ANDERSON MŌRI & TOMOTSUNE

FINANCIAL SERVICES & TRANSACTIONS GROUP NEWSLETTER

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Draft Cabinet Ordinances and Cabinet Office Ordinances, Etc. Concerning Stablecoin Legislation (Part I)[1]

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Ⅰ. Introduction

The “Bill for partial amendment to the Payment Services Act, etc. for the purpose of establishing a stable and efficient payment and settlement system” (the “Amended Act”) was promulgated on June 10, 2022 with an aim to clarify and introduce regulations on the distribution of Electronic Payment Instruments (i.e. stablecoins). The effective date of the Amended Act is to be within 1 year from the promulgation, and thus the Amended Act will come into effect in the first half of 2023.

In connection with the commencement of the Amended Act, on December 26, 2022, the Financial Services Agency (the “FSA”) announced the drafts of government ordinances, cabinet office ordinances, guidelines, etc. that are associated with the Amended Act (the “Draft Subordinate Legislation”), and solicited public comments in accordance with the public comment procedures.

1 We issued a newsletter about this topic in Japanese. It can be found on our website (see below link). This newsletter is not an exact translation thereof.
https://www.amt-law.com/asset/pdf/bulletins2_pdf/230208.pdf

The Draft Subordinate Legislation mainly focuses on (1) determining the scope of a definition of the "Electronic Payment Instruments"; (2) developing regulations imposed on banks, fund transfer service providers, and trust companies that issue stablecoins; (3) determining the scope of an "Electronic Payment Instruments Exchange Service", meaning an intermediary (exchange) business for stablecoins; and (4) establishing registration procedures and code of conducts imposed on Electronic Payment Instruments Exchange Service Providers. This newsletter explains the Draft Subordinate Legislation with a focus on topics (1) and (2) (the scope of Electronic Payment Instruments and regulations imposed on the issuers). Please see our next newsletter for topics (3) and (4) (the scope of an Electronic Payment Instruments Exchange Service and regulations imposed on Electronic Payment Instruments Exchange Service Providers).

II. Definition of "Electronic Payment Instruments"

The Amended Act provides a new definition of "Electronic Payment Instruments" to refer to digital-money type stablecoins[2] as follows:

Article 2, Paragraph 5 of the Amended Payment Services Act

The term "Electronic Payment Instruments" used herein means:

(i) property value (limited to currency-denominated assets which are recorded on an electronic device or any other object by electronic means, and excluding securities, electronically recorded monetary claims specified in Article 2, Paragraph 1 of the Electronically Recorded Monetary Claims Act, prepaid payment instruments and other instruments specified in cabinet office ordinances as being equivalent to the foregoing items **[Condition 3-1]** (except those specified in the cabinet office ordinances taking into account their transferability and other factors **[Condition 3-2]**) which can be used in relation to unspecified persons for the purpose of paying consideration **[Condition 1]** for the purchase or leasing of goods or the receipt of provision of services, and can also be purchased from and sold to unspecified persons acting as counterparties **[Condition 2]**, and which can be transferred by means of an electronic data processing system (except those that fall under item (iii));

(ii) property value which can be mutually exchanged with those set forth in the preceding item with unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system (except those that fall under the next item);

(iii) specified trust beneficial interests; and

(iv) those specified by cabinet office ordinances as being equivalent to those listed in the preceding three items.

2 Stablecoins are broadly classified into (i) digital-money type stablecoins (i.e., those issued at a price correlated with the value of a legal currency (e.g., 1 coin = 1 yen) and promised to be redeemed in the same amount as its issue price), and (ii) crypto-assets type stablecoins (i.e., those that aim to stabilize value by algorithms). Among these, the latter are basically classified as "crypto-assets" under Japanese laws and regulations, and are regulated in accordance with the existing legislation on crypto-assets.

(1) Electronic Payment Instrument I

Electronic Payment Instruments specified in item (i) (“Electronic Payment Instrument I”) are currency-denominated assets that are recorded and transferred electronically and that can be used for paying consideration to unspecified persons, and also can be purchased from or sold to unspecified persons.

