



# JAPAN

## FINANCIAL SECTOR ASSESSMENT PROGRAM

May 2024

### TECHNICAL NOTE ON REGULATION AND SUPERVISION OF FINTECH

This Technical Note on Regulation and Supervision of Fintech for the Japan FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 16, 2024.

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April 16, 2024

# TECHNICAL NOTE

## REGULATION AND SUPERVISION OF FINTECH

Prepared By  
**Monetary and Capital  
Markets Department,  
IMF**

This Technical Note was prepared by Cristina Cuervo (IMF) in the context of the Financial Sector Assessment Program (FSAP) in Japan, led by Mahvash Qureshi (IMF). It contains the technical analysis and detailed information underpinning the FSAP findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

## CONTENTS

Glossary	3
<b>EXECUTIVE SUMMARY</b>	<b>4</b>
<b>INTRODUCTION</b>	<b>6</b>
<b>FINTECH LANDSCAPE</b>	<b>7</b>
<b>INSTITUTIONAL FRAMEWORK AND REGULATORY APPROACH TO FINTECH</b>	<b>14</b>
<b>REGULATION AND SUPERVISION OF CRYPTO ASSETS</b>	<b>22</b>
A. Regulatory Framework	22
B. Registration	28
C. Supervision and Enforcement	29
D. Findings and Recommendations	30
<b>BOX</b>	
1. The Case of FTX	24
<b>FIGURES</b>	
1. Selected Countries: Recent Developments in Fintech	9
2. Selected Countries: Growth in Cashless Payments	10
3. Crypto-Asset Exchange Landscape	12
4. Development of Crypto Asset Regulatory Framework	23
<b>TABLES</b>	
1. Recommendations on Regulation and Supervision of Fintech	6
2. Sandbox Projects (2018-2023)	15
3. FSA Fintech-Related Licenses	17

## Glossary

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
API	Application Programming Interface
AUM	Assets Under Management
BaaS	Banking as a Service
BCBS	Basel Committee on Banking Supervision
BOJ	Bank of Japan
CESP	Crypto Asset Exchange Service Provider
CBDC	Central Bank Digital Currencies
EPSP	Electronic Payment Service Providers
EPIESP	Electronic Payment Instrument Exchange Service Provider
ERTR	Electronically Recorded Transferable Rights
FIEA	Financial Instruments and Exchange Act
FIBO	Financial Instruments Business Operator
FSA	Financial Services Agency
FSB	Financial Stability Board
FSAP	Financial Sector Assessment Program
FTSP	Funds Transfer Service Providers
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
JPY	Japanese Yen
JVCEA	Japan Virtual and Crypto Assets Exchange Association
KYC	Know Your Customer
LFB	Local Finance Bureau
MCM	Monetary and Capital Markets Department, IMF
PPI	Pre-paid Payment Instrument
PPII	Pre-paid Payment Instrument Issuer
SRO	Self-Regulatory Organization
TN	Technical Note

## EXECUTIVE SUMMARY<sup>1</sup>

**This technical note reviews the functioning and effectiveness of the regulation, supervision, and systemic risk monitoring of fintech in Japan.** It focuses on the institutional arrangements for fintech monitoring, as well as the approach that the Japanese authorities have taken to review the regulatory perimeter around fintech-related issues, noting regulatory amendments on digital payments, banking, and crypto assets most notably. On crypto assets, the note reviews the regulatory framework in Japan, and the approach of the Financial Services Agency (FSA) to licensing and supervision of crypto exchanges. The note sets out a series of recommendations to further strengthen the domestic regulatory, supervisory, and risk monitoring frameworks.

**The fintech market is growing in Japan, mostly concentrated in the digital payments sphere.** Although cash and credit cards are still prevalent, the use of QR code and smartphone app payment services by Fund Transfer Service Providers (FTSPs) and Prepaid Payment Instrument Issuers (PPIIs) has significantly increased in recent years. This has been spurred by a government initiative to promote Japan's transition to cashless payments. The banking industry is also steadily moving into the digital space, with increased use of open banking and recent growth of some digital banks. Crypto activity is picking up, under a relatively mature regulatory regime and experienced players. Stablecoin initiatives are underway by several entities, although there has been no issuance yet.<sup>2</sup>

**The FSA monitors fintech developments through various channels and responds as needed with targeted regulatory initiatives.** The FSA has a Fintech Policy Office to internally coordinate fintech regulatory and supervisory work and monitors developments through different means, including industry outreach, analysis of data from licensed firms, and engagement with Self-Regulatory Organizations and study groups. Recent fintech-related regulatory initiatives have been undertaken across services, including amendments to the Payment Services Act, the Banking Act, and the Financial Instruments Exchange Act, among others. The Fintech Policy Office is also in charge of the licensing and supervision of fintech-related firms, namely FTSPs, PPIIs, Crypto-asset Exchange Service Providers (CESPs), and other fintech registrants for the provision of intermediation within financial services (e.g., through the use of open Application Programming Interfaces). As fintech continues to grow, a more systematic approach to data gathering that enables the FSA to have a

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<sup>1</sup> This Technical Note has been prepared by Ms. Cristina Cuervo (Senior Financial Sector Expert, Monetary and Capital Markets Department of the IMF), with input from Mustafa Yenice. The on-site work supporting the findings and conclusions was conducted during January 2024. The information in this note is current as of January 2024. The FSAP thanks the authorities for the constructive dialogue and the insights that they have shared.

