan has adopted the promotion of Web3, including NFTs and DAOs, as a national strategy.

### 1.3 Decentralised Finance Environment

There is no definition of decentralised finance (DeFi) under Japanese law, and there is no regulatory framework that focuses specifically on DeFi.

However, under Japanese law, if the operation of a DeFi platform conflicts with existing financial regulations, the latter will apply.

Existing financial regulations – such as regulations in respect of crypto-asset exchange services (CAES) (as discussed in **2.1 Regulatory Overview**) under the PSA, investment fund regulations and derivatives regulations under the Financial Instruments and Exchange Act (FIEA), or funds remittance transaction (*kawasetorihiki*) regulations under the PSA, the Banking Act or the Money Lending Business Act (MLBA) – may apply to the operator of the DeFi platform, depending on the functions of the platform, if the DeFi platform contains:

- an automated market maker (AMM) function that enables the buying, selling and exchange of tokens that fall within the definition of crypto-assets;

- wallet aggregators;
- a decentralised synthetic investment platform;
- a decentralised prediction market;
- decentralised stablecoins; and
- a decentralised lending platform.

### 1.4 Non-fungible Tokens

NFTs are generally non-substitutable tokens that are issued on a blockchain, with values and attributes unique to the token itself. The issue in this context is whether NFTs constitute crypto-assets (as defined in **2.1 Regulatory Overview**) under the PSA, because NFTs, like crypto-assets, are tokens issued on the blockchain.

In this regard, according to the Crypto Asset Guidelines dated 24 March 2023 and issued by the Financial Services Agency of Japan (JFSA), a factor for determining whether a token constitutes a Type I crypto-asset (as defined in **2.1 Regulatory Overview**), is whether the token is an asset that can be purchased or sold using legal fiat currency or crypto-assets under socially accepted norms. Specifically, a token that satisfies items (i) and (ii) below generally will not constitute a Type I crypto-asset, and the same applies to the determination of whether a token constitutes a Type II crypto-asset (as defined in **2.1 Regulatory Overview**).

- (i) Where the issuer, etc has made it clear that the token is not intended to be used as payment for goods, etc to unspecified parties. This can be achieved by, for example, stating clearly in the terms and conditions of the issuer or its business handling service provider, or in the product description, that use of the token as a means of payment to unspecified parties is prohibited, or that the token or related system is designed in a way

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that does not enable it to be used as a means of payment to unspecified parties.

- (ii) Where use of the token as a means of payment for goods, etc to unspecified parties is permitted, certain requirements on the price and quantity of the relevant goods, etc and on the technical characteristics and specifications of the token must be met. For example, at least one of the following characteristics must be present:
  - (a) the minimum value per transaction must be sufficiently high (ie, JPY1,000 or more); or
  - (b) the number of tokens issuable as a proportion of a transaction of minimum value is limited (ie, not exceeding one million).

denominated assets – the same applies in the following bullet point) that:

- (a) may be used to pay an unspecified person the price of any goods, etc purchased or borrowed or any services provided;
  - (b) may be sold to or purchased from an unspecified person; and
  - (c) may be transferred using an electronic data processing system (“Type I crypto-asset”).
- A proprietary value that:
    - (a) may be exchanged reciprocally for a proprietary value specified in the preceding bullet point with an unspecified person; and
    - (b) may be transferred using an electronic data processing system (“Type II crypto-asset”).

## 2. Regulation in General

### 2.1 Regulatory Overview

Under the PSA, a person who engages in the purchase and sale of crypto-assets as a business is required to be registered as a crypto-asset exchange service provider (CAESP) (Article 63-2 of the PSA). Only CAESPs are permitted to engage in CAES. The PSA requires a person who provides CAES to be registered with the JFSA. A person who engages in CAES without registration is punishable by imprisonment for a term not exceeding three years or by a fine not exceeding JPY3 million, or both (Article 107, Item 5 of the PSA).

#### Definition of “Crypto-Asset”

The term “crypto-asset” is defined in the PSA as follows.

- A proprietary value (limited to that recorded on electronic devices or other objects by electronic means and excluding Japanese and other foreign currencies and currency-

“Currency-denominated assets” means assets denominated in Japanese yen or another foreign currency. Such assets do not fall within the definition of crypto-assets. For example, prepaid e-money cards are usually considered currency-denominated assets. If a coin issued by a bank is guaranteed to have a certain value vis-à-vis fiat currency, such a coin is unlikely to be deemed a crypto-asset but would instead be considered a currency-denominated asset.

#### Definition of Crypto-Asset Exchange Services

The term “crypto-asset exchange services” (CAES) means any of the following acts carried out as a business:

- sale and purchase of crypto-assets or exchange of crypto-assets for other crypto-assets;
- intermediary, brokerage or delegation of such sale, purchase or exchange;



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- management of users' money in connection with the acts listed in the two bullet points above; or
- management of crypto-assets for the benefit of another person.

