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Japan

Blockchain

Contributor

Anderson Mori &
Tomotsune



Ken Kawai

Partner | ken.kawai@amt-law.com

Takeshi Nagase

Partner | takeshi.nagase@amt-law.com

Takato Fukui

Partner | takato.fukui@amt-law.com

Keisuke Hatano

Partner | keisuke.hatano@amt-law.com

This country-specific Q&A provides an overview of blockchain laws and regulations applicable in Japan.

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Japan: Blockchain

1. Please provide a high-level overview of the blockchain market in your jurisdiction. In what business or public sectors are you seeing blockchain or other distributed ledger technologies being adopted? What are the key applications of these technologies in your jurisdiction?

Japan was the first country to establish a regulatory framework for crypto assets ("Crypto Assets"). Perhaps because of this head start, blockchain technology is now being increasingly adopted in the Japanese financial industry. (As of September 30, 2023, there are 29 licensed Crypto Asset exchange service providers ("CAESPs") in Japan). Recently, a bill for amending the Payment Services Act (the "PSA") was passed by the Diet and promulgated in June 2022, with the aim of introducing new regulations on stable coins. The amendments entered into force on June 1, 2023.

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, a subsidiary of Kenedix, one of the leading real estate companies in Japan, launched the first public offering of asset-backed security tokens in Japan in July 2021, and multiple similar projects thereafter. Most of such asset-backed security tokens are based on a beneficiary certificate issuance trust scheme that utilises a blockchain platform. In addition, digital art and digital trading cards represented by non-fungible token ("NFTs"), which are non-replaceable digital tokens issued on a blockchain, have recently been traded for considerable amounts. As a result, NFTs have been garnered considerable attention in Japan. NFTs are considered innovative because they involve the creation of unique, one-of-a-kind data based on blockchain technology, unlike other digital data that are inherently free and easy to copy.

These developments demonstrate that the application of blockchain technology to business is moving from the stage of Proof of Concept ("PoC") to the stage of practical application.

2. To what extent are tokens and virtual assets in use in your jurisdiction? Please mention any notable success stories or failures of applications of these technologies.

As noted in our response to Q12, the trading of Crypto Assets on CAESPs is now prevalent in Japan.

Additionally, games that employ blockchain technology ("Blockchain Games") are gaining in popularity in Japan. Typically, in a Blockchain Game, a business operator will issue game characters or game items as NFTs on a blockchain, and give such characters or items unique characteristics or make them transferable on the blockchain. In such cases, the issue arises as to whether such game characters or items constitute Type II Crypto Assets (as defined in our response to Q9 below) under the PSA, because such characters or items are mutually exchangeable with Type I Crypto Assets (as defined in our response to Q9 below), such as Bitcoin or Ether, among unspecified persons on the blockchain. According to the FSA Administration Guidelines on Crypto Assets ("Crypto Asset Guidelines"), dated March 24, 2023 issued by the Financial Services Agency of Japan (the "FSA"), one of the factors for determining whether a token constitutes a Type I Crypto Asset is whether it is "an asset capable of being purchased or sold with legal fiat currency or crypto assets under socially accepted norms". Specifically, a token that satisfies criteria (i) and (ii) below generally will not constitute a Type I Crypto Asset. The same applies to assessment of whether a token constitutes a Type II Crypto Asset:

- (i) The issuer 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 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. Specifically, at

least one of the following conditions must be satisfied:

- a. the minimum value per transaction must be sufficiently high (i.e., JPY1,000 or more); or
- b. the number of tokens issuable, in proportion to the aforementioned minimum value of a transaction, must be limited (i.e., must not exceed 1 million).