<sup>2</sup> The Bank of Japan (BOJ) currently has no plans to issue a central bank digital currency (CBDC) but has been conducting technical experiments to prepare for a change in circumstances. In this context, it has conducted a Proof of Concept that concluded in March 2023 and has initiated a pilot program in April 2023 without an end date to develop a system for experimenting with the end-to-end process. Experimentation remains at an early stage and no decision has been made with regards to the model that would be used for CBDC. The pilot program, which does not include real-world testing, is complemented by a CBDC Forum involving about 60 participants from the private sector.

domestic outlook and, as needed, carry out analysis from a financial stability perspective, would be a welcome step.

**The fast pace of growth in digital payment services warrants intensified monitoring of developments and enhanced supervision of most relevant players.** While it is understood that a steady transition to cashless payments is a government priority, the authorities need to ensure that this does not come at the expense of potential risks. The FSA should closely monitor developments in this sector to determine whether the current regulatory safeguards remain adequate. In the absence of specific capital requirements for FTSPs, it may also consider requiring entities to develop wind-down plans in the event of a failure of an FTSP. Additionally, an analysis should be carried out to determine whether the requirement for third-party PPIIs to retain only 50 percent of funds transmitted by clients remains adequate in an era of digital PPIs, given the sector's rapid growth.

**Japan has developed a comprehensive conduct and prudential regulatory framework for CESTPs.** While the basic framework, which includes Anti-Money Laundering and Counter the Financing of Terrorism (AML/CFT) measures and certain user protection requirements for CESTPs was introduced in 2017, the regime has gradually evolved to incorporate more stringent user protection, prudential, and conduct of business requirements. It currently constitutes a comprehensive and detailed approach to the regulation and supervision of CESTPs, providing safeguards in relation to the most prominent risks, particularly through strict asset segregation requirements and compulsory use of cold wallets. The framework also provides detailed screening at the time of licensing new service providers and listing new crypto assets as well as offsite and onsite supervision of licensed firms. In addition, the FSA monitors the provision of services by non-regulated entities to Japanese clients and issues warnings to the entities and disseminates alerts on those entities to the public.

**Going forward, the FSA could strengthen its customer education and enforcement efforts regarding crypto, and further tailor the regulatory framework to the particularities of crypto assets, particularly regarding market integrity.** The FSA could enhance its efforts to educate the public on the risks regarding crypto assets and the overall functioning of crypto asset markets, beyond the issuance of warnings and alerts. It should also review the effectiveness of its enforcement program against non-licensed firms, including whether the use of monetary penalties could increase deterrence. Additionally, the FSA could work with the industry to identify ways to improve the market surveillance approach of CESTPs so that it adequately addresses the specificities of crypto asset markets to improve identification of market abuse conducts.

**Table 1. Japan: Recommendations on Regulation and Supervision of Fintech**

Recommendations	Timing <sup>1</sup>	Authorities
<b>Institutional arrangements</b>		
Develop a more systematic approach for the collection and analysis of domestic fintech related data.	ST	FSA
Continue to work with the Local Finance Bureaus (LFBs) to ensure an adequate supervision of fintech-related registrants.	I	FSA, LFBs
<b>Digital payment service providers</b>		
Intensify monitoring of FTSPs and PPIIs considering their fast growth.	I	FSA
Enhance supervision of significant FTSPs.	ST	FSA
Require FTSPs to develop wind-down plans.	ST	FSA
Carry out analysis to determine whether 50 per cent asset retention requirement for third-party PPIIs remains adequate.	ST	FSA
<b>Crypto assets</b>		
Broaden background of CESP monitoring/supervision by incorporating securities markets expertise in the team.	ST	FSA
Work with industry and SRO to study how market surveillance approach could be better tailored to identify market abuse specifically for crypto assets.	ST	FSA
Enhance investor education approach regarding crypto assets and CESPs.	ST	FSA
Strengthen enforcement approach: (i) review the FSA's enforcement program and consider including monetary penalties as part of available tools, (ii) monitor enforcement approach by the JVCEA to ensure adequate use of its enforcement powers.	ST	FSA
<sup>1</sup> I Immediate (within 1 year); ST Short Term (within 1-2 years); MT Medium Term (within 3–5 years).		

## INTRODUCTION

**1. This technical note (TN) covers the implications of fintech for the regulation and supervision of the Japanese financial services sector.** This note is part of the 2024 Financial Sector Assessment Program (FSAP), drawing on discussions held with government officials of Japan and private sector entities in January 2024, as well as on materials provided by the authorities and publicly available information.

**2. The note draws upon evolving guidance by global standard-setting bodies and other international organizations, and best practices to support the analysis and policy recommendations.** Most relevant, as of January 2024, are the Financial Stability Board (FSB) Global Regulatory Framework for Crypto Asset Activities and High Level Recommendations for Global

Stablecoins.<sup>3</sup> the Basel Committee on Banking Supervision (BCBS) standards on the prudential treatment of crypto asset exposures,<sup>4</sup> the International Organization of Securities Commissions (IOSCO) Policy Recommendations for Crypto and Digital Asset Markets<sup>5</sup>, IOSCO Report on Crypto Asset Trading Platforms<sup>6</sup>, the World Bank–International Monetary Fund (IMF) Bali Fintech Agenda,<sup>7</sup> and IMF publications including Fintech Notes on Regulating the Crypto Ecosystem,<sup>8,9</sup> Institutional Arrangements for Fintech Regulation,<sup>10</sup> the Board endorsed Elements of Effective Policies for Crypto Assets,<sup>11</sup> and the IMF and FSB Synthesis Paper: Policies for Crypto Assets.<sup>12</sup> It should be noted that while the TN may refer to AML/CFT relevant issues as needed, no assessment or detailed analysis of compliance with the Financial Action Task Force (FATF) standards has been carried out.