## 2.2 International Standards

In 2017, based on the suggestions of the Financial Action Task Force (FATF) that virtual currencies could be used for money laundering, the Act on Prevention of Transfer of Criminal Proceeds (APTCP) was amended to include CAESPs as “specified business operators” and to impose an obligation on CAESPs to verify the identity of their customers.

Under the APTCP, specified business operators must verify the identity of their customers and comply with the APTCP and rules issued thereunder.

## 2.3 Regulatory Bodies

The JFSA has supervisory powers over CAESPs based on the delegation of such powers to it from the Prime Minister.

As a result, the JFSA has the power, where necessary for the proper and secure provision/performance of CAES by a CAESP, to:

- order the CAESP to submit additional reports or materials;
- enter the office or other facilities of the CAESP to conduct inspections; and
- enquire about the status of the CAESP's business or properties or inspect its books and documents.

The JFSA can also sub-delegate its supervisory powers over CAESPs to the relevant Local Finance Bureau, which are organs of the Ministry

of Finance directed and supervised by the JFSA Commissioner.

## 2.4 Self-Regulatory Organisations

For the purpose of ensuring proper provision of CAES and to protect users of CAES, the Japan Virtual and Crypto-assets Exchange Association (JVCEA) was appointed as an approved self-regulatory organisation to regulate CAESPs. The primary objectives of the JVCEA are:

- the formulation of self-governance rules;
- the inspection of its members to ensure their compliance with the relevant self-governance rules; and
- the handling of user complaints.

## 2.5 Judicial Decisions and Litigation

There is an important judicial precedent of the Tokyo District Court dated 5 August 2015 which states that legal ownership or title does not apply to crypto-assets, because they are intangible assets. As a consequence, the transfer of a crypto-asset does not equate to the transfer of legal ownership or title in such crypto-asset under the Civil Code of Japan (the “Civil Code”).

## 2.6 Enforcement Actions

In 2018, as a result of the leakage of users' crypto-assets with a value of approximately USD530 million from a cyber-attack on one of the biggest CAESPs, the JFSA conducted sweeping on-site inspections of registered and provisional CAESPs. This was followed by the JFSA's announcement, on 8 March 2018, of the imposition of business suspension orders on two provisional CAESPs, and business improvement orders on two registered CAESPs and on three provisional CAESPs. After further review, on 22 June 2018 the JFSA also imposed business improvement orders on six additional major registered CAESPs.

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In addition, on 21 June 2019, the JFSA imposed a business improvement order on a CAESP for the inadequacy of its business management, anti-money laundering and counter-terrorist financing, and risk management systems, among other things.

More recently, on 10 November 2022, FTX Japan received an administrative disposition from the JFSA, including a business suspension order and a business improvement order, amid the financial difficulties experienced by its parent company, FTX Trading Limited. On 11 November 2022 (US time), FTX Trading and its group companies filed for Chapter 11 proceedings under the US Federal Bankruptcy Code; FTX Japan and its parent company, FTX Japan Holdings, were included in the filing.

## 2.7 Regulatory Sandbox

To encourage fintech innovation, including the development and usage of blockchain technology, in June 2018 the Japan Economic Revitalisation Bureau established a cross-governmental one-stop desk for a regulatory sandbox scheme in Japan. This scheme, available to foreign as well as to Japanese companies, enables applicants (once approved) to carry out, under certain conditions, a demonstration of their projects even if such activities are not yet covered under current laws and regulations. Blockchain technology, together with AI, IoT and big data, is explicitly mentioned in the basic policy of the regulatory sandbox scheme as a prospective and suitable area for exploration and development.

## 2.8 Tax Regime

One of the most important issues in Japanese taxation of crypto-assets has been the treatment of consumption tax. Previously, the sale of crypto-assets was subject to consumption tax if

the office of the transferor was located in Japan. However, this was overturned in 2017.

The National Tax Agency of Japan also announced that gains realised from the sale or use of crypto-assets will be treated as “miscellaneous income” (*zatsu-shotoku*) and that taxpayers will not be permitted to utilise losses elsewhere to offset gains realised from the sale or use of crypto-assets. Furthermore, inheritance tax will be imposed upon crypto-assets in the estate of a deceased person.

Further, in December 2022, in the “Ruling Party’s Tax Reform Proposal”, it was decided that the year-end corporate taxation in respect of crypto-assets would not apply to crypto-assets held by a corporation at the end of a fiscal year if such crypto-assets are subject to valuation gains or losses based on market valuation and also meet certain requirements, such as where they have been issued by the corporation and have been held continuously since their issuance.