The relationship between intellectual property and NFTs has also been attracting attention in Japan. In general, exchanges of NFTs do not constitute copyright infringement even if the artworks underlying NFTs infringe copyrights. This is because NFTs themselves do not constitute the relevant artwork. Currently, protection of copyrights and other forms of intellectual property in the growing NFT market are based on consent, such as through the terms of use of NFT market platforms. Against this backdrop, the Copyright Distribution Subcommittee of the Japan Contents Blockchain Initiative (the "Copyright Distribution Subcommittee") on June 1, 2021 issued a document entitled "Concept on NFT for Contents (Content-NFT)", declaring NFT as an important technology that contributes to the facilitation and revitalization of content distribution and that appropriate rules and environments should be established for the trading of NFTs. The Copyright Distribution Subcommittee is made up of companies and government agencies that regulate content creation and distribution through NFT technology.

3. To what extent has blockchain technology intersected with ESG (Environment, Social and Governance) outcomes or objectives in your jurisdiction?

In Japan, there has so far been limited interrelation between blockchain technology and ESG outcomes and goals. There are, however, some companies that use blockchain technology to address environmental and other ESG issues. For example, on February 9, 2021, the Japanese retail giant Aeon Co., Ltd. announced the release of a quilt made of recycled polyester from plastic bottles collected in the coastal areas of the Philippines. It was stated in the announcement that the provenance of such quilts is guaranteed by blockchain technology¹.

In addition, in September 2022, JPX Market Innovation & Research, Inc. announced the establishment of a "Study Group on the Use of Digital Bonds for ESG Investment," involving issuers and prospective investors of environmental bonds, such as green bonds, as well as securities companies, banks and trust banks, and ESG-related evaluation organizations, system vendors, public

institutions and the like. According to the announcement, the study group aims to deepen understanding of the functions of a "Green Tracking Hub" to monitor power generation through renewable energy projects and the issuance of green and other environmental bonds using security tokens. As part of its agenda, the study group will explore various issues related to investment in green bonds and security tokens.

Footnotes:

¹https://www.aeon.info/wpcontent/uploads/news/pdf/2021/02/210209R_2.pdf

4. Please outline the principal legislation and the regulators most relevant to the use of blockchain technologies in your jurisdiction. In particular, is there any blockchain-specific legislation or are there any blockchain-specific regulatory frameworks in your jurisdiction, either now or envisaged in the short or mid-term?

No blockchain-specific regulatory framework currently exists in Japan, nor is such regulatory framework anticipated in the near future. Accordingly, blockchain or related businesses and services will be regulated under existing laws or regulations, depending on the legal characteristic of the token minted on a blockchain or the substance of such services.

For example:

- i. if the tokens minted on a blockchain ("Blockchain-minted Tokens") fall within the definition of "Crypto Asset" under the PSA, then a business operator who purchases or sells such tokens in the course of its business will be regulated as a CAESP;
- ii. a person who sells, purchases or handles the public offering of Blockchain-minted Tokens that fall within the definition of "securities" under the Financial Instruments and Exchange Act (the "FIEA") must be registered as a Type I Financial Instruments Business Operator;
- iii. an issuer of Blockchain-minted Tokens that are pegged to fiat currencies (such as the JPY or USD) (i.e., stable coins), or an affiliate of such issuer who guarantees the redemption of such stable coins in fiat currencies may be required to undergo licensing as a Bank under the Banking Act, a fund remittance business operator ("FRBO") under the PSA, or as a trust company under the Trust Business Act;

- iv. a business operator that handles the personal information of its users may be subject to the Act on the Protection of Personal Information ("APPI"); and
- v. issuance of NFTs and provision of trading services in respect of NFTs are not subject to financial regulations.

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<https://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/ap2019en.pdf>

3

<https://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/fu2020.pdf>

⁴https://www.boj.or.jp/en/announcements/release_2021/rel210405b.pdf

5. What is the current attitude of the government and of regulators to the use of blockchain technology in your jurisdiction?

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

For instance, in June 2019, the Japanese government published an "Action Plan of the Growth Strategy"², which discussed the importance of the use of blockchain technology, stating that "AI, IoT, robots, big data, blockchain ...are general purpose technology (GPT) that broadly affect all industries, similar to adoption of electric power from the 19th to 20th century and IT inroads through the end of the 20th century."

