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## Draft Cabinet Ordinances and Cabinet Office Ordinances, Etc. Concerning Stablecoin Legislation (Part II)<sup>1</sup>

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### Contents

- I. Introduction
- II. Definition of “Electronic Payment Instruments Exchange Service”
- III. Regulations imposed on “Electronic Payment Instruments Exchange Service Providers”

## 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. It amends the Payment Services Act, the Banking Act and other related acts, aiming to clarify and introduce regulations on the distribution of Electronic Payment Instruments (i.e., stablecoins). The Amended Act is to be effective within 1 year from its promulgation, i.e., in the first half of 2023.

On December 26, 2022 and February 3, 2023, the Financial Services Agency (the “FSA”) released drafts of government ordinances, cabinet office ordinances, guidelines, etc. in connection with the Amended Act and solicited public comments in accordance with the public comment procedures. The drafts focus mainly on (1) determining the scope of the definition of stablecoins, namely,

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<sup>1</sup> We issued a newsletter about this topic in Japanese. It can be found on our website (see link below). This newsletter is not an exact translation thereof.

[https://www.amt-law.com/asset/pdf/bulletins2\\_pdf/230327.pdf](https://www.amt-law.com/asset/pdf/bulletins2_pdf/230327.pdf)

“Electronic Payment Instruments”; (2) developing regulations imposed on banks, funds transfer service providers and trust companies that issue stablecoins; (3) determining the scope of an “Electronic Payment Instruments Exchange Service” (an intermediary (exchange) business for stablecoins); and (4) establishing registration procedures and a code of conduct to be newly imposed on Electronic Payment Instruments Exchange Service Providers. This newsletter provides commentary primarily on topics (3) and (4) (the scope of an Electronic Payment Instruments Exchange Service and regulations imposed on Electronic Payment Instruments Exchange Service Providers). For topics (1) and (2) (the scope of Electronic Payment Instruments and regulations imposed on the issuers), please see our previous newsletter.<sup>2</sup>

## II. Definition of “Electronic Payment Instruments Exchange Service”

The Amended Act provides the definition of “Electronic Payment Instruments Exchange Service” in the Payment Services Act, and the definition of “Electronic Payments Handling Service” in the Banking Act<sup>3</sup> as follows:

### **Article 2, Paragraph 10 of the Amended Payment Services Act**

The term “Electronic Payment Instruments Exchange Service” as used herein means engaging in any of the following acts on a regular basis. The term “Exchange etc. of Electronic Payment Instruments” means the acts specified in Item (i) or (ii), and the term “Management of Electronic Payment Instruments” means the acts specified in Item (iii).

- (i) the sale and purchase of an electronic payment instrument, or the exchange thereof with another electronic payment instrument
- (ii) serving as intermediary, brokerage, or agency for the acts specified in the preceding item
- (iii) the act of managing electronic payment instruments for others (except those specified by cabinet office ordinances as not giving rise to a risk of insufficient protection for users, taking into account their details and other factors) or
- (iv) the act of making an agreement, under entrustment from a funds transfer service provider (“FTSP”), with a user (limited to those who have concluded a contract with the funds transfer service provider under which funds transfers are to be carried out on a continuous or recurring basis) on behalf of the funds transfer service provider, to carry out any of the following acts by a means that uses an electronic data processing system, and by increasing or reducing the amount of claims against the FTSP pertaining to obligations relating to funds transfer service based on said agreement.
  - (a) transferring funds based on said contract and reducing the amount of the claim pertaining to the obligation against the FTSP relating to the funds transfer service that is equivalent to the amount of said funds or

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<sup>2</sup> AMT Financial Services & Transactions Group Newsletter, dated April 17, 2023: [https://www.amt-law.com/asset/pdf/bulletins2\\_pdf/230417.pdf](https://www.amt-law.com/asset/pdf/bulletins2_pdf/230417.pdf)

<sup>3</sup> The Act on Financial Businesses by Cooperatives, which establishes legislation concerning *shinkin* banks and credit unions, also has a system corresponding to the Electronic Payments Handling Services.

- (b) increasing the amount of the claim pertaining to the obligation relating to the funds transfer that is equivalent to the amount of funds received by the funds transfer.