## 2.9 Other Government Initiatives

The Japanese government has a generally positive view of the use of blockchain technology in various kinds of businesses.

For instance, in June 2019 the Japanese government published a “Growth Strategy Action Plan” discussing the importance of the use of blockchain technology, stating that “AI, IoT, robots, big data, blockchain... are general purpose technologies (GPT) that broadly affect all industries, similar to the adoption of electric power from the 19th to 20th century and the inroads made by IT through the end of the 20th century.”

In addition, as stated in **1.2 Business Models**, in April 2023 the LDP released a “Web3 White Paper” containing a summary of issues needing

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immediate resolution for the promotion of Web3, as well as proposals for accompanying legislative revisions.

## 3. Cryptocurrencies and Other Digital Assets

### 3.1 Ownership

The legal nature of crypto-assets under Japanese civil law statutes is still unclear. According to a judicial precedent of the Tokyo District Court dated 5 August 2015, legal ownership or title does not apply to crypto-assets because they are intangible assets. As a consequence, the transfer of a crypto-asset does not equate to the transfer of legal ownership or title in that crypto-asset under the Civil Code.

Furthermore, from the perspective of the Civil Code, it is unclear when transfers of crypto-assets via a blockchain network would be considered final, because the legal characteristics of crypto-assets have not yet been firmed up.

### 3.2 Categorisation

Digital assets generated and traded on a blockchain are not necessarily classified as crypto-assets; their legal statuses vary depending on the function of the individual digital assets and other factors.

For example, if a digital asset is prepaid and can only be used for settlement with specified persons (ie, at member stores) to the extent of the amount prepaid, and is prohibited in principle from being replenished, the digital asset may be classified as a prepaid payment instrument (PPI), while those that can be replenished in value may be classified as electronic money issued by fund transfer service providers.

With the development of blockchain technology, so-called security tokens, or digital assets that represent shares, corporate bonds, fund interests, etc, have also emerged, and these are treated as securities, based on their nature and functions.

More specifically, if profit is distributed to the digital asset holder from the business income of the digital asset issuer, such digital asset would be classified as a security under the FIEA. If no profit is distributed, the next factor to consider is whether the digital asset is issued for consideration. Digital assets that are issued for no consideration will likely be deemed unregulated service points. Where a digital asset is issued for consideration, its legal status will depend on whether the digital asset constitutes a currency-denominated asset.

If a digital asset constitutes a currency-denominated asset, it will constitute either a PPI, electronic money issued by fund transfer service providers or an EPI (discussed in **3.3 Stablecoins**).

On the other hand, a digital asset that does not constitute a currency-denominated asset, and that can be used vis-à-vis unspecified persons and be bought, sold or exchanged vis-à-vis unspecified persons, will in principle likely be deemed a crypto-asset.

### 3.3 Stablecoins

As noted in **1.1 Evolution of the Blockchain Market**, in response to the increasing issuance and circulation of so-called stablecoins overseas, the Amendment Bill has introduced the concept of EPIs, which corresponds to the concept of stablecoins.

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The Amendment Bill stipulates four categories of EPIs, as follows (Article 2, paragraph 5 of the Amended PSA):

- currency-denominated assets that are recorded and transferred electronically, that are usable for paying consideration to unspecified persons, and that may be purchased from or sold to unspecified persons (Type I EPI);
- a property value exchangeable with a Type I EPI with an unspecified counterparty, and transferable by means of an electronic information processing system (Type II EPI);
- specified trust beneficiary rights (Type III EPI), which is defined as a trust beneficial right that is electronically recorded and transferred and where the trustee manages the entire amount of money constituting the trust property by bank deposits; and
- those instruments specified by Cabinet Order as being equivalent to those listed in the preceding three items (Type IV EPI).

Regarding the definition of a Type I EPI, “currency-denominated assets” are defined as assets denominated in Japanese yen or in a foreign currency, or with respect to which the performance, repayment or any other activity equivalent thereto will be carried out in Japanese yen or in a foreign currency. Based on this definition, a digital coin whose value is pegged to the Japanese yen, US dollar or any other fiat currency (such as, for example, where the price of a digital coin is always fixed at one yen or dollar, or where a digital coin is redeemable at one yen or dollar) may fall within the definition of a Type I EPI, but would not fall within the definition of crypto-assets.

In view of the above, so-called algorithmic stablecoins that are not collateralised by fiat currency but whose values are linked to fiat currency

through an algorithm are unlikely to qualify as currency-denominated assets. Such algorithmic stablecoins will likely fall within the category of crypto-assets if they are transferable or tradeable with unspecified parties on the blockchain.

Type I EPIs and other currency-denominated assets are distinguished by the following factors:

- (i) whether they may be used as payment for consideration to unspecified persons; and
- (ii) whether they may be purchased from or sold to unspecified persons.