In addition, in July 2020, the Japanese government published a "Follow-up for Growth Strategy"³, stating that "In a decentralized financial system based on blockchain technology, where there are no regulated intermediaries, the Japanese Government will lead the international discussion by actively contributing to the Blockchain Governance Initiative Network (BGIN) to achieve financial administrative objectives, such as financial system stability, user protection and prevention of money laundering, etc."

On June 18, 2021 the Japanese cabinet approved the "Growth Strategy (2021)," which includes facilitation of blockchain technology. The development of an ecosystem surrounding NFTs and Security tokens is also specifically mentioned in the "Plans for Implementing Growth Strategy" published on the same date⁴.

Furthermore, it was stipulated in a paper entitled "Grand Design and Action Plan for a New Form of Capitalism 2023 Revised Version", which was approved by the Cabinet in June 2023, that the Japanese government would foster the development of an environment for the promotion of web3, including the use of NFTs and decentralised autonomous organisations (DAOs) based on blockchain technology.

Footnotes:

6. Are there any governmental or regulatory initiatives designed to facilitate or encourage the development and use of blockchain technology (for example, a regulatory sandbox or a central bank digital currency initiative)?

To encourage Fintech innovation, including the development and usage of blockchain technology, the FSA introduced the "Fintech Testing Hub" in September 2017. As part of this initiative, the FSA will set up, on a case-by-case basis, a support team that helps Fintech companies and financial institutions to identify and solve potential legal issues and risks associated with new Fintech schemes.

In addition, in June 2018, the headquarters of Japan's Economic Revitalization of the Cabinet Secretariat established a cross-governmental one-stop desk for the Regulatory Sandbox Scheme in Japan. This resource, available to Japanese as well as foreign 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, are explicitly mentioned in the basic policy of the Regulatory Sandbox Scheme as prospective and suitable areas for exploration and development.

Furthermore, in February 2019, METI held an event entitled "Blockchain Hackathon 2019". The event is generally known as the first step towards social implementation of blockchain technologies in the domains of academic degrees, courses and career certifications, as well as in the recording and storage of research data⁵.

Adding to the above, the Bank of Japan ("BOJ") commenced its PoC phase of a proposed central bank digital currency ("CBDC") on April 5, 2021. The aim for phase 1 of the PoC was to develop a test environment for the CBDC system and conduct experiments on the basic functions that are central to the CBDC as a payment instrument, such as functions relating to issuance,

distribution, and redemption. Phase 1 of the PoC ended in March 2022. In "Proof-of-Concept Phase 2", conducted from April 2022 to March 2023, the BOJ added several peripheral functions to the CBDC, in order to ascertain certain important processing performance and technical capabilities in respect of the CBDC ledger. The BOJ also looked at the possibility of applying new technologies to data models and databases in respect of the CBDC. The government of Japan has so far not decided whether to issue any CBDC in Japan, but discussions continue to be held in this regard.

Footnotes:

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https://www.meti.go.jp/english/press/2019/0228_003.html

7. Have there been any recent governmental or regulatory reviews or consultations concerning blockchain technology in your jurisdiction and, if so, what are the key takeaways from these?

METI has conducted the "FY2017 Infrastructure Development Program Concerning Data-driven Society in Japan (Survey on Technology and Institutes Related to Distributed System)" to uncover core technologies and legal systems that are required for the public implementation of distributed systems (such as blockchain technologies), and compiled the survey results into the "Report on the Survey on Technology and Institutes Related to Distributed System"⁶, on July 23rd, 2019 (the "METI Report 2019").

It is stated in the METI Report 2019 that METI chose the following three usage areas as targets for the evaluation of distributed systems, with the aim of (i) showing case examples of how distributed systems work in practice (which may vary greatly from case to case) and (ii) promoting their utilization:

- (i) medical and healthcare industry: clinical trial data management platform;
- (ii) logistics, supply chains and mobility industry: EV battery life-cycle management platform; and
- (iii) smart property industry: smart token platform.