**Article 2, Paragraph 17 of the Amended Banking Act**

The term “Electronic Payments Handling Service” as used herein means a business that carries out the following acts, and the term “Electronic Payments Related Deposit Intermediary Service” means the act specified in Item (ii):

- (i) the act of making an agreement, under entrustment from a bank, with a depositor who has opened a deposit account with the bank on behalf of the bank to carry out any of the following acts by a means that use an electronic data processing system, and of increasing or reducing the amount of claims under a deposit contract (“Deposit Claim” in this item) based on said agreement:
  - (a) transferring funds pertaining to the said account and reducing an amount of Deposit Claims that is equivalent to the amount of said funds; or
  - (b) increasing an amount of Deposit Claims that is equivalent to the amount of funds received by the funds transfer;
- (ii) acting as an intermediary for the conclusion of a contract for acceptance of deposits on behalf of the bank referred to in the preceding item (“Entrusting Bank”) in connection with the act in the same item that is performed.

The acts in Items (i) through (iii) of Article 2, Paragraph 10 of the Amended Payment Services Act that define “Electronic Payment Instruments Exchange Service” refer to the sale, purchase and exchange (Item (i)), serving as intermediary, brokerage, or agency for the sale, purchase, and exchange (Item (ii)) and management (Item (iii)) of Electronic Payment Instruments. These acts are collectively defined as “Electronic Payment Instruments Related Service” (Article 2, Paragraph 11 of the Amended Payment Services Act). “Those [activities] specified by cabinet office ordinances as not giving rise to a risk of insufficient protection for users, taking into account their details and other factors” are excluded from the management of Electronic Payment Instruments (Item (iii)); Article 4 of the draft Cabinet Office Ordinance on Electronic Payment Instruments Exchange Service Providers (the “Draft EPIESP Cabinet Office Ordinance”) excludes management “conducted by a trust company, etc. as Trust Business Activities defined in Article 2, Paragraph 1 of the Trust Business Act in accordance with the Trust Business Act and the Act on Engagement in Trust Business Activities by Financial Institutions”.

Although the definition of “Electronic Payment Instruments Related Service” seems not to include the exchange of Electronic Payment Instruments and crypto-assets or serving as intermediary, brokerage, or agency for such exchange, the Draft of Administrative Guideline (Third Volume: Financial Institutions, 17 Guideline for Supervision of Electronic Payment Instruments Exchange Service Providers) (“Draft Guideline for Electronic Payment Instruments Exchange Service Providers”) I-1-2-2(ii) provides the interpretation that any transaction where an Electronic Payment Instruments Exchange Service Provider delivers Electronic Payment Instruments to a user and the user receives crypto-assets in exchange constitutes the “sale and purchase of an electronic payment instrument”

as defined under Article 2, Paragraph 10, Item (i) of the Amended Payment Services Act, and a transaction where an Electronic Payment Instruments Exchange Service Provider delivers crypto-assets to a user and the user receives Electronic Payment Instruments in exchange constitutes the “sale and purchase of crypto-assets” defined under Article 2, Paragraph 15, Item (i) of the Amended Payment Services Act. Based on this interpretation, engaging in a two-way exchange of Electronic Payment Instruments and crypto-assets would require registration both as an Electronic Payment Instruments Exchange Service Provider and as a Crypto-Asset Exchange Service Provider.

Article 2, Paragraph 10, Item (iv) of the Amended Payment Services Act sets forth certain acts which are other types of “Electronic Payment Instruments Exchange Services”. Hence, subject to the entrustment from a funds transfer service provider, an Electronic Payment Instruments Exchange Service Provider agrees to transfer funds to/from a user’s account, which leads to a reduction (in relation to the recipient; Item (iv)(b)) or increase (in relation to the remitter; Item (iv)(a)) in the amount of the claim pertaining to the outstanding liabilities assumed by the funds transfer service provider.

Further, the basic structure of Article 2, Paragraph 17 of the Amended Banking Act that defines “Electronic Payments Handling Service” corresponds to the above-cited provision of Article 2, Paragraph 10, Item (iv) of the Amended Payment Services Act. To be specific, an Electronic Payments Handling Service” means that, subject to the entrustment from a bank, an Electronic Payments Handling Service Provider agrees with a user to transfer funds to another user, leading to an increase (in relation to the recipient; Article 2, Paragraph 17, Item (i)(b)) or decrease (in relation to the remitter; Article 2, Paragraph 17, Item (i)(a)) in the amount of the Deposit Claim against the bank.

It is noteworthy that, by virtue of the fact that the concept of “Electronic Payments Handling Service” under the Banking Act is distinct from “Electronic Payment Instruments Exchange Service” under the Payment Services Act, and that the Banking Act does not state that a person having obtained a license for either of the services may perform the other service without separately obtaining a license therefor, it would be necessary to separately obtain the two licenses in order to perform both services.