**3. The note is structured into three main sections.** The first section briefly describes the industry landscape for fintech in Japan, its most pressing topics, and relevant initiatives. The second section focuses on how responsibilities are distributed across public and self-regulatory organizations in relation to fintech regulation and supervision, and how authorities engage with the industry and monitor risks from fintech; it also covers the most significant fintech-related regulatory initiatives by the authorities in recent years. The third section provides a more detailed analysis of the regulatory and supervisory approaches to crypto assets in Japan.

**4. The case studies described in this note do not indicate endorsement of the underlying technologies and business models.** One of the important features and challenges is that most of the fintech business models and underlying technologies are still under development and evolving very rapidly. This note includes case studies to illustrate industry developments in the jurisdiction. The inclusion of specific cases in this report should not be construed as an endorsement.

## FINTECH LANDSCAPE

**5. Despite recent developments, particularly in relation to digital payments and crypto assets, adoption of fintech remains relatively modest in Japan.** Compared to its regional peers, Japan has not seen a similar pace of development, for example, of the use of online financial services. The size of the crypto-asset market in Japan compared with markets abroad is also limited, even

<sup>3</sup> [FSB Global Regulatory Framework for Crypto-Asset Activities; High-level Recommendations for the Regulation, Supervision and Oversight of Global Stablecoin Arrangements: Final report - Financial Stability Board \(fsb.org\).](#)

<sup>4</sup> [Prudential treatment of crypto asset exposures \(bis.org\).](#)

<sup>5</sup> [FR11/23 Policy Recommendations for Crypto and Digital Asset Markets \(iosco.org\).](#)

<sup>6</sup> [FR02/2020 Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms \(iosco.org\).](#)

<sup>7</sup> [The Bali Fintech Agenda \(imf.org\).](#)

<sup>8</sup> [Regulating the Crypto Ecosystem: The Case of Unbacked Crypto Assets \(imf.org\).](#)

<sup>9</sup> [Regulating the Crypto Ecosystem: The Case of Stablecoins and Arrangements \(imf.org\).](#)

<sup>10</sup> [Institutional Arrangements for Fintech Regulation: Supervisory Monitoring \(imf.org\).](#)

<sup>11</sup> [Elements of Effective Policies for Crypto Assets \(imf.org\).](#)

<sup>12</sup> [IMF-FSB Synthesis Paper: Policies for Crypto-Assets - Financial Stability Board.](#)



though the number of users of crypto is on the rise. Although digital payments are picking up, especially after the COVID-19 pandemic, cash is still dominant (Figure1).

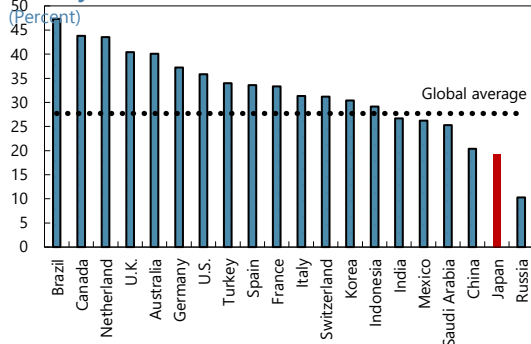
**6. However, recent trends suggest a faster transition into cashless payments, with pre-paid instruments and QR code systems leading the way.** The cashless payment ratio has increased from 21.3 percent in 2017 to 36.0 percent at end 2022, and while credit card payments still account for a large share of cashless payments, in recent years there has been a marked increase in the retail use of QR code payments provided by Funds Transfer Service Providers (FTSPs) and Prepaid Payment Instrument Issuers (PPIIs). In 2022, FTSPs handled approximately JPY 7.5 trillion in annual transactions, and the number of payments reached approximately 2.3 billion, a significant increase from 2020 (approximately JPY 2.3 trillion in transactions, 450 thousand payments). In addition, the annual issuance of PPIs increased to JPY 29.5 trillion in 2022, from JPY 23.7 trillion in 2017. There are several reasons behind this recent trend, including the increased demand for contactless payment methods due to the COVID-19 pandemic, as well as government measures to promote cashless payments (Figure 2). Some of these firms are also developing financial applications that consolidate a number of financial services in one space, offering a one-stop shop for access to payments, credit, insurance and asset management services. Applications can provide access to the firm's own brand financial services or to third parties' services and have the potential to become "SuperApps."

**7. Japan was also a pioneer in the crypto sphere, with an initially booming market that stalled after severe hacking incidents in 2014 and 2018.** While crypto penetration is now rather limited, Japan was a leading crypto service provider jurisdiction in the earlier days of crypto activity. Mt. Gox was a Tokyo-based crypto asset exchange that operated between 2010 and 2014 and was responsible for a large share of Bitcoin transactions globally. In 2014, it was reportedly the target of a cyber-attack that resulted in the loss of a significant amount of crypto assets that belonged to clients and the company filed for bankruptcy. Later in 2018, another security incident in an exchange supervised by the FSA, resulted in severe loss of clients' assets. These incidents, as explained below, prompted the introduction of a gradually stricter regulatory framework (including strict asset handling requirements and hard limits on leverage trading), which likely partly accounts for the decline in trading activity in the following years.