In the process of evaluating the practical usage of distributed systems, METI recognized the existence of many challenges to the commercialization of distribution systems (such as blockchain technologies), because the approaches taken under these systems (which are based

on trustworthy centralized databases) are different from the approaches under conventional systems. METI has made it a priority to overcome these challenges and is exploring core technologies for purposes of doing so.

Footnotes:

6

https://www.meti.go.jp/english/press/2018/0723_003.html

8. Has any official guidance concerning the use of blockchain technology been published in your jurisdiction?

No official guidance concerning the use of blockchain technology has been published in Japan so far.

9. What is the current approach in your jurisdiction to the treatment of cryptocurrencies for the purposes of financial regulation, anti-money laundering and taxation? In particular, are cryptocurrencies characterised as a currency?

9.1 Financial regulation

The PSA requires any person who provides Crypto Asset Exchange Services to be registered with the FSA.

"Crypto Asset" is defined in the PSA as:

- (i) proprietary value that may be used to pay an unspecified person the price of any goods, etc. purchased or borrowed or any services provided and may be sold to or purchased from an unspecified person (limited to that recorded on electronic devices or other objects by electronic means and excluding Japanese and other foreign currencies, and Currency Denominated Asset EPIs (as defined below) (excluding Currency Denominated Assets); the same applies in the following item) and that may be transferred using an electronic data processing system ("Type I Crypto Asset"); or
- (ii) proprietary value that may be exchanged reciprocally for proprietary value specified in the preceding item with an unspecified person and that may be transferred using an electronic data processing system ("Type II Crypto Asset").

"Currency Denominated Assets" means any assets that are denominated in Japanese or other foreign currency. Such assets do not fall within the definition of Crypto Asset. Accordingly, Crypto Assets are not considered

currency under Japanese law.

The term "Crypto Asset Exchange Services" means any of the following acts that is carried out in the course of business:

- (i) sale and purchase of Crypto Asset or exchange of Crypto Asset for other Crypto Asset;
- (ii) intermediary, brokerage or delegation for the acts listed in (i) above;
- (iii) management of users' money in connection with the acts listed in (i) or (ii) above; or
- (iv) management of users' Crypto Assets for the benefit of another person.

Only those registered with the FSA to engage in Exchange Services may provide such services.

9.2 Anti-money laundering

Under the Act on Prevention of Transfer of Criminal Proceeds, Exchange Providers are obligated to, among other things: (i) verify the identities of customers and persons with substantial control over such customers' businesses before they are permitted to provide services to such customers; (ii) prepare verification records and transaction records in respect of customers; (iii) maintain the records for seven years; and (iv) report suspicious transactions to the relevant authority.

9.3 Taxation

The National Tax Agency of Japan has announced that profits realised from the trading of Crypto Assets constitute "miscellaneous income" (zatsu-shotoku). The tax rate for miscellaneous income is progressive, ranging from 5% to 45%. In addition to this, 10% of such profits are payable to the local government as inhabitant's tax. Taxpayers are able to utilise losses from Crypto Asset trading to offset such profits.

No consumption tax is imposable on the sale or exchange of Crypto Assets. However, consumption tax will be levied on lending fees and interests received on Crypto Assets. Furthermore, inheritance tax will be imposed upon the Crypto Assets in the estate of any deceased person.

It is also stated in the Japanese government's paper entitled "Ruling Party's Tax Reform Proposal", published in December 2022, that 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 (i) are subject to valuation gains or

losses based on market valuation, and (ii) meet certain requirements, such as if they have been issued by that corporation and have been continuously held since their issuance. As a result, on June 20, 2023, the National Tax Administration issued a notification entitled "Partial Revision of the Basic Notification on Corporate Tax, etc. (Notification on Interpretation of Laws and Regulations)", stipulating that Crypto Assets held by a corporation at the end of its fiscal year will be excluded from corporate taxation if such assets meet the following conditions:

- (i) The Crypto Assets were issued by that corporation and have been continuously held since their issuance.
- (ii) The Crypto Assets have been continuously restricted from being transferred by way of any of the following means since the date of their issuance:
 - a. certain technical measures have been taken to ensure that the Crypto Assets cannot be transferred to another party; or
 - b. the Crypto Assets have been held in a trust that meets certain requirements.