### **III. Regulations imposed on “Electronic Payment Instruments Exchange Service Providers”**

This paragraph does not intend to provide a comprehensive explanation on the regulations imposed on each type of Electronic Payment Instruments Exchange Service, but rather focuses on the regulations imposed on the performance of Electronic Payment Instruments Related Services (sale, purchase and exchange (Item (i)), serving as intermediary, brokerage or agency for the sale, purchase and exchange (Item (ii)), and management (Item (iii)) of Electronic Payment Instruments), which is of interest to those involved in the industry.

#### **(1) Regulations commonly imposed on the listing of Electronic Payment Instruments issued in Japan and the listing of those issued in foreign countries**

Below is a summary of the regulations commonly imposed on the listing of Electronic Payment

Instruments issued in Japan and in foreign countries:

Management of Information Security	The service providers are required to take measures necessary for ensuring security management of information (Article 62-10 of the Amended Payment Services Act).
Management of Entrusted Parties	Upon the entrustment of any part of the Electronic Payment Instruments Exchange Service to a third party, the service providers are required to take measures necessary for ensuring the proper and steady conduct of the service (Article 62-11 of the Amended Payment Services Act).
Measures with respect to User Protection	The service providers are required to provide explanations to prevent users from mistaking the service provider for an issuer of stablecoins, provide information on fees and other contract terms and take other measures necessary for protecting users and ensuring proper and secure conduct of the service (Article 62-12 of the Amended Payment Services Act).
Prohibition on Receipt of Deposit of Money or Other Valuables from Users	In principle, the service providers are prohibited from receiving deposits of money or other valuables from users in relation to their Electronic Payment Instruments Exchange Service (Article 62-13 of the Amended Payment Services Act); with the proviso that such deposits may be allowed in exceptional cases "specified by cabinet office ordinances as not giving rise to a risk of insufficient protection for users."
Obligation to Separately Manage Users' Electronic Payment Instruments	The service providers are required to manage users' Electronic Payment Instruments separately from their own Electronic Payment Instruments and have the state of the management regularly audited by a certified public accountant or audit corporation (Article 62-14 of the Amended Payment Services Act).
Obligation to Conclude Contract with Issuer.	The service providers are required to conclude a contract concerning their Electronic Payment Instruments Exchange Service with the issuer, setting forth the conditions, such as the burden of the liability for compensation of damages, if any, incurred by any user. They must perform the services for the relevant issuer in accordance with such contract (Article 62-15 of the Amended Payment Services Act).
Obligation to Conclude Contract with Designated Dispute Resolution Organizations	The service providers are required to take alternative dispute resolution procedures equivalent to the ones required to be taken by funds transfer service providers and crypto-assets exchange service providers under the Payment Services Act (Article 62-16 of the Amended Payment Services Act).
Application mutatis mutandis of the	The provisions of the Financial Instruments and Exchange Act shall be applied mutatis mutandis to Electronic Payment Instruments

Financial Instruments and Exchange Act	Exchange Service Providers engaging in Electronic Payment Instruments Related Service dealing with Electronic Payment Instruments whose price may fluctuate due to fluctuations in indicators, such as the value of currencies as specified by the Cabinet Office Order (Article 62-17 of the Amended Payment Services Act).
Obligations such as Confirmation at the Time of Transaction	Since Electronic Payment Instruments Exchange Service Providers now constitute “specified business operators” (Article 2, Paragraph 2, Item 31-2 of the amended Act on Prevention of Transfer of Criminal Proceeds (the “APTCP”)), they are subject to the various obligations imposed on specified business operators under the APTCP, such as the obligations to confirm customers at the time of transaction and report suspicious transactions.
“Travel Rule,” etc.	As obligations unique to Electronic Payment Instruments Exchange Service Providers rather than general obligations of specified business operators, such service providers are subject to the following obligations under the APTCP: (i) to confirm counterparties at the time of the transaction or take other measures if the transfer of Electronic Payment Instruments takes place repeatedly with a person exchanging or managing Electronic Payment Instruments in foreign countries (Article 10-2 of the amended APTCP); and (ii) “Travel Rule” (such as the obligation to notify the customer’s information at the time of a transfer of Electronic Payment Instruments to the Electronic Payment Instruments Exchange Service Provider that is the transferee (Article 10-3 of the amended APTCP). Provided, however, that these obligations are not applicable to Electronic Payment Instruments that constitute specific trust beneficial interests.