A. Condition 1

The applicability of Condition 1 (“can be used in relation to unspecified persons for the purpose of paying consideration”) is determined on a case-by-case basis by standards such as “whether the property value has a structure that allows transfer of the property value among unspecified persons through a network such as a blockchain”, “whether stores that accept the payment with the Electronic Payment Instruments are limited due to contracts between the issuer and the stores or other reasons”, and “whether the issuer manages stores that accept the Electronic Payment Instruments” (Draft of Administrative Guideline (Third Volume: Financial Institutions, 17 Guideline for Supervision of Electronic Payment Instruments Exchange Service Providers) (“Draft Guideline for Electronic Payment Service Providers”) I-1-1(i)). These standards are congruous with those specified as the criteria to judge the applicability of crypto-assets in the guideline for crypto-asset exchange service providers (Administrative Guideline (Third Volume: Financial Institutions, 16 Guideline for Supervision of Crypto-Asset Exchange Service Providers)). Based on our analysis in terms of these standards, most of the current payment instruments that are widely adopted in the retail sector in Japan, such as electronic money which are issued by fund transfer service providers (e.g., “Pay” service providers), prepaid payment instruments (prepaid cards), and various rewards programs (i.e., points), would not fall under the category of Electronic Payment Instruments because they are issued without using a blockchain or other similar technologies and the issuer centrally manages the balance of each user and the scope of the accepting stores (member stores).

B. Condition 2

The applicability of Condition 2 (“can also be purchased from and sold to unspecified persons acting as counterparties”) is determined by standards such as “whether the property value has a structure that allows transfer of the property value among unspecified persons through a network such as a blockchain”, “whether it can be exchanged for Japanese or foreign currency without restrictions imposed by the issuer”, and “whether a market exists for exchanging with Japanese or foreign currency” (Draft Guideline for Electronic Payment Service Providers I-1-1(ii)).

In this regard, the Draft Guideline for Electronic Payment Service Providers I-1-1 (Note 1) indicates that digital money issued by banks or fund transfer service providers does not meet Requirement 2 and not fall under the category of Electronic Payment Instruments 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 (i.e., KYC) under the Act on Prevention of Transfer of Criminal Proceeds, and if the issuer’s consent or other involvement is required for each transfer of the digital money. Consequently, currency-denominated tokens issued using a blockchain by banks or fund transfer service providers would be generally considered not to fall under the category of Electronic Payment Instruments if the issuer has taken the above measures and the tokens are designed to require the

issuer's consent or other involvement for each transfer. However, permissionless stablecoins issued by banks, fund transfer service providers, or foreign issuers would be considered to fall under Electronic Payment Instruments I in most cases, as permissionless stablecoins generally does not require KYC of new stablecoin holders nor any other issuer's involvement when transferred.

C. Condition 3

(a) Condition 3-1 (those excluded from the definition of "Electronic Payment Instruments")

The definition of Electronic Payment Instrument I excludes (a) securities, (b) electronically recorded monetary claims specified in Article 2, Paragraph 1 of the Electronically Recorded Monetary Claims Act, (c) prepaid payment instruments, and (d) other instruments specified in cabinet office ordinances as being equivalent to the foregoing (a) through (c) (Condition 3-1). Article 2, Paragraph 1 of the draft Cabinet Office Ordinance on Electronic Payment Instruments Exchange Service Providers (the "Draft Cabinet Office Ordinance on EPIESP") specifies Item (d) as follows:

Article 2, Paragraph 1 of Draft Cabinet Office Ordinance on EPIESP

The instruments specified in the cabinet office ordinance as being equivalent to securities specified in Article 2, Paragraph 5, Item (i) of the Act, electronically recorded monetary claims specified in Article 2, Paragraph 1 of the Electronically Recorded Monetary Claims Act, or prepaid payment instruments specified in Article 3, Paragraph 1 of the Act, shall be the property value that is issued without receiving consideration and that can be used by its presentation, delivery, notice, or other means for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services from the issuer of the property value or a person designated by the issuer.