**Figure 1. Selected Countries: Recent Developments in Fintech**

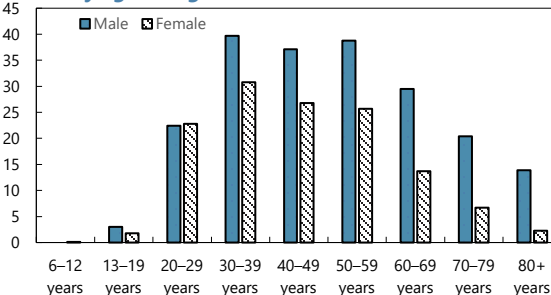
The usage rate of online financial services in Japan is lower compared to most of its peers.

**Usage Rate of Online Financial Services by Country**



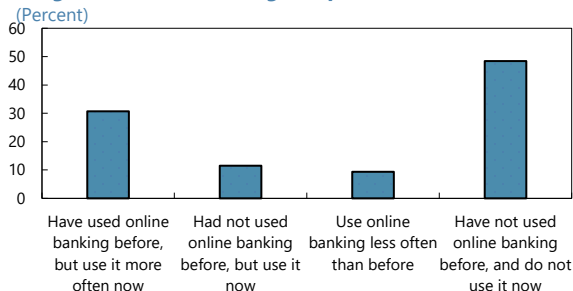
Male respondents in surveys are the primary users of internet banking for financial transactions.

**Internet Usage for Financial Transactions in Japan 2022, by age and gender (Percent)**



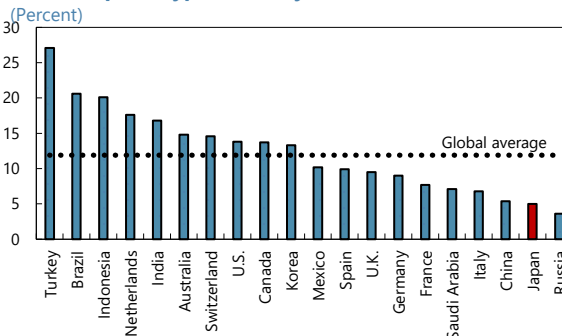
Around 40 percent of individuals have increased their online banking usage compared to pre-COVID-19 years.

**Usage of Internet Banking compared to COVID-19, 2022**



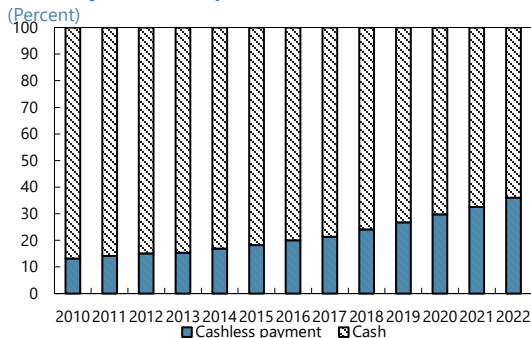
The crypto assets ownership rate remains relatively modest.

**Ownership of Cryptocurrency, 2022**

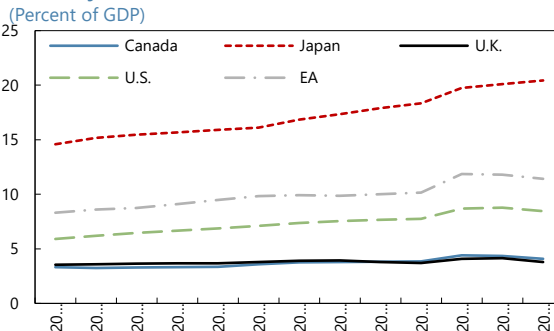


Despite the growing trend towards cashless transactions, there is a noticeable increase in the demand for physical cash in the market.

**Total Payments in Japan**



**Currency in Circulation**



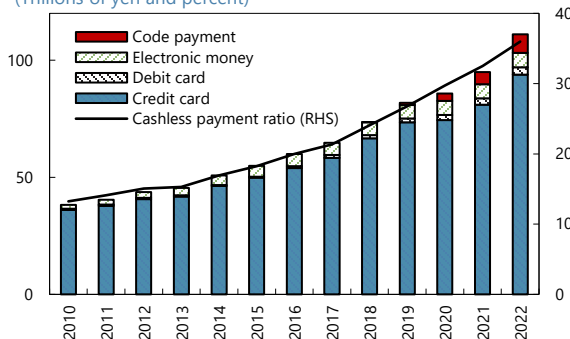
Sources: e-Stat; Haver analytics; and central banks; Japan Ministry of Economy, Trade and Industry; Japan Ministry of Internal Affairs and Communications; Mobile Society Research Institute, We Are Social & Meltwater (2023), "Digital 2023 Global Overview Report."

**Figure 2. Selected Countries: Growth in Cashless Payments**

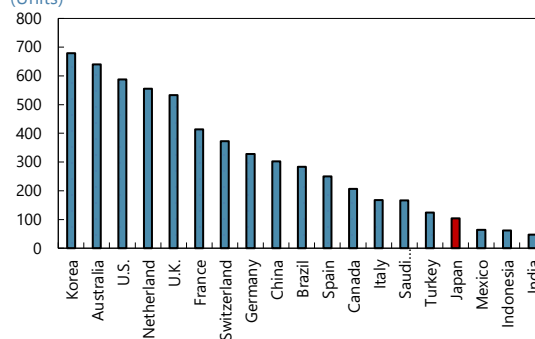
There has been a steady increase in cashless payments...