The sections below provide further explanations on the some of the matters listed above, which should be paid attention to in practice.

#### **A. Measures with respect to User Protection**

Electronic Payment Instruments Exchange Service Providers are required to provide explanations to prevent users from mistaking the service provider for an issuer of stablecoins, provide information on fees and other contract terms and take other measures necessary for protecting users and ensuring proper and secure conduct of the service (Article 62-12 of the Amended Payment Services Act).

As one of the measures with respect to user protection, the Draft Guideline for Electronic Payment Instruments Exchange Service Providers I-1-2-3(1) sets out the following criteria for judging the appropriateness of Electronic Payment Instruments that can be listed by Electronic Payment Instruments Exchange Service Providers. The criteria provide the same obligations as those imposed on issuers of Electronic Payment Instruments (funds transfer service providers) (please see our

previous newsletter<sup>4</sup> at III-(1)A(b)).

- (i) clarifying the timing of and procedures for the transfer of rights to the Electronic Payment Instruments listed (e.g., by having a contract or terms of use set forth the procedures to be taken for transfer of Electronic Payment Instruments, and timing for finalizing the transfer and reasons therefor, and sufficiently explaining these matters to users);
- (ii) properly establishing a system necessary for AML/CFT specified in the Draft Guideline for Electronic Payment Instruments Exchange Service Providers II-2-1-2;
- (iii) ensuring that the users' rights are properly protected by allowing termination or cancellation of transactions (including restoration to original condition) by, or ensuring compensation for losses incurred by, the issuer or the Electronic Payment Instruments Exchange Service Provider in the event of a failure or technological problems (including, but not limited to, cyberattack, clerical error, internal fraud, and system failure) of the issuer or Electronic Payment Instruments Exchange Service Provider; and
- (iv) taking the following measures to promptly and properly redeem the Electronic Payment Instruments in response to requests from users for redemption of Electronic Payment Instruments.
  - ✓ the issuer establishes a contact-desk and the Electronic Payment Instruments Exchange Service Provider confirms redemption requests (or the Electronic Payment Instruments Exchange Service Provider establishes a contact desk if it is to receive redemption requests from users);
  - ✓ providing appropriate information to users; and
  - ✓ if the Electronic Payment Instruments Exchange Service Provider is to receive redemption requests from users, it establishes internal rules for redemption procedures.

## **B. Prohibition on Receipt of Deposit of Money or Other Valuables from Users**

Electronic Payment Instruments Exchange Service Providers are prohibited from receiving deposits of money or other valuables from users of their Electronic Payment Instruments Exchange Service (Article 62-13 of the Amended Payment Services Act).

Having said that, this prohibition is not applicable to the cases where an Electronic Payment Instruments Exchange Service Provider receives deposits of money, etc. from users in relation to its exchange, etc. of Electronic Payment Instruments (meaning the acts listed in Items (i) and (ii) of Paragraph 10, Article 2 of the Amended Payment Services Act) and the cash, etc. is then entrusted to a "trust company, etc."<sup>5</sup> ("segregated user money management trust") and managed separately from the service provider's property through the trust (Article 33, Paragraph 1, Item (i) of the Draft EPIESP Cabinet Office Ordinance). Therefore, any Electronic Payment Instruments Exchange Service Provider that receives deposits of money from its users in relation to the transactions of Electronic Payment Instruments needs to have the money held in trust by a trust company, etc. (i.e., a segregated user money management trust).

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<sup>4</sup> [https://www.amt-law.com/asset/pdf/bulletins2\\_pdf/230417.pdf](https://www.amt-law.com/asset/pdf/bulletins2_pdf/230417.pdf)

<sup>5</sup> As defined in Article 2, Paragraph 26 of the Amended Payment Services Act (Article 2, Paragraph 16 of the current Payment Services Act), i.e., a trust company, and a bank or other financial institutions authorized to conduct trust business.

This allows for business models, like the current crypto-assets exchanges, where an Electronic Payment Instruments Exchange Service Provider first receives deposits of money from users and then uses the money to purchase stablecoins (Electronic Payment Instruments) on the condition that the money is held in trust.

### **C. Obligation to Separately Manage Users' Electronic Payment Instruments**

Electronic Payment Instruments Exchange Service Providers have to manage users' Electronic Payment Instruments separately from their own Electronic Payment Instruments (Article 62-14 of the Amended Payment Services Act).