Item (d) specified in Article 2, Paragraph 1 of the Draft Cabinet Office Ordinance on EPIESP may be considered to encompass currency-denominated points that are granted as free gifts or premiums when a customer receives goods or services from a service provider. Hence, such points will be, in principle, excluded from the definition of the Electronic Payment Instruments even if they are issued as permissionless tokens. However, since the points issued on a permissionless chain may fall under the category of crypto-assets, it is necessary to separately consider whether such points meet the definition of crypto-assets.

(b) Condition 3-2 (those not excluded from the definition of "Electronic Payment Instruments")

Article 2, Paragraph 5, Item (i) of the Amended Payment Services Act further excludes "those specified in the cabinet office ordinances taking into account their transferability and other factors" from Items (a) through (d) above (Condition 3-2); hence, if an instrument falls under this exception, the instrument will fall under the category of Electronic Payment Instruments. This means that the Act has set forth the exceptions to the exceptions. Article 2, Paragraph 2 of the Draft Cabinet Office Ordinance on EPIESP provides for Requirement 3-2 as follows:

Article 2, Paragraph 2 of the Draft Cabinet Office Ordinance on EPIESP

The instruments specified in the cabinet office ordinance taking into account their transferability and other factors as set forth in Article 2, Paragraph 5, Item (i) of the Act shall be prepaid payment instruments specified in Article 3, Paragraph 1 of the Act (excluding Balance Transfer type Prepaid Payment Instruments as defined in Article 1, Paragraph 3, Item (iv) of Cabinet Office Ordinance on Prepaid Payment Instruments, Code Notifying Type Prepaid Payment Instruments as defined in Item (v) of the said paragraph, and others that require consent or other involvement of the issuer of the prepaid payment instrument on a case-by-case basis to complete the transfer).

This means that although prepaid payment instruments are excluded from the definition of Electronic Payment Instruments under Article 2, Paragraph 5, Item (i) of the Amended Payment Services Act, prepaid payment instruments that are traded and exchanged via a permissionless blockchain will in general fall under the category of Electronic Payment Instruments by virtue of Article 2, Paragraph 2 of the Draft Cabinet Office Ordinance on EPIESP. More specifically, prepaid payment instruments that do not require consent or other involvement of the issuer to complete the transfer[3] (e.g. prepaid payment instruments that are issued by using such infrastructure as a blockchain with specifications that can be distributed to unspecified persons, and that can be used as a means of remittance and settlement to unspecified persons（i.e., not limited to the settlement to the issuer or member stores）) will fall under the category of Electronic Payment Instruments (Draft Guideline for Electronic Payment Service Providers I-1-1 (Note 2)).

In addition, for the purpose of protecting users and ensuring sound and proper operation of the service, a new obligation will be imposed on issuers of prepaid payment instruments that requires such issuers to take proper measures not to issue a prepaid payment instrument that falls under the category of Electronic Payment Instruments (Article 23-3, Item (iii) of Draft Cabinet Office Ordinance on Prepaid Payment Instruments).

Given the above, it can be understood that the Amended Act and the Draft Subordinate Legislation in principle prohibit the issuance of Electronic Payment Instruments (permissionless stablecoins) in the form of a prepaid payment instrument. Such prohibition seemed to be introduced to regulate a few existing prepaid payment instruments “issued on a permissionless distributed ledger with specifications that can be distributed to unspecified persons and used as a means of remittance and settlement to unspecified persons”. The JFSA’s intention of this prohibition was already implied in the report of the Payment Services Working Group of the Financial System Council.

Nevertheless, Article 2 of Supplementary Provisions to the Draft Cabinet Office Ordinance on EPIESP provides for transitional measures that exempt the application of Article 2, Paragraph 2 of the Draft Cabinet Office Ordinance on EPIESP for 2 years from the effective date thereof. Therefore, during such period, prepaid payment instruments type stablecoins issued on a permissionless blockchain will not fall under the category of Electronic Payment Instruments, and consequently the regulations

3 Balance Transfer Type Prepaid Payment Instruments and Code Notifying Type Prepaid Payment Instruments mentioned in the parentheses in Article 2, Paragraph 2 of the Draft Cabinet Office Ordinance on EPIESP do not fall under the category of Electronic Payment Instruments as they require the consent or other involvement of their issuer to complete the transfer.

on Electronic Payment Instruments will not be applied to the prepaid stablecoins issued on a permissionless blockchain, and their issuance will not be prohibited during the transition period.