More specifically, PPI and electronic money that are issued by fund transfer service providers do not satisfy condition (i), as their issuers would centrally manage the balance of each user and the scope of accepting stores (member stores). Additionally, even though digital money is issued on a blockchain, it will not satisfy condition (ii) if its issuer has taken technical measures to allow the digital money to be transferred only to persons who have passed confirmation at the time of transaction (ie, know-your-customer (KYC)), and if the issuer’s consent or other involvement is required for each transfer of the digital money. Consequently, only permissionless stablecoins (eg, USDT and USDC) would typically be considered as falling within the definition of Type I EPIs, as permissionless stablecoins generally do not require KYC of new stablecoin holders or any other involvement of the issuer when transferred.

Since EPIs must be property value-denominated in a legal currency, and issuance and redemption of EPIs enable parties across long distances to pay and receive funds without directly delivering cash, the issuance and redemption of EPIs thus constitute “fund remittance transactions (*kawase-torihiki*)”. Consequently, a banking licence or fund transfer business registration

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would in principle be required in order to issue and redeem EPIs. In addition, trust companies and foreign trust companies are also permitted to issue EPIs, though they are only permitted to issue Type III EPIs (specified trust beneficiary rights).

It is also worth noting that it is not possible for a CAESP to list EPIs on its exchange without being registered as an electronic payment instruments exchange service provider (EPIESP). More specifically, a person who engages in activities including but not limited to the following (electronic payment instruments exchange services – EPIES) is required to be registered as an EPIESP:

- sale and purchase of EPIs or exchange of EPIs for other EPIs;
- intermediary, brokerage or delegation activities in respect of such sale, purchase or exchange; and
- management of EPIs for the benefit of another person.

### 3.4 Use of Digital Assets

There is in general no limitation on the use of crypto-assets for payments. Accordingly, payments are allowed to be made with crypto-assets in Japan. It should be noted, however, that under the Foreign Exchange and Foreign Trade Act, notification to the Minister of Finance is required when a payment is made or received between Japan and a foreign country, or between a resident and a non-resident, in an amount exceeding the equivalent of JPY30 million. This notification requirement is applicable both where payment in crypto-assets is made or where payment in crypto-assets is received.

### 3.5 Non-fungible Tokens

Please refer to **1.4 Non-fungible Tokens**.

## 4. Exchanges, Markets and Wallet Providers

### 4.1 Types of Markets

In Japan, regardless of whether a business operator keeps the private keys to crypto-assets held by a user, the business operator is required to undergo registration as a CAESP if it engages in the sale or exchange of crypto-assets as a business. In other words, all crypto-asset exchanges in Japan are operated by registered CAESPs. Similarly, a business operator is required to undergo registration as an EPIESP if it engages in the sale or exchange of EPIs as a business.

Decentralised exchanges (DEXs) are not specifically regulated in Japan. However, as some of the services provided by DEXs may be deemed CAES (eg, sale or exchange of crypto-assets, intermediation of such sale or exchange, etc) and/or EPIES (eg, sale or exchange of EPIs, intermediation of such sale or exchange, etc), it is highly likely that, where the operator of the DEX is identified, it will need to undergo registration as a CAESP and/or an EPIESP.

### 4.2 On-Ramps and Off-Ramps

See **Definition of Crypto-Asset Exchange Services** in **2.1 Regulatory Overview** for a list of the activities that constitute CAES.

In this regard, the exchange of crypto-assets for legal tender (and vice versa) constitutes “sale and purchase of crypto-assets”. Accordingly, a business operator that engages in the exchange of crypto-assets for legal currency (and vice versa) as a business will be engaging in CAES and thus will be subject to CAESP registration requirements.

As is clear from the definition of CAES, crypto-to-crypto exchanges also constitute CAES,

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and business operators that engage in such exchanges as a business will also be subject to CAESP registration requirements.

Additionally, see **3.3 Stablecoins** for a list of activities considered as engagement in EPIES under the PSA.

In this regard, the exchange of EPIs for legal tender (and vice versa) constitutes “sale and purchase of EPIs”. Accordingly, a business operator that engages in the exchange of EPIs for legal currency (and vice versa) as a business will be engaging in EPIES and thus will be subject to EPIESP registration requirements. Moreover, a business operator that engages in the exchange of EPIs for crypto-assets (and vice versa) as a business will be subject to both CAESP and EPIESP registration requirements.

### 4.3 KYC/AML/Sanctions

Under the APTCP, specified business operators, including CAESPs and EPIESPs, must verify their customers’ identities and comply with the requirements stipulated below.