#### **(a) Separate management through Trust of Users' Separately Managed Electronic Payment Instruments**

Electronic Payment Instruments deposited by users ("Deposited Instruments") should be entrusted to a trust company, etc. ("Trust of Users' Separately Managed Electronic Payment Instruments"). The Electronic Payment Instruments Exchange Service Providers are then required to have the trust company, etc. separately manage the Deposited Instruments (meaning the manner of management wherein Electronic Payment Instruments of a user is clearly distinguished from other Electronic Payment Instruments so that the Electronic Payment Instruments are readily identifiable as the ones of the relevant user (including the manner of management wherein the quantity of the relevant user's Electronic Payment Instruments is readily identifiable in a book kept by the trust company, etc.)). It is also necessary to meet all of the requirements set forth in the items of Paragraph 2, Article 38 of the Draft EPIESP Cabinet Office Ordinance (such as the requirement that the Electronic Payment Instruments Exchange Service Provider, the trust company, etc., and a user act as the settlor, the trustee, and the beneficiary of the principal, respectively; and the requirement that the trustee only preserves the trust property or, otherwise, utilizes and/or improves the trust property without changing its nature).

Under the current regulations, crypto-assets exchange service providers are deemed as sufficiently managing deposited crypto-assets insofar as the crypto-assets are separately managed in a cold wallet held by them. Therefore, the regulation requiring a trust is unique to Electronic Payment Instruments Exchange Service Providers.

#### **(b) Separate management through Self-declared Trust of Users' Separately Managed Electronic Payment Instruments**

There are, however, exceptional cases where, subject to an approval from the competent authorities, Deposited Instruments may be managed by declaring a trust of their own in the method prescribed in Article 3, Item (iii) of the Trust Act ("Self-declared Trust of Users' Separately Managed Electronic Payment Instruments") and placing them in a cold wallet (Article 38, Paragraphs 3 and 4 of the Draft EPIESP Cabinet Office Ordinance). In practice, this method would be a more realistic option for the separate management of Deposited Instruments.



To obtain an approval from the competent authorities, it is necessary to meet all of the following conditions:

- (i) the amount of stated capital and the amount of net assets are equivalent to at least 30 million yen;
- (ii) the statements given in the document providing details of administrative procedures and the method for the Self-declared Trust of Users' Separately Managed Electronic Payment Instruments are in compliance with laws and ordinances and are sufficient to properly perform the affairs; and
- (iii) in light of its personnel composition, the Electronic Payment Instruments Exchange Service Provider has the knowledge and experience to properly perform the administrative procedures relating to the Self-declared Trust of Users' Separately Managed Electronic Payment Instruments.

Further, a Self-declared Trust of Users' Separately Managed Electronic Payment Instruments is also required to meet all of the requirements prescribed in the items of Paragraph 5, Article 38 of the Draft EPIESP Cabinet Office Ordinance (such as the requirement that a user shall be the beneficiary of the principal; and the requirement that the trustee only preserves the trust property or, otherwise, utilizes and/or improves the trust property without changing its nature.).

- (c) Separate management in a cold wallet

Notwithstanding (a) and (b) above, Electronic Payment Instruments which obviously belong to the relevant user can be separately managed in a cold wallet (i.e., without having to manage them through a Trust of Users' Separately Managed Electronic Payment Instruments or Self-declared Trust of Users' Separately Managed Electronic Payment Instruments) (Article 38, Paragraph 7 of the Draft EPIESP Cabinet Office Ordinance). The phrase "Electronic Payment Instruments which obviously belong to the relevant user" would mean, for example, the case whereby an Electronic Payment Instruments Exchange Service Provider manages for users, a "specified beneficial interest in trust" (defined in Article 2, Paragraph 5, Item (iii) of the Amended Payment Services Act) that constitutes a beneficial interest in a trust with certificates of beneficial interest, and the view is that this case applies if each user is stated as a beneficiary in the beneficial interest holder register (Draft Guideline for Electronic Payment Instruments Exchange Service Providers 2-2-3-2(3)(iv) (Note)). Hence, the mere fact that users have the right to claim returns against the Electronic Payment Instruments Exchange Service Provider is insufficient, and the above exception would be applicable only when it is legally obvious that the Electronic Payment Instruments are attributed directly to the users.

#### **D. Obligation to Conclude Contract with Issuer.**

Electronic Payment Instruments Exchange Service Providers must conclude a contract with the issuer in relation to the Electronic Payment Instruments Exchange Service, setting forth the Electronic Payment Instruments Exchange Services to be performed for the relevant issuer in accordance with the contract (Article 62-15 of the Amended Payment Services Act).