10. Are there any prohibitions on the use or trading of cryptocurrencies in your jurisdiction?

No.

11. To what extent have initial coin offerings taken place in your jurisdiction and what has been the attitude of relevant authorities to ICOs?

The Japan Virtual and Crypto asset Exchange Association ("JVCEA"), a self-regulatory organisation established under the PSA, has established its self-regulatory rules and guidelines regarding Initial Coin Offerings ("ICOs") for Crypto Asset-type tokens entitled "Rules for Selling New Crypto Asset" ("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.

12. If they are permissible in your jurisdiction, what are the key requirements that an entity would need to comply with when launching an ICO?

According to the ICO Rules, there are two types of ICO. The first is where an 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. As a general matter, the ICO Rules stipulates the following

requirements for each type of ICO:

(i) maintenance of a structure for the review of a business that raises funds via an ICO;

(ii) disclosure of information on the token, the token issuer's purpose for the funds, and the like;

(iii) segregated management of funds (both fiat and Crypto Assets) raised by an ICO;

(iv) maintenance of proper accounting practices and records and financial disclosure of funds raised by an ICO;

(v) ensuring the security of newly issued tokens, and of the blockchain, smart contracts, wallet tools, and the like in respect of such tokens; and

(vi) proper valuation of newly issued tokens.

Additionally, the ICO Rules (as well as the PSA) require an ICO to be implemented in compliance with the following steps:

(i) the CAESP that will be handling the ICO token is required to assess both the feasibility of the ICO and the security of such ICO token;

(ii) the CAESP that will be handling the ICO token is required to prepare and submit a report in respect of item (i) above to the JVCEA for review;

(iii) if the report is approved by the JVCEA, the Exchange Provider must submit a notification of change in handling Crypto Assets to the FSA; and

(iv) upon the FSA's receipt of such notification, the CAESP will be permitted to make the ICO to Japanese residents.

13. Is cryptocurrency trading common in your jurisdiction? And what is the attitude of mainstream financial institutions to cryptocurrency trading in your jurisdiction?

According to the statistics published by the JVCEA, the total volume of Crypto Asset spot trading handled by CAESPs in Japan as of October 4, 2023, is approximately JPY 501 billion⁷. The total volume of Crypto Asset margin trading handled by CAESPs is approximately JPY 239 billion. Under the PSA, Crypto Asset margin trading is regulated for the protection of users and for purposes of ensuring the appropriate conduct of such transactions.

Footnotes:

⁷ <https://jvcea.or.jp/about/statistics/>

14. Are there any relevant regulatory restrictions or initiatives concerning tokens and virtual assets other than cryptocurrencies (e.g. trading of tangible property represented by cryptographic tokens)?

Tokens issued by way of ICOs take many forms, and the Japanese regulations applicable to each token vary depending on the ICO scheme involved.

14.1 Securities-type Tokens

The FIEA introduced the concept of "Electronically Recorded Transferable Rights" ("ERTRs"), which clarify the scope of tokens governed by the FIEA as securities.

The concept of ERTRs relates to the rights set forth in Article 2, Paragraph 2 of the FIEA that are represented by proprietary value that is transferrable by means of an electronic data processing system (but limited only to proprietary values recorded in electronic devices or otherwise by electronic means), excluding those rights specified in the relevant Cabinet Office Ordinance in light of their negotiability and other factors.

Although Article 2, Paragraph 2 of the FIEA refers to rights of various kinds, tokens issued in "security token offerings" ("STOs") are understood to constitute, in principle, "collective investment scheme interests" ("CISIs") under the FIEA. CISIs are deemed to be formed when the following three requirements are met: (i) investors (i.e., rights holders) invest or contribute cash or other assets to a business; (ii) the cash or other assets contributed by investors are invested in the business; and (iii) investors have the right to receive dividends of profits or assets generated from investments in the business. Tokens issued under STOs would constitute ERTRs if the three requirements above are satisfied.