...but the number of cashless payments per capita remains relatively low compared to other countries.

**Total Cashless Payment**  
(Trillions of yen and percent)

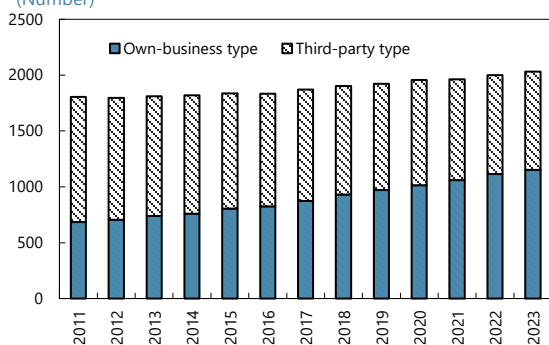


**Average Number of Cashless Payments per Capita, 2021**  
(Units)

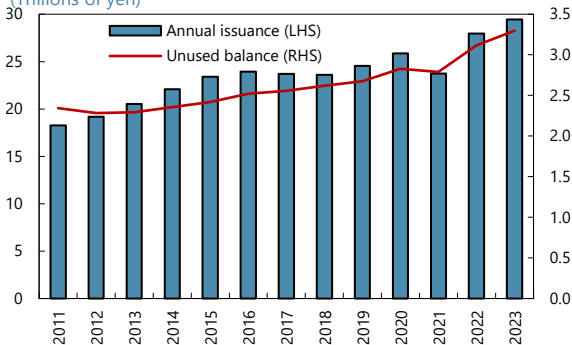


The annual issuance of Prepaid Payment Instruments (PPIs) in 2010 has seen a substantial increase of approximately 50 percent, reaching a total of JPY 29 trillion recently.

**Number of Prepaid Payment Instruments Issuers**  
(Number)

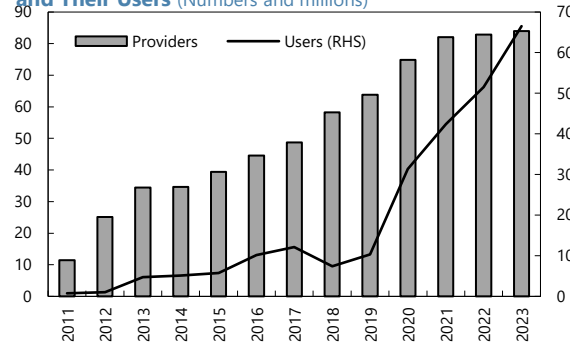


**Unused Balance of Prepaid Payment Instruments**  
(Trillions of yen)

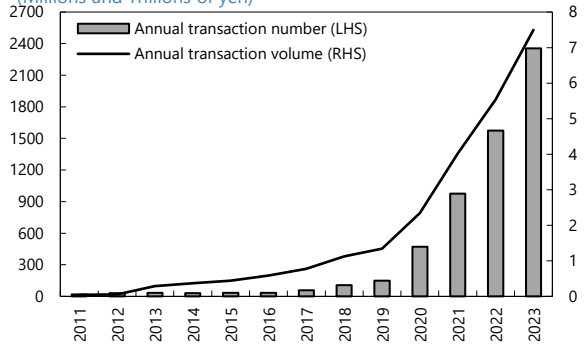


The Fund Transfer Service Providers (FTSPs) sector in Japan has experienced significant growth, in terms of user base as well as in the number of providers. These handled around JPY 7.5 trillion in annual transactions in 2023.

**Number of Funds Transfer Service Providers (Type2) and Their Users** (Numbers and millions)



**Number and Volume of Annual Transactions** (Millions and Trillions of yen)



Sources: BIS statistics; FSA statistics; and Japan Ministry of Economy, Trade and Industry.

**8. Crypto penetration seems to be slowly picking up.** Chainalysis has recently included Japan within the top-20 countries regarding crypto adoption in the world.<sup>13</sup> Japan ranked 18<sup>th</sup>, along with three other G-7 peers: the US (4<sup>th</sup>), the UK (14<sup>th</sup>) and Canada (19<sup>th</sup>). Most other jurisdictions in the top 20 positions are emerging market economies. Although data is limited, this seems to suggest an increase in crypto asset penetration. For reference, further to a survey by the Central Council for Financial Services Information<sup>14</sup> from 2019, the penetration of crypto assets was rather limited, with only 7.8 percent of individuals in the study sample holding crypto. The number of accounts at exchange service providers has doubled since 2018, according to the Japan Virtual and Crypto assets Exchange Association (JVCEA)<sup>15</sup>, although domestic trading volumes have remained low since 2021, in line with the decline in Bitcoin prices and probably due to gradually stricter regulatory requirements (Figure 3).

**9. Japan was an early introducer of regulation on crypto assets, with rules for exchanges adopted early on in 2017, and a regime for stablecoins recently introduced in June 2023.** Japan is one of the first countries to develop a comprehensive regime for crypto assets and stablecoins for prudential and conduct purposes, and the country with the longest track record of licensing and supervising crypto asset exchanges for these purposes.

**10. There are currently 29 crypto exchange service providers registered in Japan, although the provision of services is mostly concentrated in three.** As of end November 2023, there were about 8.6 million domestic accounts on the crypto exchanges, with the top three providers accounting for approximately 60 percent of those. The average annual trading volume in these three exchanges for 2023 was JPY 3.18 trillion, with spot trading accounting for JPY 2.18 trillion and margin trading contributing JPY 1.00 trillion.