(2) Electronic Payment Instrument II

Any property value that can be exchanged with Electronic Payment Instrument I with unspecified persons acting as counterparties will fall under the category of Electronic Payment Instruments specified in item (ii) ("Electronic Payment Instrument II") even if such property value cannot be directly purchased from or sold to unspecified persons.

Whether property value can be exchanged for or from Electronic Payment Instrument I with unspecified persons is determined by standards such as "whether property value has a structure that allows transfer of the property value among unspecified persons through a network such as a blockchain", "whether it can be exchanged for Electronic Payment Instrument I with no involvement by the issuer", "whether a market exists for exchanging with Electronic Payment Instrument I", and "whether it has economic functions equivalent to Electronic Payment Instrument I (i.e., whether it has a function beyond goods and rights that can be purchased by Electronic Payment Instrument I)" (Draft Guideline for Electronic Payment Service Providers I-1-1(iii)).

(3) Electronic Payment Instrument III

The Electronic Payment Instruments specified in Article 2, Paragraph 5, Item (iii) of the Amended Payment Services Act ("Electronic Payment Instrument III") are defined as a "specified trust beneficial right".

Article 2, Paragraph 9 of the Amended Payment Services Act sets forth the following requirements for a trust beneficial right to be deemed a "specified trust beneficial right": the trust beneficial right is electronically recorded and transferred, and the trustee manages the entire amount of money constituting the trust property by bank deposits.

Article 3 of the Draft Cabinet Office Ordinance on EPIESP further specifies requirements that in the event that a specified trust beneficial right is issued in Japanese Yen, all of the trust property shall be managed by bank deposits, etc. (excluding foreign currency deposits, certificate of deposits, etc.) for which the depositors thereof may request withdrawal at any time, and that in the event that a specified trust beneficial right is issued in a foreign currency, all of the trust property shall be managed by foreign currency deposits, etc. (excluding certificate of deposits, etc.) in the foreign currency of the trust property for which the depositors, etc. thereof may request withdrawal at any time.

It is noteworthy that the specified trust beneficial rights do not fall under the category of "securities" specified in Article 2 of the Financial Instruments and Exchange Act (Article 2, Paragraph 2 of the Amended Financial Instruments and Exchange Act, Article 1-2 of Draft Amendments to Order for Enforcement of the Financial Instruments and Exchange Act, Article 4-2 of Draft Amendments to the Cabinet Office Ordinance on Definitions), and are not subject to the offering disclosure regulations and code of conducts under the Financial Instruments and Exchange Act.

(4) Electronic Payment Instrument IV

Under Article 2, Paragraph 5, Item (iv) of the Amended Payment Services Act, "those specified by cabinet office ordinances as being equivalent to those listed in the preceding three items" are also

classified as Electronic Payment Instruments ("Electronic Payment Instrument IV").
Electronic Payment Instrument IV is defined as follows under Article 2, Paragraph 3 of the Draft Cabinet Office Ordinance on EPIESP:

Article 2, Paragraph 3 of Draft Cabinet Office Ordinance on EPIESP
The instruments specified in Article 2, Paragraph 5, Item (iv) of the Act shall be property value (limited to those recorded on an electronic device or any other object by electronic means) which can be used in relation to unspecified persons for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services, and can also be purchased from and sold to unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system **[Requirement 1]** (except those that fall under item (i) or (iii) of the said paragraph) and which is specified by the Commissioner of the Financial Services Agency taking into account the scope that it can be used for paying the consideration, its usage, and other factors **[Requirement 2]**.

Any property value with a structure that allows the transfer of it through a network, such as a blockchain, will fall under Electronic Payment Instrument IV if so designated by the Commissioner of the FSA in a public notice, etc. However, as the Commissioner of the FSA has yet to designate any property value as Electronic Payment Instrument IV in the Draft Subordinate Legislation, there is nothing that falls under Electronic Payment Instrument IV at the time the Amended Act becomes effect. Nevertheless, it should be noted that any digital asset that meets the definition of crypto-assets under the Payment Services Act may be considered to satisfy Requirement 1 and such digital asset may fall under Electronic Payment Instrument IV as a result of designation by the Commissioner of the FSA if a particular crypto-asset becomes widely adopted and used as a means of settlement in the future. Digital assets that have deemed as the Electronic Payment Instruments will no longer fall under the category of crypto-assets under the Payment Services Act (see Article 2, Paragraph 14, Item (i) of the Amended Payment Services Act).