#### Obligation to Identify Customers

When providing CAES or EPIES to customers, specified business operators must verify the following (Article 4 of the APTCP):

- the customer’s identity;
- the purpose of the transaction;
- the customer’s occupation/lines of business;
- the identity of persons with substantial control of the customer’s business; and
- (under certain circumstances) the assets and income of the customer.

#### Obligation to Prepare and Maintain Verification Records

Specified business operators must, after conducting customer identification, immediately prepare customer identification records, and maintain such records for seven years from the date on which the contract for a specified transaction, etc terminates (Article 6 of the APTCP).

#### Obligation to Prepare and Maintain Transaction Records

Specified business operators must, after conducting a transaction in connection with specified business affairs, immediately prepare transaction records, and maintain such records for seven years from the date on which the transaction was conducted (Article 7 of the APTCP).

#### Obligation to Report Suspicious Transactions to the Relevant Authority

If a property accepted through its specified business affairs is suspected of being criminal proceeds or a customer is suspected of being engaged in money laundering in connection with specified business affairs, a specified business operator must promptly report such to the relevant authority (Article 8 of the APTCP).

#### Measures for Appropriate Conduct of Verification at the Time of Transaction

Specified business operators must:

- take such measures as necessary to keep matters verified at the time of transaction up-to-date;
- endeavour to improve the education and training of their employees in respect of verification matters; and
- maintain such other systems as necessary (Article 11 of the APTCP).



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## Travel Rules

When a CAESP or EPIESP transfers digital assets to a customer of another CAESP or EPIESP (including any foreign CAESP and EPIESP) at the request of a customer, the CAESP or EPIESP must notify the receiving CAESP or EPIESP of the identification information, including the name and blockchain address, pertaining to the sender and the receiver (the so-called Travel Rule). However, transfers to a CAESP or EPIESP in countries that do not yet have any Travel Rule legislation are not subject to the rule. In addition, when a CAESP or EPIESP transfers digital assets to an unhosted wallet at the request of a customer, it is not subject to the Travel Rule. Nevertheless, even for transactions that are not subject to Travel Rules, information on the counterparty (name, blockchain address, etc) must be obtained and recorded.

## 4.4 Regulation of Markets

Under the PSA, CAESPs and EPIESPs are required to:

- take such measures as necessary to ensure the safe management of information available to them;
- provide sufficient information to customers;
- take such measures as necessary for the protection of customers and for the proper provision of services;
- segregate the property of their customers from their own property and subject such segregation to regular audits by a certified public accountant or audit firm; and
- establish internal management systems to enable the provision of fair and appropriate responses to customer complaints, and implement measures for the resolution of disputes through financial ADR proceedings.

It should be noted that, under the PSA, CAESPs are required to both manage the money of users separately from their own money, and to entrust users' money to a trust company or a trust bank in accordance with the provisions of the relevant Cabinet Office Ordinance. CAESPs are required to manage users' crypto-assets separately in a wallet that is different from their own crypto-assets, but are not required to hold them in trust.

Additionally, under the PSA, EPIESPs are required to both manage the money and EPIs of users separately from their own assets, and to entrust users' money and EPIs to a trust company or a trust bank in accordance with the provisions or the relevant Cabinet Office Ordinance. Moreover, EPIESPs are required to conclude an agreement with EPI issuers regarding the sharing of liability in the event of damage to users and the provision by the EPI issuer to the EPIESP of information necessary to ascertain the identity of EPI holders.

In addition, the FIEA prohibits, with penalties, unfair acts in crypto-asset trading (without limitation as to the victims of such acts) for purposes of protecting users and preventing unjust gains.

However, insider trading regulations in respect of crypto-assets have not been included within the scope of the FIEA because of the difficulties in identifying issuers of crypto-assets and undisclosed material facts pertaining to crypto-assets.

## 4.5 Re-hypothecation of Assets

As noted in 4.4 Regulation of Markets, CAESPs and EPIESPs are obliged to segregate the digital assets deposited by their customers from their own assets, and to manage customers' assets separately from their own assets.

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Therefore, CAESPs and EPIESPs cannot create any security interest over the digital assets they manage as fiduciaries on behalf of their customers in favour of any third party without the consent of their customers.

## 4.6 Wallet Providers

The PSA designates “management of crypto-assets for the benefit of another person” as a type of CAES. Consequently, management of crypto-assets without the sale and purchase of such assets (“crypto-asset custody services”) is now included within the scope of CAES. This means that a person engaging in crypto-asset custody services needs to undergo registration as a CAESP.

In this context, the Guidelines on Crypto-assets issued by the JFSA provides the following clarification in respect of management of crypto-assets for the benefit of another person: “although each case should be determined based on its actual circumstances, it would constitute management of crypto-assets if the operator were in a position that enabled it to voluntarily transfer its users’ crypto-assets (such as, for example, when the operator owns a private key with which it may transfer its users’ crypto-assets on its own or jointly with related parties, without the involvement of its users).”