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<sup>13</sup> 2023 Chainalysis Global Crypto Adoption Index. Chainalysis started its Geography of Crypto Reports and global ranking in 2020.

<sup>14</sup> The Bank of Japan serves as secretariat for the Central Council for Financial Services Information.

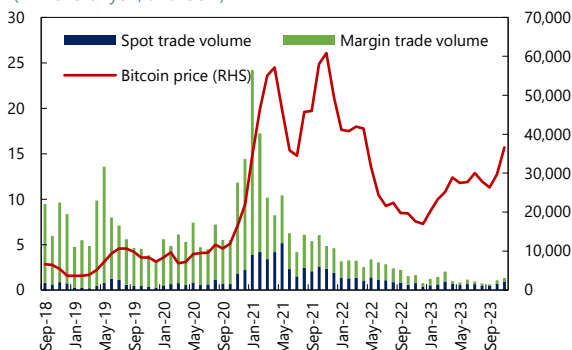
<sup>15</sup> The JVCEA is certified by the FSA as the Self-Regulatory Organization (SRO) for crypto asset exchange service providers.

**Figure 3. Japan: Crypto-Asset Exchange Landscape**

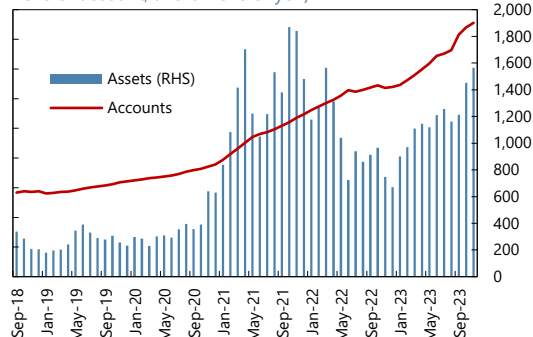
Both spot trading and margin trading decreased significantly ...

... despite an increase in user accounts.

**Japan Domestic Transaction Amount and Bitcoin price**  
(Trillions of yen, and USD)



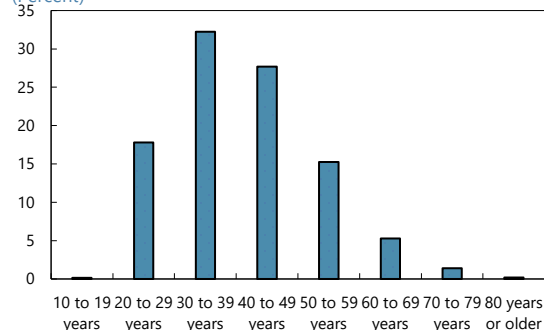
**User Accounts and Assets in CESP**  
(Millions of account, and billions of yen)



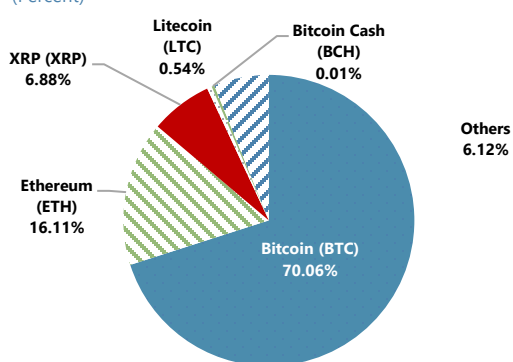
Majority of account holders are in their 30s and 40s.

Bitcoin accounts for about 70 percent of crypto asset spot transactions in Japan.

**Age Distribution of Crypto Asset Account Holders, FY22**  
(Percent)



**Value of Crypto Spot Transactions, FY22**  
(Percent)



Sources: FSA statistics; Japan Virtual and Crypto assets Exchange Association; Haver analytics; and Coingecko.

**11. The banking sector is also slowly moving into the digital sphere.** Although there is no official definition of digital bank in the regulatory framework, the “Comprehensive Guidelines for Supervision of Major Banks, etc.” issued by the FSA contemplates a category of banks which provide their services fully on-line and without physical branches. These can be generally referred to as “digital banks” for the purposes of this note. Their presence is still modest, although some are growing at a significant pace. The first digital bank was licensed in the year 2000 and there are currently 11 digital banks registered with the FSA. The first one to operate exclusively via smartphone app was licensed in 2020. It is growing at a significant pace, reaching almost 600,000 accounts in its first two years; however, this number is still small compared to those held by traditional deposit-

taking institutions<sup>16</sup>. Incumbents are also increasingly providing banking services through partnerships with non-financial institutions (e.g., Banking as a Service is emerging as shown by increase in partnerships between incumbents and non-bank entities like Electronic Payment Service Providers, Financial Service Intermediaries and Bank Agents).<sup>17</sup> Open banking is permitted in Japan, and most banks have currently developed systems for the introduction of open Application Programming Interfaces (APIs).<sup>18</sup> As noted above, recent legislation enables trust banks/companies and FTSPs to issue stablecoins, and several entities have projects under consideration<sup>19</sup>.