To put it simply, rights treated as "Paragraph 2 Securities" (i.e., rights that are deemed securities pursuant to Article 2, Paragraph 2 of the FIEA) and represented by negotiable digital tokens will be treated as Paragraph 1 Securities (e.g. shares, bonds and notes, etc.) unless they fall under an exemption. As a result of the application of disclosure requirements to ERTRs, issuers of ERTRs are in principle required, upon making a public offering or secondary distribution, to file a securities registration statement and issue a prospectus. Any person who causes other persons to acquire ERTRs or who sells ERTRs to other persons through a public offering or secondary distribution must deliver a

prospectus to such other persons in advance or at the same time.

As ETRs are expected to constitute Paragraph 1 Securities, registration as a Type I Financial Instruments Business Operator will be required for the purposes of selling, purchasing or handling the public offering of ETRs in the course of a business. In addition, any ETR issuer who solicits acquisition of such ETR (i.e., undertaking an STO), will be required to undergo registration as a Type II Financial Instruments Business Operator, unless such issuer qualifies as a specially permitted business for qualified institutional investors.

14.2 Prepaid Card-type Tokens

If the tokens are similar in nature to prepaid cards and can be used as consideration for goods or services provided by token issuers, they may be regarded as "Prepaid Payment Instruments" (*maebarai-shiki-shiharai-shudan*), which are subject to the relevant regulations under the PSA (in which case, regulations in respect of Crypto Assets under the PSA would not be applicable).

14.3 StableCoins

As noted in the response to Q9 above, "Currency Denominated Assets" are excluded from the definition of Crypto Assets. "Currency Denominated Assets" is defined under Article 2, Paragraph 6 of the PSA as assets denominated in Japanese Yen or 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 a foreign currency. Based on this definition, a digital coin whose value is pegged to the JPY, USD or any other fiat currency (such as, for example, where the price of a digital coin is always fixed at one JPY or one USD, or where a digital coin is redeemable at one JPY or one USD) would fall outside the definition of "Crypto Assets".

On March 4, 2022, the "Bill for Partial Amendment to the Act on Payment Services Act, etc. for the Purpose of Establishing a Stable and Efficient Funds Settlement System" (the "Amendment Act") was submitted to the Diet. The Amendment Act, which aims to introduce new regulations in respect of stable coins, was approved on June 3, 2022 and came into effect on June 1, 2023.

Under the Amendment Act:

(i) Electronic Payment Instruments ("EPIs") (i.e., currency-denominated stable coins) would be distinguished from other currency denominated assets based on the following factors: (a) whether they can be used as

payment for consideration to unspecified persons; and (b) whether they may be purchased from or sold to unspecified persons. Based on this, prepaid payment instruments and electronic currency that are issued by fund transfer service providers do not satisfy condition (a), as their issuers would centrally manage the balance of each user and the scope of member stores that accept the relevant prepaid payment instruments and electronic money. Additionally, digital currencies, notwithstanding that they are issued on blockchains, will not satisfy condition (b) if their issuers have taken technical measures that restrict the transfer of such digital currencies only to persons who have been verified as unproblematic under know-your-customer ("KYC") checks at the time of transaction, and if the issuers' consent or other involvement is required for every transfer of the digital currencies. Consequently, stable coins issued on a permissionless blockchain would typically be deemed EPIs, as new holders of such stable coins generally are not required to undergo KYC checks and transfers of such stable coins do not require the involvement of their issuers.

(ii) Those who are permitted to issue EPIs directly to Japanese residents are limited to banks, funds transfer service providers, trust banks or trust companies that are licensed in Japan. This is because the issuance and redemption of EPIs constitute "fund remittance transactions" (*kawase-torihiki*).

(iii) It is not possible for a CAESP to list EPIs on any exchange or manage EPIs for its users, without being registered as an Electronic Payment Instruments Exchange Service Provider ("EPIESP").