Accordingly, it is generally understood that the mere provision of crypto-asset wallet services to users to enable them to manage private keys on their own would not constitute a crypto-asset custody service. This is also understood to apply equally to EPIES in general.

## 5. Capital Markets and Fundraising

### 5.1 Initial Coin Offerings

Based on the prevailing view and current practices, where a token issued via an initial coin offering (ICO) is already in circulation on a Japanese or foreign crypto-asset exchange, such token would be deemed a crypto-asset under the PSA, since a market of exchange for that token is already in existence.

The JVCEA published its self-regulatory rules and guidelines regarding ICOs for crypto-assets entitled “Rules for Selling New Crypto-assets” (the “ICO Rules”). Under the ICO Rules, an ICO can be legally launched in Japan as long as such launch is conducted in compliance with the ICO Rules.

The ICO Rules contemplate two types of ICOs. The first is where a CAESP issues new tokens and sells such tokens by itself. The second is where a token issuer delegates the sale of newly issued tokens to CAESPs (a so-called initial exchange offering (IEO)). As a general matter, the ICO Rules stipulate the following requirements for both types of ICO:

- maintenance of a structure for the review of a business that raises funds via an ICO;
- disclosure of information on the token, the token issuer’s purpose for the offering proceeds, and similar;
- segregated management of funds (both fiat and crypto-assets) raised by the ICO;
- maintenance of proper accounting practices and records, and financial disclosure of funds raised by the ICO;
- ensuring the security of newly issued tokens, and of the blockchain, smart contracts, wallet tools and similar in respect of such tokens; and



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- proper valuation of newly issued tokens.

Additionally, the ICO Rules require an ICO to be implemented in compliance with the following steps:

- the CAESP that will be handling the ICO token is required to assess both the feasibility of the ICO and the security of the ICO tokens;
- the CAESP that will be handling the ICO token is required to prepare and submit a report in respect of that assessment to the JVCEA for review;
- if the aforementioned report is approved by the JVCEA, the CAESP must submit a notification of change in handling crypto-assets to the JFSA; and
- upon the JFSA's receipt of such notification, the CAESP will be permitted to make the ICO to Japan residents.

## 5.2 Initial Exchange Offerings

As noted in 5.1 Initial Coin Offerings, IEOs are subject to essentially the same rules as ICOs.

## 5.3 Other Token Launch Mechanisms

As noted in 2.1 Regulatory Overview, CAES includes sale and purchase of crypto-assets or exchange of crypto-assets.

By contrast, an airdrop of crypto-assets does not constitute a “sale and purchase” or an “exchange” for a fee, since it is an act of granting crypto-assets for free. Based on this, the authors believe that airdrops granting crypto-assets for free do not constitute CAES.

Under the Amendment Bill, the act of issuing EPIs constitutes a fund transfer transaction. Therefore, only licensed banks or registered fund transfer service providers are allowed to issue EPIs in Japan.

## 5.4 Investment Funds

As a result of amendments to the Regulations for Enforcement of the Act on Investment Trusts and Investment Corporations, as well as to the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc, investment trusts and investment corporations are prohibited from investing in crypto-assets.

Accordingly, an investment fund that invests in crypto-assets must be established in the form of a partnership-type investment fund based on a silent partnership agreement under the Commercial Code.

## 5.5 Broker-Dealers and Other Financial Intermediaries

Crypto-assets are subject to regulation applicable to CAES – ie, regulations that relate to the exchange, intermediation, agency and brokerage of crypto-assets (Article 2, paragraph 7, Item 2 of the PSA).

In other words, broker-dealers or other financial intermediaries that deal in crypto-assets will also be subject to regulations concerning CAES.

This applies equally to EPIES in general.

## 6. Smart Contracts

### 6.1 Enforceability

There is no clear definition of “smart contracts” under Japanese law, nor is there any specific regulation of smart contracts in Japan.

The authors understand smart contracts to generally mean self-executing contracts containing terms that are predetermined pursuant to specific programming codes on blockchain. The use of smart contracts may raise issues of their validity

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and enforceability as legal contracts. However, such issues may be offset by the fact that smart contracts are effectively enforceable regardless of their legal validity.

For instance, a smart contract would be automatically enforced and irrevocable even if such contract is invalid and unenforceable for violating applicable law. It should be noted that there is currently no judicial precedent in Japan addressing the legal enforceability of such smart contracts.

## 6.2 Developer Liability

There are no regulations in Japan that focus specifically on the responsibility of developers of blockchain-based networks or on the codes that run on such networks.

In general, however, if there is any breach of contract in terms of the work performed by a contractor, the contractor will be responsible for losses arising from such breach under the Civil Code.