**12. Financial institutions are increasingly incorporating technology-driven innovation in their operations.** For example, the use of robo-advisors in investment management is growing, with the Assets Under Management (AUM) of the major firms using this technology increasing significantly. The leading asset manager in this space held JPY 928 billion in AUM as of September 2023, which marks a four-fold increase over the last four years (AUM were JPY 203 billion in 2019). Also, regulated entities are increasingly relying on cloud services for their internal business systems and web servers, with a survey by the Center for Financial Industry Information Systems reporting 67 percent of financial institutions having adopted cloud services as of end March 2022, up from 46.7 percent as of end March 2018.

**13. The financial sector has recently started experimenting with tokenization, but the size of this market is very small.** Asset tokenization has mostly concentrated in tokenized Real Estate trust fund units, with an approximate issuance size of JPY 23 billion and tokenized corporate bonds, with an approximate issuance size of JPY 1.8 billion. There has been no issuance of tokenized deposits yet.

**14. Insurtech remains at a very nascent stage of development.** Despite a few projects in the Government Sandbox (see next section of this Technical Note for details), there are few fintech-related initiatives in the insurance sector with most firms still relying on physical offices for the provision of services and a more traditional approach to client onboarding.

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<sup>16</sup> For comparison, the total number of accounts held by the top five traditional banks amounts to approximately 320 million.

<sup>17</sup> Please refer to the next section for details on new intermediation licenses and services related to open APIs.

<sup>18</sup> The digitalization of the banking sector is expected to continue growing, as smaller banks are also expected to increasingly use digital channels (as noted in [the BOJ's Financial System Report Annex on Results of the Cybersecurity Self-Assessment for Regional Financial Institutions](#) (FY2022))

<sup>19</sup> While no entity has made a final official application to the FSA for clearance, several have already contacted the FSA as they advance in their projects to discuss key issues or ask questions. Based on that information and public statements by some entities, it is understood that approximately 9 projects are currently underway in varying stages of development. The most advanced seems to be a project under an alliance of several financial institutions, led by MUFG (Prograt coin), a platform for the issuance of stablecoins, but the launch date is still unknown and no application has yet been submitted with the FSA.

## INSTITUTIONAL FRAMEWORK AND REGULATORY APPROACH TO FINTECH

**15. Japan does not have a specific Fintech strategy, but initiatives are guided by government-wide policies.** The Grand Design and Action Plan for a New Form of Capitalism from June 2022 sets the basis of infrastructure development for a digital garden city approach, including improving optical fiber and 5G connection across the country. The Action Plan also more specifically notes the Government's intention to promote fintech, including by ensuring the screening process to authorize new crypto assets by exchanges is not too time consuming. The Basic Policy on Economic and Fiscal Management and Reform further sets out initiatives to promote digitalization, including by promoting regulatory reform and speeding up procedures where necessary.

**16. The Financial Services Agency takes these country-wide initiatives into account when designing its Strategic Priorities on a yearly basis.** The FSA, as the authority in charge of regulating and supervising the financial sector in Japan, is the responsible authority for the oversight of technology-driven innovation in financial services. As part of its 2022-23 Strategic Priorities, and further to the government policy, the FSA commits to work to realize a digital society, by developing a favorable environment for digital money and crypto assets in order to support the development of Web 3.0 and the Metaverse from the financial side.

**17. A regulatory sandbox also sits at the Cabinet level, with involvement from the FSA for any innovation project related to financial services (Table 2).** The FSA does not have a specific sandbox, as technology driven innovative projects for all sectors are tested at a Regulatory Sandbox managed by the Government of Japan,<sup>20</sup> with projects approved by Competent Ministers in the relevant areas. Projects can apply to run testing at the Sandbox, in which case, the relevant competent Minister and other government authorities are involved in the screening process. Whenever a financial sector related project initiates a consultation with the Sandbox, the competent ministries and agencies, including the FSA, will be involved, in the screening process and subsequent recommendation to join the Sandbox or not.

**18. The Sandbox was established in 2018 and since then, more than 30 projects have been approved in a broad range of fields.** Only three Sandbox case studies to date have related to the FSA purview: two on insurtech and one on crypto asset exchange service providers. The majority of the projects have involved innovation in the fields of mobility, healthcare, and environment and recycling.

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<sup>20</sup> The Regulatory Sandbox Team sits within the Secretariat of New Form of Capitalism Realization of the Cabinet Secretariat.

**Table 2. Japan: Sandbox Projects (2018-2023)**

Fintech	Healthcare
<ul style="list-style-type: none"> <li>• Fintech x Privacy Protection</li> <li>• Insurtech (P2P Insurance)</li> <li>• Small short term loan (P2P Insurance)</li> </ul>	<ul style="list-style-type: none"> <li>• Online Medical Advices with Diagnostic Kit</li> <li>• Digital Living Will with Biometric Identity Authentication</li> <li>• Real-time Blood Collection Test for Sports</li> <li>• Pharmacy x Medical Supplies Vending Machines</li> <li>• Manual of POP Display about Vegetables</li> <li>• Pharmacy x Disaster Countermeasure Medical Supply Vehicles</li> </ul>
Mobility	AI/IoT/DX
<ul style="list-style-type: none"> <li>• Electric Scooter Sharing</li> <li>• Switchable Electric Micro Bike</li> <li>• Space Sharing of Camper Bus</li> </ul>	<ul style="list-style-type: none"> <li>• IoT x Home Appliances</li> <li>• DX x Real Estate Transactions</li> <li>• DX x Notice of Transfer of Claims</li> <li>• DX x Employment of People with Disabilities</li> <li>• DX x Real Estate Transactions</li> <li>• AI x Coffee Vending Machines</li> <li>• DX x Prepaid Payment Instruments</li> </ul>
Blockchain	Environment/Recycling
<ul style="list-style-type: none"> <li>• Blockchain x Crypto Exchanges</li> <li>• Blockchain x Clinical Development</li> <li>• Blockchain x Notice of Transfer of Claims</li> </ul>	<ul style="list-style-type: none"> <li>• IoT x Recycling</li> <li>• Labelless Products x Vending Machines</li> </ul>

Source: Secretariat of New Form of Capitalism Realization Headquarters Cabinet Secretariat, Government of Japan.

