



## Proposed Legal and Regulatory Framework for Stablecoins

On March 4, 2022, the Financial Services Agency of Japan (“FSA”) submitted a bill, amending the Payment Services Act (“PSA”) and other laws relating to electronic payments, to the National Diet of Japan. The provisions under this amendment bill include a new regulatory framework for stablecoins, aimed at responding to the significant growth in the issuance and distribution of stablecoins overseas, and associated issues such as protection of users. If the bill is passed by the Diet, the new framework is likely to be introduced in 2023.

Under the framework, stablecoins that are considered as electronic money (see section 1 below) will be regulated as money transmissions and means of payment. Issuers will be limited to banks, funds transfer service providers and trust companies. Also, a new “Electronic Payment Instrument Business” (as defined in section 2. below) license will be introduced for intermediaries who handle such stablecoins.

This article gives an overview of the proposed new legal and regulatory framework.

### 1. Electronic Payment Instrument

According to the FSA, stablecoins can be categorized as follows:

- (i) stablecoins that are issued at a price linked to the value of fiat currency (e.g., 1 coin = 1 Japanese Yen) enabling redemption of the issued price; and
- (ii) stablecoins other than (i) above (e.g., stablecoins that attempt to achieve price stability through means of algorithmic mechanisms).

The stablecoin usage described in (i) above is said to be similar to that of electronic money and the proposal is to regulate such stablecoins as “Electronic Payment Instruments” (as defined in this section 1 below) under the PSA. The stablecoins described in (ii) above are regulated as “crypto-assets” under the pre-existing PSA.

In relation to stablecoins regulated as Electronic Payment Instruments (see (i) above), there are concerns regarding redemption rights in the context of bankruptcy of issuer or intermediary. Therefore, it is proposed that issuers of such stablecoins will be limited to: (a) banks regulated under the Banking Act; (b) funds transfer service providers regulated under the PSA; and (c) trust companies regulated under the Trust Business Act. It is currently understood that the respective bankruptcy protection regimes in the case of (a) to (c) will be as follows:

- (a) The value of user assets (at the time of issuance) are protected as deposit rights under the existing deposit insurance system.
- (b) The value of user assets (at the time of issuance of the asset) will be protected by deposit, bank guarantee or trust under the PSA.

(c) User assets will be bankruptcy remote as they are held in trust.

Category	Stablecoins	
	Electronic Payment Instruments	Crypto-assets
Issuers regulated?	Yes.	No.
Intermediaries regulated?	Yes, under the proposed framework.	Yes.

Under the proposed amendment to the PSA, “Electronic Payment Instrument” shall mean any of the following:

- (i) property value (limited to currency-denominated assets that are recorded on an electronic device or any other object by electronic means, and, excluding securities, electronically recorded monetary claims, prepaid payment instruments and other similar items to be specified under the Cabinet Office Order) that can be used by unspecified persons for providing consideration for the purchase or leasing of goods, or provision of services. Such property value can also be purchased from, and sold to, unspecified persons acting as counterparties, and transferred by means of an electronic data processing system;
- (ii) property value that can be mutually exchanged with the property value described in the preceding item, with unspecified persons acting as counterparties, and transferred by means of an electronic data processing system;
- (iii) specific beneficial interest; and
- (iv) other items to be designated by Cabinet Office Order.

“Specific beneficial interests” means beneficial interests in money trusts (limited to property values that can be recorded and transferred electronically) where the entire amount of money entrusted under the trust contract is managed as savings.

## 2. Introduction of “Electronic Payment Instrument Business” Registration

### (1) Definition of “Electronic Payment Instrument Business”

As part of the proposed new framework, the FSA will introduce a new registration system for intermediaries, with respect to stablecoins regulated as Electronic Payment Instruments. Any of the following business activities of intermediaries will fall within the scope of Electronic Payment Instrument Business and, thus, will be subject to the new registration system:

- (i) purchase and sale of an Electronic Payment Instrument, or exchange with another such instrument;
- (ii) intermediary, brokerage or agency services in connection with the preceding item;
- (iii) management of Electronic Payment Instruments on behalf of another person (excluding some use cases to be specified by Cabinet Office Order); or
- (iv) on behalf of the fund transfer service provider, (a) transferring funds and reducing the value of a user’s claim against the provider, by an amount equivalent to such exchange transaction or (b) when receiving funds, increasing the value of a user’s claims against the provider, by an amount equivalent to such exchange transaction.