Below are the specific matters that have to be stated in a contract to be concluded with the issuer.

(Article 40, Paragraph 2, Item (i) of the Draft EPIESP Cabinet Office Ordinance, and Draft Guideline for Electronic Payment Instruments Exchange Service Providers II-2-2-4-2(1)(2)):

- the following matters regarding the burden of the liability for compensation for damages, if any, incurred by users which is to be shared between the issuer of the Electronic Payment Instruments listed by the relevant Electronic Payment Instruments Exchange Service Provider and the Electronic Payment Instruments Exchange Service Provider:
  - (i) Contact-desk for receiving complaints from users;
  - (ii) Criteria or procedures for compensation (such as the information users are requested to provide, and the criteria for the decision of the presence or absence of negligence);
  - (iii) Method for compensation (such as the indemnifying party, and the method for calculation of damages);
  - (iv) Scope of compensation; and
  - (v) Indemnification between the parties in the case of the compensation made by either party (how to share the burden of compensation for damage).
- Matters necessary for an Electronic Payment Instruments Exchange Service Provider to promptly provide, upon the request by the issuer of the Electronic Payment Instruments listed by the Electronic Payment Instruments Exchange Service Provider, information necessary for the Electronic Payment Instruments Exchange Service Provider to identify the holders of the Electronic Payment Instruments issued by it (including matters concerning the frequency and timing of the provision of the relevant information), such as transaction records prescribed in Article 75, Paragraph 1, Item (i) and Article 76, Paragraph 1 of the Draft EPIESP Cabinet Office Ordinance, and information on the management of Electronic Payment Instruments prescribed in Article 75, Paragraph 1, Item (vii) of the Draft EPIESP Cabinet Office Ordinance (Electronic Payment Instruments Exchange Service Providers should establish a system whereby they promptly meet such requests, whenever received from the issuer, regardless of whether regularly or during emergencies).

Since the major stablecoins already issued and outstanding in foreign countries are all permissionless stablecoins and basically do not assume the conclusion of a contract between the issuer and the intermediary, the obligation to conclude a contract with the issuer may hinder the distribution of such stablecoins in Japan. Yet, if Electronic Payment Instruments Exchange Service Providers list such Electronic Payment Instruments issued overseas by meeting the obligations to repurchase them and secure assets for the repurchase as to be stated in (2)B below, they are relieved from the obligation to conclude a contract with the issuer (Article 40, Paragraph 1 of the Draft EPIESP Cabinet Office Ordinance). On the other hand, for stablecoins issued in Japan, for which no such relief is provided, it would be necessary to conclude a contract between the issuer and the Electronic Payment Instruments Exchange Service Provider even if the Electronic Payment Instruments are permissionless stablecoins.

#### **E. “Travel Rule”**

Under the APTCP, Electronic Payment Instruments Exchange Service Providers are subject to the following obligations: (i) if the transfer of Electronic Payment Instruments takes place repeatedly with

foreign CEXs, the Electronic Payment Instruments Exchange Service Providers has to confirm whether the foreign CEXs conduct KYCs on its customers at the time of the transaction (Article 10-2 of the amended APTCP); and (ii) “Travel Rule” (meaning the obligation to notify customer information at the time of a transfer of Electronic Payment Instruments to the Electronic Payment Instruments Exchange Service Provider that is the transferee (Article 10-3 of the amended APTCP)).

The “Travel Rule” is applicable to transfers of Electronic Payment Instruments to or from custodial wallets (meaning wallets managed by another Electronic Payment Instruments Exchange Service Provider or a business operator providing Electronic Payment Instruments Exchange Service in a foreign country (limited to business operators located in the U.S., Canada, Germany, Singapore, or other countries or regions set out in the items of Article 1 of the Notification by the Financial Services Agency/Ministry of Finance (“Designated Countries or Regions”)), whereas the “Travel Rule” is not applicable to the sending or receipt of Electronic Payment Instruments between un-hosted wallets (meaning wallets managed by users) and custodial wallets of Electronic Payment Instruments Exchange Service Providers located in any country or region other than the Designated Countries or Regions. Having said that, Article 24, Item (viii), (c) and (d) of the Draft Regulation for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds published on February 3, 2023 (the “Draft APTCP Enforcement Regulation”) provides that the matters equivalent to the matters to be notified under the Travel Rule<sup>6</sup> shall be stated in the transaction records even in the case of sending or receiving Electronic Payment Instruments to or from un-hosted wallets.