III. Regulations Imposed on "Issuers" of Electronic Payment Instruments

(1) Banks and fund transfer service providers (excluding specified trust companies)

Since Electronic Payment Instruments must be property value denominated in a legal currency as stated in II above, and issuance and redemption of the Electronic Payment Instruments enable parties at a distance to pay and receive funds without directly delivering cash, the issuance and redemption of Electronic Payment Instruments, thus, fall under the category of the "funds transfer transactions (*kawase-torihiki*)"[4]. Consequently, it is in principle required to obtain a banking business license or

4 "Funds transfer transaction" is interpreted to mean "accepting a request from a customer to transfer funds using the mechanism of transferring funds between people in remote locations without directly transporting funds, or accepting and actually carrying out the request" (Ruling by the Supreme Court on March 12, 2001).

fund transfer business registration in order to issue and redeem such Electronic Payment Instruments (Article 2, Paragraph 2, Item (ii) and Article 4, Paragraph 1 of the Banking Act, and Article 2, Paragraph 2 and Article 37 of the Payment Services Act) (see (2) below for specified trust companies).
As described in I. (1) B. (Condition 2) above, tokens issued by a bank or a fund transfer service provider on a permissionless blockchain and tokens issued on a permissioned blockchain that are not designed to require the issuer's consent or other involvement for each transfer, fall under the category of Electronic Payment Instruments.
When the issuer is a bank, excepting in the event where a trust bank issues tokens as a specified trust beneficial right, it seems natural to understand that the rights linked to the tokens are deposit claims against the bank, assuming that the user has the right to request redemption thereof. However, since Electronic Payment Instruments circulating on a blockchain can be transferred not only to wallets managed by Electronic Payment Instruments Exchange Service Providers but also to unhosted wallets (meaning wallets managed by the holders themselves), it would be technically difficult for the issuing bank to have information of the holders of such Electronic Payment Instruments (i.e., depositors) in a timely manner. It can be said that such a situation is unforeseen under the current deposit insurance system, which requires prompt aggregation and reporting of all customers' information in the event of a bank failure. Moreover, it appears that no special measures to handle Electronic Payment Instruments under the deposit insurance system are provided in the Amended Act and the Draft Subordinate Legislation. Consequently, unless this challenge is resolved on a practical or legislative level, it will be virtually impossible for banks to issue Electronic Payment Instruments (tokenized deposits) linked to deposit claims.
Accordingly, we believe that issuers of Electronic Payment Instruments I might be a fund transfer service provider for the time being. As such, the following sections will describe an overview of the regulations imposed on fund transfer service providers that issue and redeem digital money that falls under the category of Electronic Payment Instruments.

A. Regulations imposed on fund transfer service providers which issue Electronic Payment Instrments

(a) Restrictions on the retention of funds and regulations on the maximum remittance amount

Although type I fund transfer service providers are not explicitly prohibited under applicable laws and regulations from conducting funds transfer transaction as an issuer of Electronic Payment Instruments, they are subject to strict regulations on the retention of funds (Article 51-2 of the Payment Services Act) and it seems, thus, virtually impossible for them to conduct funds transfer transaction as an issuer of EPIs as the regulations on the retention of funds conflict with the scheme of Electronic Payment Instruments which a fund transfer service provider will retain customers' funds unless they are redeemed.
Type II fund transfer service providers may conduct funds transfer transaction as an issuer of Electronic Payment Instruments, and in this case, they are subject to regulations as a type II fund transfer service provider including the regulations on the retention of funds and regulation on maximum remittance amount detailed below.