Issuers such as banks and funds transfer service providers are not required to register to conduct Electronic Payment Instrument transactions, but they must comply with some of the rules applicable to Electronic Payment Instrument Business Operators.

### (2) Registration Requirements

An applicant will have to either be incorporated as a stock company (*kabushiki kaisha*) in Japan, or in the case of a foreign Electronic Payment Instruments Business Operator, have a business office and a representative domiciled in Japan. The applicant will also need to satisfy certain financial requirements to

be specified by Cabinet Office Order and have in place, effective and reliable business systems, as specified and required under all relevant laws.

### (3) Requirements of Electronic Payment Instruments Business Operators

- (i) Information security management measures must be taken.
- (ii) Provision of information regarding terms and conditions of contracts relating to Electronic Payment Instruments Business and implementation of measures necessary for protecting users and conducting such business activities in an appropriate manner.
- (iii) The receipt of deposits of money or other property from users in connection with Electronic Payment Instrument Business activities is prohibited.
- (iv) Electronic Payment Instruments of users must be managed separately from the business operator's own assets and regularly audited by a certified accountant or an audit corporation.
- (v) The Electronic Payment Instrument Business Operator and issuer must enter into a contract that includes provisions regarding the sharing of liability between the Electronic Payment Instrument Business Operator and the issuer.

### (4) Supervision

The proposed amendment to the PSA includes provisions regarding preparation of books and reports, submission of relevant reports together with audit reports of certified accountants or audit corporations, on-site inspections, issuance and compliance with business improvement orders, etc.

### (5) Self-Regulatory Body

A general incorporated association is to be established by stakeholders, such as Electronic Payment Instrument Business Operators, in order to provide guidance to members on compliance with the provisions of the PSA and other laws, regulations and rules. It is expected that the FSA will certify the association, provided that it satisfies certain requirements, such as providing adequate oversight of the Electronic Payment Instrument Business sector in Japan.

## 3. Foreign Electronic Payment Instrument Business Operator

The proposed amendments to the PSA prohibits foreign Electronic Payment Instruments Business Operators from soliciting residents in Japan, unless they are registered with the FSA and are in compliance with all relevant requirements under Japanese law. Therefore, intermediaries, such as crypto exchanges and wallet service providers, who provide services to residents in Japan related to stablecoins that are categorized as Electronic Payment Instruments, will likely be required to register with the FSA, in the same manner. In addition, foreign issuers of such stablecoins are required to obtain a banking license or to register as funds transfer service providers so that their stablecoins can be issued to, and used by, residents in Japan.

## 4. Electronic Payment Service Operator

Similar to the concept of Electronic Payment Instrument Business under the PSA, an intermediary will be considered as an "Electronic Payment Service" and will be subject to the new registration system, under the proposed amendments to the Banking Act, if such intermediary conducts the following activities:

- (i) on behalf of the bank, (a) transferring funds from the bank account, thereby reducing the value of a user's bank deposit, or (b) increasing the value of a user's bank deposit, equivalent to the amount of funds received through an exchange transaction; and
- (ii) in connection with the preceding item, entering into a contract as an intermediary for the acceptance of deposits on behalf of the bank.

The registration requirements, restrictions, supervision and self-regulatory body for Electronic Payment Service Operators, are similar to those of Electronic Payment Instruments Business Operators.

As mentioned above, bank deposits are protected under the existing deposit insurance system. The Deposit Insurance Corporation may require an Electronic Payment Service Operator to report and submit materials, and has the authority to conduct on-site inspections.

## **5. AML/CFT**

Under the proposed amendments to the Act on Prevention of Transfer of Criminal Proceeds, Electronic Payment Instrument Business Operators and Electronic Payment Service Operators will be required to conduct customer due diligence (CDD). If an Electronic Payment Instrument Business Operator enters into a contract with an offshore Electronic Payment Instrument Business Operator, for continuous or repeated transfers of Electronic Payment Instruments, confirmation that the foreign-located counterparty has established a sufficient system to conduct CDD will be required. In addition, when an Electronic Payment Instrument Business Operator performs transfers of Electronic Payment Instruments per customer requests, it must submit customer identification details to the beneficiary institutions.

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