(iv) An EPIESP is subject to anti-money laundering/counter-financing of terrorism ("AML/CFT") regulations, including a "travel" rule. More specifically, an EPIESP, when transferring EPIs to any other EPIESP, is required to provide a customer's identification information to such other EPIESP. Moreover, an EPIESP who sends or receives EPIs to or from overseas virtual asset service providers ("VASPs") on a regular basis is required needs to check whether such VASPs are conducting appropriate due diligence on its users for AML/CFT purposes.

15. Are there any legal or regulatory issues concerning the transfer of title to or the granting of security over tokens and virtual assets?

The legal characteristics of Crypto Assets under the Civil Code of Japan is currently unclear. According to a judicial precedent of the Tokyo District Court dated August 5,

2015, legal ownership or title does not apply to Crypto Assets, as 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. Similarly, the grant of security over Crypto Assets would also be difficult.

However, a person who deposits Crypto Assets with an CAESP will have a claim against such CAESP for the return of the deposited Crypto Asset under the CAESP's terms of service, or the like. In such cases, the creditors of persons may create a security over such persons' claim for Crypto Assets against the relevant CAESPs.

In the regulatory context, the amended Act on Prevention of Transfer of Criminal Proceeds, which came into effect on June 1, 2023, imposes the Travel Rule on the transfer of Crypto Assets and EPIs. The Travel Rule is a system that requires CAESPs and EPIESPs (collectively referred as "VASPs"), when transferring Crypto Assets or EPIs, to share certain information about originators and beneficiaries with the relevant beneficiary VASPs. This is to enable tracking of the transaction path of these assets for AML/CFT purposes, in compliance with FATF standards.

16. How are smart contracts characterised within your legal framework? Are there any enforceability issues specific to the operation of smart contracts which do not arise in the case of traditional legal contracts?

There is not clear definition of "smart contracts" under Japanese law, nor is there any specific regulation of smart contracts in Japan.

Assuming that smart contracts generally mean "self-executing contracts containing terms that are pre-determined pursuant to specific programming codes", the use of smart contracts may raise issues of enforceability, although the costs of resolving such issues may be offset by the use of smart contracts.

For instance, a smart contract based on blockchain technology would be automatically enforced and irrevocable even if such contract is unenforceable for violating applicable law.

However, the automatic enforcement of smart contracts is only applicable where the subject of the contract are on-chain assets, such as Crypto Assets or Stablecoins. For purposes of enforcing rights against off-chain assets, a party would need to prove in court that the relevant smart contract had been validly concluded, as is the case

with traditional paper contracts. Currently, there is no known judicial precedent in Japan that explores the issue of validity of smart contracts.

17. To what extent are smart contracts in use in your jurisdiction? Please mention any key initiatives concerning the use of smart contracts in your jurisdiction, including any examples relating to decentralised finance protocols.

In Japan, the use of smart contracts is largely still at the PoC stage.

In this regard, in October 2022, the Web 3.0 Study Group established by the Digital Agency, a government agency established to facilitate the digitalization of Japan, announced that it will focus on the legal status of smart contracts relating to the operating rules of decentralized autonomous organizations (DAOs), which are organizations without legal personalities and governing bodies, and whose members operate autonomously.

18. Have there been any governmental or regulatory enforcement actions concerning blockchain in your jurisdiction?

As a result of the leakage of users' Crypto Assets with a value of approximately USD 530 million from a cyber-attack on one of the biggest CAESPs in 2018, the FSA conducted sweeping on-site inspections on registered and provisional CAESPs. This was followed by the FSA's announcement, on March 8, 2018, of the imposition of business suspension orders on two provisional exchanges, and business improvement orders on two registered exchanges and three provisional exchanges. After further review, the FSA on June 22, 2018, also imposed business improvement orders on six additional major registered exchanges.

In addition, on June 21, 2019, the FSA imposed a business improvement order on one of the Exchange Providers for the inadequacy of their business management, anti-money laundering and counter terrorist financing, and risk management systems, among other things.

However, on June 28, 2019, the FSA lifted the business improvement orders it had imposed on three companies, including one of the biggest CAESPs. In August 2020, the FSA also lifted a business improvement order it had imposed on another CAESP.