[Restrictions on the retention of funds]

Type II fund transfer service providers which issue Electronic Payment Instruments must establish a system to confirm with each of the users whether users' Electronic Payment Instruments are intended for funds transfer transaction when the balance of Electronic Payment Instruments held by the users exceeds one million yen (Article 51 of the Payment Services Act, Article 30-2, Paragraph 2 of the Draft Cabinet Office Ordinance on Fund Transfer Service Providers ("Draft Cabinet Office Ordinance on Fund Transfer Service")). However, they are only required to manage each user's balance in wallets managed by Electronic Payment Instruments Exchange Service Providers and they are not required to take into account the balance in unhosted wallets in the calculation of one million yen.

When an Electronic Payment Instruments Exchange Service Provider engages in services to transfer and manage Electronic Payment Instruments, a type II fund transfer service provider as the issuer shall comply with the following requirements to fulfill its obligation to establish the system above (Administrative Guideline (Draft) (Third Volume: Financial Institutions, 14 Guideline for Supervision of Fund Transfer Service Providers ("Draft Guideline for Fund Transfer Service Providers") IV-2):

- The type II fund transfer service provider shall by itself or shall cause the Electronic Payment Instruments Exchange Service Provider to, establish a system to confirm whether the users' Electronic Payment Instruments managed by the Electronic Payment Instruments Exchange Service Provider are intended for funds transfer transaction when the amount of Electronic Payment Instruments per user exceeds one million yen in the wallets managed by the Electronic Payment Instruments Exchange Service Provider;
- The type II fund transfer service provider shall by itself or shall cause the Electronic Payment Instruments Exchange Service Provider to, (i) request the users to redeem the Electronic Payment Instruments when the funds are, on the balance of probabilities, unlikely to be used for funds transfer transactions, and (ii) take measures not to retain the users' Electronic Payment Instruments such as redeeming the Electronic Payment Instruments to the users if the users do not follow the request.

[Regulations on the maximum remittance amount]

When a type II fund transfer service provider issues Electronic Payment Instruments, it is subject to a regulation on the maximum remittance amount of one million yen or any equivalent thereto per transaction.

Specifically, the type II fund transfer service provider as the issuer shall comply with the following requirements to follow the regulations on the maximum remittance amount (Draft Guideline for Fund Transfer Service Providers IV-2):

- The type II fund transfer service provider shall by itself or shall cause the Electronic Payment Instruments Exchange Service Provider to, establish a system to take measures to prevent the amount of each transfer of Electronic Payment Instruments from exceeding one million yen when the Electronic Payment Instruments Exchange Service Provider transfers Electronic Payment Instruments at the instruction of a user (including transfer to a wallet not managed by the Electronic Payment Instruments Exchange Service Provider);
- Same as the above in the case where the type II fund transfer service provider newly issues Electronic Payment Instruments directly to users' unhosted wallet.

(b) Additional regulations for user protection

A fund transfer service provider that issues Electronic Payment Instruments is subject primarily to the following obligations from a code of conducts for the purpose of user protection in addition to the general code of conducts for fund transfer service providers:

- Obligation to make prior notifications of ((i) any changes in the content or method of the fund transfer service associated with the commencement of funds transfer transaction by issuing Electronic Payment Instruments, (ii) any changes in the Electronic Payment Instruments if the fund transfer service provider has already engaged in funds transfer transaction by issuing Electronic Payment Instruments) (Article 9-9, Items (v) and (vi) of the Draft Cabinet Office Ordinance on Fund Transfer Service);
- Obligation to explain the details of Electronic Payment Instruments (Article 29-3 of the Draft Cabinet Office Ordinance on Fund Transfer Service);
- Obligation to take necessary measures not to issue Electronic Payment Instruments that are found likely to interfere with proper and reliable execution of user protection or fund transfer service (Article 31, Item (v) of the Draft Cabinet Office Ordinance on Fund Transfer Service);
  - Draft Guideline for Fund Transfer Service Providers II-2-2-1-1(ix) sets forth specific measures to be taken which include:
    - ✧ clarifying the timing of and procedures for transfer of rights to the Electronic Payment Instruments issued;
    - ✧ establishing a system necessary for AML/CFT specified in Draft Guideline for Fund Transfer Service Providers II-2-1-2 including a system necessary when the fund transfer service provider delegates to an Electronic Payment Instruments Exchange Service Provider administrative affairs required to fulfill the obligations under the Act on Prevention of Transfer of Criminal Proceeds such as creation and storage of transaction records, and transaction monitoring, as well as a system to suspend transfer and redemption of the Electronic Payment Instruments pertaining to wallets not managed by the fund transfer service provider (author's note: this is assumed to include unhosted wallets) when it issues Electronic Payment Instruments on a permissionless blockchain;
    - ✧ ensuring that the fund transfer service provider or the Electronic Payment Instruments Exchange Service Provider is able to cancel or nullify transactions that are related to the Electronic Payment Instruments exchange service, and to compensate for losses in the event of a failure or technological problems (e.g., cyberattack, clerical error, internal fraud, and system failure) of the fund transfer service provider or Electronic Payment Instruments Exchange Service Provider; and
    - ✧ establishing a contact desk and internal rules for redemption procedures as a system to promptly and properly redeem the Electronic Payment Instruments in response to requests from users for redemption of Electronic Payment Instruments.

