Summary of Japanese FSA Crypto Asset and Stablecoins Framework

Background

In June 2023, the Japanese Financial Services Agency (FSA) amended the Payment Services Act (PSA) to update the regulatory framework for Crypto Assets and Stablecoins. This major amendment included a revised definition of crypto assets, new guidelines for crypto asset exchanges, new travel and banking rules, and a revised framework for stablecoin issuers.

Timeline of Crypto Amendments to the Payment Services Act

- *April 2017*. Crypto asset regulations introduced, defining crypto assets, requiring service provider registration and enacting integrity measures.
- *May 2020*. Consumer protection requirements enhanced, requiring segregation of offline crypto assets and prohibiting misleading advertisement. Custodial wallet service providers now included.
- *June 2023*. Stablecoin regulations introduced, requiring registration for service providers, measures for consumer protection, and customer identity verifications.

Definition of Crypto Assets:

Under the PSA, a crypto asset is a property value satisfying the following four criteria:

- Used for Payment and sold to / purchased by unspecified persons
- Electronically recorded and transferred
- Not a fiat currency or a currency-denominated asset
- Not a security token

This brings Japan's crypto asset definition to be very similar to Singapore's, but differs from the U.S. definition.

Guidelines for Crypto Asset Exchanges:

Crypto asset exchange service providers must be registered and comply with requirements, which includes the protection of customer assets, provision of sufficient information to users market integrity and AML/CFT measures.

- Protection of customer asset requirements must be segregated, and at least 95% of customers' crypto assets must be held in an offline wallet. Segregation of assets and financial statements must be audited.
- Provision of sufficient information, in which information on contract details and fees must be provided along with balance sheets and income statements. The nature of crypto assets must also be explained to users.
- Unfair acts (e.g., market manipulation, disguised trading, and front running) are prohibited
- KYC due diligence is required, and such procedures and transactions with users must be recorded, and suspicious transactions must be reported to regulators.

Travel Rules

New travel rules effective June 2023 require an originator Virtual Asset Service Provider (VASP) to notify a beneficiary VASP of the following originator and beneficiary customer information: originator name, originator residential address or customer identification number, originator blockchain address or other identifying alphanumeric data, beneficiary name and beneficiary blockchain address or other identifying alphanumeric data.

These travel rules cover transfers of crypto assets and stablecoins with domestic VASPs and foreign VASPs which are located in countries where travel rules are effective. The travel rules do not cover transactions involving unhosted wallets.

Banking

Generally, banks and subsidiaries are currently prohibited from engaging in crypto asset exchange services, and must abide by the “Bank Holding Rule” which requires that banking groups’ holdings of crypto assets should be kept to the minimum necessary. The Bank Holding Rule does not forbid trust banks’ holding of crypto assets as trustees, and trust banks may provide trust custody services involving crypto assets.

Stablecoins

Under the new framework, the two broad categories of stablecoins are crypto assets and security tokens, and stablecoins with redemption promises at face value. Crypto assets and security tokens (e.g. algorithmic stablecoins) are subject to existing crypto security regulations. A newly-created category of stablecoins, “e-money stablecoins” has been defined as a type of stablecoin with redemption promises at face value that is distinct from tokenized deposits (e.g. bank deposits), and includes trust beneficiary rights and other tokens backed by fiat currencies. Crypto assets and security tokens could, however, be designated as e-money stablecoins if they are widely used as payment instruments.

Trust issuers are restricted to trust banks and companies, and must hold trust assets in the form of demand deposits. With tokens backed by fiat currencies, issuers are restricted to fund transfer service providers, and a reserve equal to the amount issued must be held in the form of highly-liquid assets.

Requirements for Domestic and Foreign Issuers

Domestic issuers are restricted to banks with prudential regulation and institutions that are required to preserve customers' assets (such as fund transfer services providers, trust companies, and trust banks). Foreign-issued stablecoins can be intermediated by a domestic service provider if it sets aside a reserve in Japan equal to the amount of the customers’ stablecoin in its custody.

Did you know

- As of June 2023, 30 crypto asset service providers are registered in Japan
- As of April 2023, service providers have held 7 million customers’ accounts