In November 2022, the FSA issued a business suspension

order, a business improvement order, and an order for domestic retention of assets on the Japanese subsidiary of a major foreign CAESP, due to the subsidiary's suspension of return of customer assets without clear explanation, and concerns over the creditworthiness of its parent company. Although the business suspension order was later lifted, the business improvement order and the order for domestic retention of assets are still in place due to the parent company's bankruptcy.

19. Has there been any judicial consideration of blockchain concepts or smart contracting in your jurisdiction?

There has thus far been no judicial consideration of blockchain concepts or smart contracts in Japan. As noted under Q15, however, legal ownership or title in respect of Crypto Assets under the Civil Code has been considered by the courts.

20. Are there any other generally-applicable laws or regulations that may present issues for the use of blockchain technology (such as privacy and data protection law or insolvency law)?

Business operators using blockchain technology may be subject to the APPI if they handle the personal information of their users.

In addition, 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 recorded on the blockchain, the use of blockchain technology may trigger the application of the APPI. For example, Article 22 of the APPI requires business operators who handle personal information to delete unnecessary personal information once the purpose for which such personal information is 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.

21. Are there any other key issues concerning blockchain technology in your jurisdiction that legal practitioners should be aware of?

As noted under Q14, an ERTR is required to be "represented by proprietary value transferrable by means of an electronic data processing system (but limited only to proprietary values recorded in electronic devices or

otherwise by electronic means)." As this language is consistent with the definition of Crypto Assets, Crypto Assets that are transferrable on blockchain (as is the case with Bitcoin) may constitute ERTRs.

However, tokens that do not meet the three criteria of CISIs⁸, such as the criterion requiring investors to "have the right to receive dividends of profits or assets generated from investments in the business", will not be categorized as ERTR but will likely qualify as Crypto Assets.

As stated above, ERTRs are expected to consist mainly of CISIs. It should be noted, however, that CISIs as exemplified in Article 2, Paragraph 2, Item 5 of the FIEA (other than for membership interests in incorporated associations) are stipulated as contractual rights under applicable laws and regulations. To transfer contractual status, the consent of the counterparty to the contract is required⁹. For example, where ERTRs represent the status of silent partners (*tokumei kumiai-in*) under silent partnership agreements (*tokumei kumiai keiyaku*) as set forth in the Commercial Code, then even if such ERTRs are recorded on blockchain as being transferred from the assignor to the assignee, the status of the silent partners would not be deemed to have been transferred as a matter of course to the assignee if the consent of the operator (*eigyo-sha*), who is the counterparty to the contract, has not been obtained. This issue needs to be resolved. A possible solution is to provide in the relevant silent partnership agreement that the operator will be deemed to have provided its consent to a transfer of contractual status, if a silent partner transfers its contractual status on blockchain.

Furthermore, even if contractual status or rights and obligations are transferred through the transfer of tokens, provision of a notification from the assignor to the debtor, and the debtor's consent, both documented on with a certified date, would generally be necessary under Japanese law for purposes of enforcing such transfer against third parties. However, the implementation such paper-based methods is problematic in systems predicated on blockchain technology. To address this issue, the Industrial Competitiveness Enhancement Act provides an exception under which perfection against third parties may be achieved through notifications or consents via a system that meets certain accuracy, safety and other criteria. Prior authorization from the relevant authorities must be obtained for the use of such system. Several demonstration activities relating to electronic transactions via blockchain technology are currently being conducted on the basis of such exception.

Footnotes:

⁸ See our response to question 14.

Minshu, Vol. 9, No. 10, p.1472, and Article 539-2 of the Amended Civil Code

⁹ Supreme Court Judgment of September 29, 1955,

Contributors

Ken Kawai
Partner

ken.kawai@amt-law.com



Takeshi Nagase
Partner

takeshi.nagase@amt-law.com



Takato Fukui
Partner

takato.fukui@amt-law.com



Keisuke Hatano
Partner

keisuke.hatano@amt-law.com