    The legal characterization of transfer of Electronic Payment Instrument I may be an issue in relation to "clarifying the timing of and procedures for transfer of rights to Electronic Payment Instruments issued" stated above.

In this regard, if transfer of Electronic Payment Instruments is legally construed as an assignment of monetary claims to the issuer (fund transfer service provider), such legal structure will not work as it requires perfection for assignment of claims (which requires notice by a deed bearing a certified date). Hence, a scheme may be considered that extinguishes the monetary claim of the holder of the transferor address against the issuer and simultaneously generates the corresponding monetary claim against the issuer for the holder of the transferee address. However, further examination is required in relation to whether such a scheme can legally operate without problems.

(2) Specified trust companies

Trust companies and foreign trust companies are permitted to issue Electronic Payment Instrument III (specified trust beneficial rights) as a "specified trust company" (Article 2, Paragraph 27 of the Amended Payment Services Act, Article 2-2 of the Draft Order for Enforcement of the said act). Since the "trust companies" mentioned therein include not only Investment Based Trust Companies but also Custodial Trust Companies (Article 2, Paragraph 2 of the Trust Business Act), Custodial Trust Companies are also permitted to issue Electronic Payment Instrument III.

A. Procedures required for specified trust companies to issue Electronic Payment Instruments

When a specified trust company engages in funds transfer transaction as a business through issuance of Electronic Payment Instrument III, it may issue Electronic Payment Instrument III without obtaining a banking license or fund transfer business registration (Article 37-2, Paragraph 1 of the Amended Payment Services Act). Provided, however, that it is required to notify certain matters of the relevant authorities (Paragraph 3 of the same article, Article 3-6 of the Draft Cabinet Office Ordinance on Fund Transfer Service).

B. Regulations on specified trust companies

When a specified trust company issues Electronic Payment Instrument III (specified trust beneficial rights) as a business, the specified trust company qualifies as a fund transfer service provider and becomes subject to certain regulations including code of conducts that are imposed on fund transfer service providers (Article 37-2, Paragraph 2 of the Amended Payment Services Act). Specified trust companies are also subject to provisions of the Draft Guideline for Fund Transfer Service Providers that apply to all type I through type III fund transfer service providers (Draft Guideline for Fund Transfer Service Providers VI-2).[5]

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5 Funds transfer transaction conducted by specified trust companies by a means of issuing Electronic Payment Instrument III (specified trust beneficial rights) fall under "specified trust fund transfer" (Article 2, Paragraph 28 of the Amended Payment Services Act), and when a specified trust company engages in such fund transfers as a business, such fund transfers fall under "specified fund transfer service" (Article 36-2, Paragraph 4 of the Amended Payment Services Act). Although the "specified fund transfer service" refers to engaging only in "specified trust fund transfers" among fund transfer services as a business, as this is still one form of the fund transfer services, the specified trust company qualifies as a fund transfer service provider (Article 37-2, Paragraph 2 of the Amended Payment Services

(a) Restrictions on the retention of funds and regulations on the maximum remittance amount

[Regulations on the maximum remittance amount]

Specified trust companies are also subject to the same regulations on the maximum remittance amount of one million yen equivalent as type II fund transfer service providers (Draft Guideline for Fund Transfer Service Providers VI-1).