In such cases, Electronic Payment Instruments Exchange Service Providers are further required to take the following measures (Article 32, Paragraph 6 of the Draft APTCP Enforcement Regulation):

- To investigate and analyze attributes of the counterparty to transactions (i.e., an owner of the un-hosted wallet) where the relevant Electronic Payment Instruments are transferred and assess the level of risks associated with the transactions; and
- To collect information on the transfer of the relevant Electronic Payment Instruments, such as the names and other information regarding its customer and the owner of the un-hosted wallet to which the relevant Electronic Payment Instruments are sent or from which the relevant Electronic Payment Instruments are received.

While, under the amended APTCP and the Draft APTCP Enforcement Regulation, these measures have to be taken by using best efforts, the following measures are actually imposed by the Draft Guideline for Electronic Payment Instruments Exchange Service Providers II-2-1-2-2(11):

- (i) To collect and record matters equivalent to be notified under the Travel Rule (in the case of receiving Electronic Payment Instruments from an un-hosted wallet, etc., limited to the matters

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<sup>6</sup> Information on customers transferring Electronic Payment Instruments to or from an un-hosted wallet, and information on the owner of the un-hosted wallet have to be entered in the records. As to the owner of the un-hosted wallet, the specific information to be entered in the records are (1) the owner’s name; and (2) the blockchain address utilized for the transfer, or the code or number that is sufficient to identify the blockchain address. However, in the case of a transfer from an un-hosted wallet, it is sufficient to record such information only to the extent that can be obtained by the Electronic Payment Instruments Exchange Service Provider (Article 24, Item 8(d) of the Draft APTCP Enforcement Regulation).

that can be obtained by the Electronic Payment Instruments Exchange Service Provider).

- (ii) In the case of transactions with an un-hosted wallet, etc., to investigate and analyze attributes or nature of the un-hosted wallet, etc., and assess the associated risks; and
- (iii) Further to (ii) above, as to Electronic Payment Instruments that may be broadly used and traded as instruments for remittance or payment, it is necessary to identify and assess the associated risks in light of such nature and establish an appropriate system for such risks, which includes, for example, the following elements:
  - ✓ The management shall establish a system to reduce the risks of transactions with un-hosted wallets, etc. being utilized for terrorist financing, money laundering, or other inappropriate purposes, regularly verify the effectiveness of the system, and clearly define the reduction of such risks as a matter of compliance and risk management;
  - ✓ In the monitoring and analysis of transactions with un-hosted wallets, etc., recognize the risks by assessing the blockchain or otherwise; and
  - ✓ Through investigations by users engaging in transactions with un-hosted wallets or by Electronic Payment Instruments Exchange Service Providers themselves, properly obtain information on the un-hosted wallets, etc.:
    - To be specific, establish a system wherein, in the case of transferring Electronic Payment Instruments to an un-hosted wallet, information on the un-hosted wallet as the transferee is obtained from the user or other sources, and if the transaction is found to be suspicious, make it possible to prohibit the user from transferring the Electronic Payment Instruments; and
    - Establish a system wherein, in the case of receiving Electronic Payment Instruments from an un-hosted wallet, information on the un-hosted wallet is obtained from the user or other sources, and if the transaction is found to be suspicious, make it possible to prohibit the user from using the Electronic Payment Instruments received by it.

## **(2) Additional regulations on the listing of Electronic Payment Instruments issued in foreign countries**

This section outlines the additional regulations imposed on Electronic Payment Instruments Exchange Service Providers that list Electronic Payment Instruments issued in foreign countries (“Foreign Electronic Payment Instruments”) in addition to the regulations described in (1) above.

### **A. Measures necessary for not listing inappropriate Electronic Payment Instruments**

Electronic Payment Instruments Exchange Service Providers listing Foreign Electronic Payment Instruments are required to ensure that the relevant Foreign Electronic Payment Instruments meet the following conditions (Article 30, Paragraph 1, Item (v) of the Draft EPIESP Cabinet Office Ordinance):

- Obtain a license necessary for issuing the relevant Foreign Electronic Payment Instruments in accordance with foreign laws or ordinances equivalent to the Payment Services Act or the Banking Act, and to ensure that the relevant Foreign Electronic Payment Instruments are issued by a person licensed to issue them (issuer’s license);
- Ensure that the issuer of the relevant Foreign Electronic Payment Instruments manages funds

necessary for the redemption of the relevant Foreign Electronic Payment Instruments in accordance with foreign laws or ordinances equivalent to the Payment Services Act, the Banking Act, the Act on Engagement in Trust Business Activities by Financial Institutions, or the Trust Business Act, and to ensure that the status of the management is being audited by a person with qualifications equivalent to those of Certified Public Accountants or a person equivalent to an audit corporation in the country in which the relevant Foreign Electronic Payment Instruments are issued (securing of assets); and