For software bugs, where a contractor resolves an issue without delay after such issue has been brought to the attention of the contractor, or if the contractor consults with the user and takes reasonable alternative measures for the resolution of the issue, the contractor would not be deemed to have breached the software development contract.

On the other hand, if a software bug leads to significant interference with the function of the software and cannot be resolved quickly, results in significant issues, arises regularly or causes interference with the operation of a system, then such bug would constitute a breach of a software development contract, and the software developer would be responsible for such breach.

In addition, if a smart contract user suffers damage due to a defect or bug in a smart contract that was developed without being commissioned by anyone, the question arises as to whether a tort under the Civil Code has been committed. Although no precedent can be found for such a case, in accordance with the principles of the Civil Code, if a developer can be said to have intentionally or negligently caused damage to others, the developer will be held liable for damages. However, to avoid unduly delegitimising the developer of a smart contract, careful consideration is needed of the circumstances in which negligence may be found to have been committed.

## 7. Lending, Custody and Secured Transactions

### 7.1 Decentralised Finance Platforms

The issue here would be whether operators of DeFi platforms for the lending and borrowing of digital assets that constitute crypto-assets would be deemed to be providing CAES under the PSA or conducting money lending business under the MLBA. An equally important question concerns when a person will be deemed an “operator of DeFi” to begin with, though this is beyond the scope of the current discussion and will not be explored here.

#### Applicability of CAES Regulations

As noted in 2.1 Regulatory Overview, the scope of CAES includes the sale and purchase of crypto-assets (Article 2, paragraph 7, Item 1 of the PSA) and the “management of crypto-assets for the benefit of another person” (Article 2, paragraph 7, Item 4 of the PSA).

The lending and borrowing of crypto-assets is not caught by the PSA. More specifically, crypto-

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assets that are lent to or borrowed from users are considered to belong to the crypto-asset lending company. As the lending and borrowing of crypto-assets do not constitute management of crypto-assets “for the benefit of another person”, such lending and borrowing will not constitute CAES.

As a result, the operator of a DeFi platform will not constitute a CAESP (although, depending on the factual circumstances, a DeFi platform operator that manages crypto-assets held by users may be deemed to be providing crypto-asset custody services). This applies equally to EPIES in general.

## Applicability of Money Lending Regulations

Money lending business refers to “the business of loaning money or acting as an intermediary for the lending or borrowing of money on a regular basis” (Article 2, paragraph 1 of the MLBA). Generally, crypto-assets are not deemed to constitute legal tender or “money” as such term is referred to in the MLBA.

Accordingly, operation of a DeFi platform does not constitute money lending business unless the platform is used to lend or borrow crypto-assets in such a manner as to effectively constitute the lending or borrowing of legal tender.

By contrast, since EPIs, unlike crypto-assets, are denominated in legal tender and are redeemable in legal tender, a loan of EPIs could be considered a loan of money.

## 7.2 Security

As noted in 3.1 Ownership, the concept of legal ownership of crypto-assets is not currently recognised in Japan because crypto-assets are intangible. Under Japanese law, it is considered impossible to create a security interest in an

intangible object itself, and therefore likely difficult to create a security interest directly over crypto-assets that are managed by a borrower at its own address.

By contrast, if a borrower has deposited its own crypto-assets with a CAESP, the lender would conceivably be able to create a pledge of or transfer security interest in the borrower’s claim for the return of the deposited crypto-assets against the CAESP.

The above applies equally to EPIs in general. In addition, since an EPI holder has a right to claim redemption in legal tender against the EPI issuer, the EPI holder may create security over such claim. However, in such a case, there may be issues regarding perfection requirements and the need to effectively lock up the EPI.

## 7.3 Custody

Transfers by professional investors of digital assets in which they have invested to a custodian are not specifically regulated in Japan.

Persons wishing to act as custodians of crypto-assets are required to undergo registration as CAESPs since they will be offering the service of “management of crypto-assets for the benefit of another person” (ie, crypto-asset custody services). Likewise, the act of engaging in custodianship of EPIs is considered EPIES (ie, provision of EPI custody services).

It should be noted, however, that a trust company may be entrusted with the custody of crypto-assets pursuant to the Trust Business Act without being registered as a CAESP (Article 2, paragraph 7, Item 4 of the PSA). That said, a trust company that is a subsidiary of a bank, a bank holding company or a trust bank is not permitted to hold crypto-assets on entrustment.

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## 8. Data Privacy and Protection

### 8.1 Data Privacy

Business operators using blockchain technology may be subject to the Act on the Protection of Personal Information (APPI) if they handle personal information.