Nevertheless, specified trust companies are permitted to issue Electronic Payment Instrument III which can be transferred in excess of one million yen per transaction, subject to separate approval. In such case, a specified trust company must develop a business operation plan (including the maximum amount of the fund to be transferred) to obtain approval (Article 37-2, Paragraph 2 and Article 40-2, Paragraph 1 of the Amended Payment Services Act, Article 12-4 of the Draft Order for Enforcement). In this case, the specified trust company is also required to establish a sufficient system based on risks associated with issuance of Electronic Payment Instrument III which enables funds transfer transaction in a large amount, which are similar to those provided for the type I fund transfer service providers (Draft Guideline for Fund Transfer Service Providers VI-1).

[Restrictions on the retention of funds]

Specified trust companies are not subject to the regulations on the retention of funds imposed on fund transfer service providers (replacement of the terms in Article 51 of the Amended Payment Services Act that is stipulated in Article 37-2, Paragraph 2 of the said Act does not include “measures not to hold funds that are deposited from users and are found not to be used for funds transfer transaction”, and Article 51-2 of the said act that provides for strict regulations on the retention of funds for type I fund transfer service providers also does not apply for specified trust companies).

(b) Additional regulations for user protection

For the purpose of user protection, specified trust companies are subject to the same regulations as the case where type II fund transfer service providers issue Electronic Payment Instruments set forth in (1)(b) above, in addition to the regulations imposed on general fund transfer service providers.

Among such regulations, the legal characterization of token transfers may be an issue in relation to “clarifying the timing of and procedures for transfer of rights to Electronic Payment Instruments issued” set forth in the Draft Guideline for Fund Transfer Service Providers II-2-2-1-1(9) in the case of specified trust beneficial rights that are issued by a trust company using a permissionless blockchain. Namely, general assignment of trust beneficial rights cannot be asserted against any third party other than the trustee unless such assignment is notified or approved by a deed bearing a certified date (Article 94 of the Trust Act), and assignment of beneficial rights in a beneficiary certificate issuing trust cannot be asserted against the trustee of the beneficiary certificate issuing trust (or the “trustee or other third parties” in the case of beneficial rights that do not issue beneficiary certificates) unless the name and address of the person who has acquired the beneficial rights are entered or recorded on the beneficial right register (Article 195 of the Trust Act).

Act), and becomes subject to the same regulations as fund transfer service providers and the Draft Guideline for Fund Transfer Service Providers.

However, if transfer of tokens issued by a trust company using a permissionless blockchain is legally construed as assignment of trust beneficial rights, it is difficult to use a beneficiary certificate issuing trust (as transfers to unhosted wallets are anticipated, it will be difficult to enter and record the name and address of the person who has acquired the beneficial rights on the beneficial right register). Even if the tokens are issued as general trust beneficial rights instead of beneficiary certificate issuing trusts, a notice or approval with a deed bearing a certified date is not fit for transfers on a blockchain. Therefore, transfer of permissionless tokens issued by a trust company should be legally construed not as assignment of beneficial rights but as a different legal structure.

Specifically speaking, a legal structure that (all participants in the transaction of the specified trust beneficial right agree that) transfer of a token (automatically without any indication of intention) extinguishes a beneficial right of the holder of the transferor address and simultaneously generates a beneficial right for the holder of the transferee address should be considered. However, further examination is required on whether such a scheme can legally operate without problems.

Furthermore, pursuant to the regulations imposed on specified trust companies, in the event that a beneficiary of a specified trust beneficial right requests redemption of the trust principal pertaining to such specified trust beneficial right during the term of the relevant trust agreement, the specified trust company is required to accept the request by canceling a part of the trust agreement related to such specified trust beneficial right without delay, or to purchase such specified trust beneficial right at the same price as the face value of Electronic Payment Instruments without delay (Article 37-2, Paragraph 4 of the Amended Payment Services Act, Article 3-7 of Draft Cabinet Office Ordinance on Fund Transfer Service, and Draft Guidelines for Fund Transfer Service Providers VI-3).

(Continued to Part II)

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