- If there is a suspicion that a criminal act has been conducted in light of the circumstances, such as the receipt of information from an investigative agency, etc. to the effect that the relevant Foreign Electronic Payment Instruments had been used for fraud or other criminal activities, have the issuer of the relevant Foreign Electronic Payment Instruments take measures such as suspending transactions of the relevant Foreign Electronic Payment Instruments (suspension of transactions, etc.).

In connection with these provisions, the Draft Guideline for Electronic Payment Instruments Exchange Service Providers III-2-1(1)(iii) requires the following measures to be taken in filing an application for registration of the Electronic Payment Instruments Exchange Service:

- The candidate shall explain that an issuer of Foreign Electronic Payment Instruments does not engage in or cause a third party to engage in the issuance and redemption of, or any act that is deemed as soliciting for the issuance or redemption of, Electronic Payment Instruments to users in Japan; and
- The candidate shall explain that the listing of the Electronic Payment Instruments by it and issuance thereof are lawful under foreign laws and regulations. In providing the explanation, the issuer shall submit necessary materials, such as a legal opinion of a legal expert and related statutory provisions.

#### **B. Repurchase obligation in the event of bankruptcy of the issuer, and securing of assets for the repurchase**

An Electronic Payment Instruments Exchange Service Provider listing Foreign Electronic Payment Instruments shall covenant that, if it becomes difficult for the issuer of the relevant Foreign Electronic Payment Instruments to perform or otherwise fulfill its obligations or in the event of a significant decrease in the value of the relevant Foreign Electronic Payment Instruments, the Electronic Payment Instruments Exchange Service Provider must repurchase the relevant Foreign Electronic Payment Instruments managed by it for users in Japan at a price equal to the amount for which the relevant obligations are to be performed or otherwise fulfilled, and must also secure assets necessary for the repurchase or for taking other measures necessary for ensuring equivalent protection of users (Article 30, Paragraph 1, Item (vi)(a) of the Draft EPIESP Cabinet Office Ordinance).

According to the Draft Guideline for Electronic Payment Instruments Exchange Service Providers I-1-2-3(2), the specific measures to be taken are as follows:

- Preservation by concluding a guarantee agreement or a trust agreement; and
- Provide explanation and information on the procedures for the Electronic Payment Instruments

Exchange Service Provider to repurchase Electronic Payment Instruments, and the securing of assets necessary for the repurchase.

Since deposited Electronic Payment Instruments have to be managed separately, as stated earlier at (1) C above, Electronic Payment Instruments Exchange Service Providers listing Foreign Electronic Payment Instruments have to take the above assets-securing measures using their own assets as a resource.

### **C. Maximum amount of deposit and transfer**

An Electronic Payment Instruments Exchange Service Provider is also required to take measures to ensure that the amount of foreign Electronic Payment Instruments that can be deposited or transferred by each user is equivalent to the amount when the relevant Electronic Payment Instruments Exchange Service Provider lists Electronic Payment Instruments issued by a type II funds transfer service provider (Article 30, Paragraph 1, Item (vi)(b) of the Draft EPIESP Cabinet Office Ordinance). Due to this rule, it can be presumed that the usage of Foreign Electronic Payment Instruments in Japan are restricted considerably.

According to the Draft Guideline for Electronic Payment Instruments Exchange Service Providers I-1-2-3(2), the specific measures to be taken are as follows:

- In the case of a transfer of a user's Foreign Electronic Payment Instruments deposited to an Electronic Payment Instruments Exchange Service Provider (including the case of transferring them to a wallet not managed by the Electronic Payment Instruments Exchange Service Provider), the Electronic Payment Instruments Exchange Service Provider shall ensure that the amount of each such transfer is no greater than one million yen; and
- If the amount of a user's Foreign Electronic Payment Instruments deposited to an Electronic Payment Instruments Exchange Service Provider exceeds one million yen, the Electronic Payment Instruments Exchange Service Provider shall take measures to ensure that the user no longer holds the Foreign Electronic Payment Instruments that are found unlikely to be transferred (such as repurchase such Foreign Electronic Payment Instruments).

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