Considering that a public blockchain involves the sharing of a database among unspecified participants, where information on the blockchain will not in principle be deleted or retracted once uploaded on the blockchain, the use of blockchain technology may trigger the application of the APPI. For example, Article 19 of the APPI requires business operators who handle personal information to delete unnecessary personal information once the purpose for which such personal information was required has been achieved. However, a business operator that records the personal information of its users on a blockchain may have difficulty deleting such information, and this could result in a violation of the APPI.

### 8.2 Data Protection

Data that creatively expresses thoughts or sentiments, such as images and music, falls within the definition of “work” under the Copyright Act. This means that use of such data may be subject to the Copyright Act. Where the Copyright Act applies, it would be necessary to ensure non-infringement of the rights of the data’s author.

Additionally, use of data that constitutes trade secrets may be subject to the Unfair Competition Prevention Act (UCPA). Where the UCPA applies, it would be necessary to ensure that the interests of owners of such trade secrets are not infringed.

## 9. Mining and Staking

### 9.1 Mining

Under Japanese regulations, including the PSA, the mining of crypto-assets itself does not fall within the definition of CAES. Accordingly, mining activities are not regulated under existing Japanese regulations.

It bears noting, however, that interests in mining schemes formulated as collective investment schemes or in cloud mining schemes may be deemed securities under the FIEA, and could therefore be subject to provisions under the FIEA.

### 9.2 Staking

The staking of tokens itself is not regulated in Japan. Depending on the content of the staking service involved, however, this may trigger CAES regulations under the PSA or regulations in respect of collective investment schemes under the FIEA.

More specifically, if the private keys of crypto-assets held by customers in the staking service are transferred to the provider of the staking service, and such service provider is able to transfer and dispose of the crypto-assets without the involvement of the customers, then the staking service will likely constitute either:

- CAES, as it involves “the management of crypto-assets for the benefit of another person”; or
- Type II financial instruments business, as it involves solicitation in respect of a collective investment scheme stipulated in Article 2, paragraph 2, Item 5 of the FIEA.

In contrast, if the staking service involves no transfer of the private keys of crypto-assets held

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by customers to the staking service provider, such that the service provider cannot transfer or dispose of such crypto-assets without the involvement of the customers, then such staking service is unlikely to constitute “management of crypto-assets for the benefit of another person” or solicitation in respect of a collective investment scheme.

## 10. Decentralised Autonomous Organisations (DAOs)

### 10.1 General

Currently, there is no legal definition of decentralised autonomous organisations (DAOs) in Japan, nor is there any law that stipulates the legal treatment or composition of DAOs.

Accordingly, the authors believe that DAOs would likely be treated as associations, partnerships or companies under existing laws and regulations, depending on the legal and governance structure of the relevant DAO.

For example, even if a group operating as a DAO does not have a juridical personality, it will likely be treated as an “association without rights and powers” if it has the actual substantive status of an association.

For this purpose, an “association without rights and powers” means an entity:

- made up of individuals who have been brought together for a common purpose;
- organised as an association;
- subject to the principle of majority voting;
- that continues to exist despite changes in its members; and
- in respect of which a system has been put in place for its representation, management,

management of property, and other matters essential to its organisation (Supreme Court Decision of 15 October 1964).

If a DAO constitutes an “association without rights and powers”, the rights and obligations of the DAO will be vested in the members of the DAO, and each of these members will bear limited liability for the obligations of the association that has no juridical personality.

### 10.2 DAO Governance

As noted in **10.1 General**, there is no law in Japan that specifically regulates DAOs or the governance thereof.

Consequently, there are no laws regulating the method of distributing governance tokens to DAO members in DAOs, nor are there laws on whether governance tokens should be granted on- or off-chain.

Additionally, there are no laws that stipulate the criteria necessary for decision-making in DAOs.

### 10.3 Legal Entity Options

As noted in **10.1 General**, there is no law in Japan that specifically regulates DAOs or the governance thereof.

As a result, if a so-called DAO in Japan tries to enter into a transaction with a non-blockchain local entity (such as a company or financial institution that adopts the legal structure of a stock company), it is unclear who in the DAO will have representative authority. Accordingly, as a practical matter it may be difficult for a DAO to conclude a contract with a local entity.

In this regard, according to the Web3 White Paper published by the LDP in April 2023, when considering the granting of legal personal-

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ity to DAOs, the limited liability company (LLC) structure (among the various legal entity forms available) is considered highly compatible with the functions of DAOs, as the LLC structure is premised upon ownership and management being consistent in their positions with respect to business matters, and the articles of incorporation of an LLC are generally recognised. From this perspective, the Web3 White Paper states that a potential option is to first enact a special law on LLC-type DAOs, before applying the rules regarding LLCs in the Companies Act and the rules on membership tokens under the FIEA to LLC-type DAOs, in each case with the necessary modifications.

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