**19. For those projects that relate to financial services, the FSA is involved throughout the process.** The Cabinet Secretariat acts as a single point of entry for applicants to find information and seek a prior consultation. The Cabinet Secretariat consults and coordinates with relevant ministries and supports the preparation of applications. For projects that relate to laws and regulations under FSA purview, applications are then considered by the FSA and the Cabinet Secretariat jointly, to determine whether the project is suited for the Sandbox. There is not a fixed set of criteria, but consideration is given to the innovative nature of the technology and business model, whether questions regarding the applicability of the regulatory framework support a trial phase, and whether the project proposed would be feasible and would not violate any laws and regulations. If approval is granted, a term is agreed with the participating entity for the duration of the trial, after which a determination would be made in relation to the applicability of the regulatory framework and any need for regulatory amendment. During the life of the project, two or three staff from the FSA would be involved in monitoring developments, through regular reporting and meetings with participants.

**FSA’s Approach to Fintech Monitoring**

**20. For the purposes of engaging with the fintech industry and monitoring developments in this field, the FSA has established several channels.** The Fintech Policy Office is the main coordinator for fintech related issues within the FSA and has approximately 50 staff, dedicated to a number of different areas.



**21. The Fintech and Innovation Office sits within the Fintech Policy Office and its aim is to provide support to new businesses and initiatives promoting technology-driven innovation in financial services.** They deliver this via the Fintech Support Desk, which is designed to serve as a one-stop contact point for inquiries and exchange of information in relation to fintech matters. This includes the submission of questions in relation to licenses and applicability of regulation, as well as the initiation of discussions with the regulator on potential innovation projects and feedback from the industry on regulatory initiatives.

**22. The Fintech Policy Office is also in charge of fintech policy design as well as oversight of licensed fintech-related entities (Table 3).** Staff is assigned to a number of different areas, including the engagement with the Cabinet Sandbox, regulatory initiatives regarding fintech (including those arising out of the Sandbox), as well as registration, offsite monitoring and onsite supervision of fintech-related licensed entities, in particular:

- a. The Payment Services Monitoring Office carries out the registration, monitoring and supervision of FTSPs and PPIIs.
- b. The Crypto Asset Exchange Service Providers Monitoring Office, takes care of the registration, monitoring and supervision of CESP. This Office is also in charge of work in relation to the new stablecoin regime and will carry out registration and supervision of Electronic Payment Instruments Service Providers (EPISPs, or stablecoin exchanges).
- c. Financial Services Intermediary Business and Electronic Payment Service Providers Office is in charge of registration and supervision of Financial Services Intermediaries Business Operators and Electronic Payment Service Providers.

Supervision of these firms is done jointly with the Local Finance Bureaus (LFBs), which are local arms of the FSA. Normally, the FSA is in charge of overall monitoring, as well as offsite supervision of the most relevant firms<sup>21</sup>, while the LFBs are responsible for offsite supervision of remaining firms and for conducting onsite supervision with the assistance of the FSA for specific areas, particularly regarding information technology (IT) systems. The FSA and LFBs coordinate regularly regarding supervisory matters.

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<sup>21</sup> The FSA would determine what firms to directly supervise based on different criteria like share of account holders, assets, complexity of services, etc.

**Table 3 Japan: FSA Fintech-Related Licenses**  
(As of end December 2023)

License	Type of Service	Number
<b>Crypto Asset Exchange Service Provider (CESP)</b>	Unbacked crypto asset exchange/wallet	29
<b>Electronic Payment Instruments Service Provider (EPISP)</b>	Stablecoin exchange/wallet	0
<b>Fund Transfer Service Provider (FTSP)</b>	Electronic payment services (e.g., QR code)	84
<b>Pre-paid Payment Instrument Issuer (PPI)</b>	Issuer or pre-paid cards (self or third-party)	1,192 (self) 866 (3 <sup>rd</sup> party)
<b>Electronic Payment Service Provider (EPSP)</b>	Gateway payment services (usually via open APIs)	118
<b>Financial Services Intermediaries Business Operators</b>	Provision of intermediary services in relation to any licensed financial service (insurance, securities or banking)	8

Source: FSA.

**23. Several other offices within the FSA carry out a role related to fintech regulation and supervision.** For the purposes of AML/CFT issues related to fintech, the AML/CFT Policy Office is in charge of policy development and monitoring of firms and the Research Office of the Policy Markets Bureau takes care of AML/CFT regulatory development. The Banking and Payment Regulations Office leads work regarding the development of payment and crypto regulation. Finally, the International Affairs Office contributes to discussions at Standard Setting Bodies and International Organizations and the Securities Business Division has staff involved in issues regarding security tokens. A total of approximately 70 staff are involved in fintech matters across the FSA.

**24. The Fintech Policy Office coordinates as needed across divisions, as well as with external stakeholders.** This coordination happens mostly on a bilateral basis, between the relevant area of the Fintech Policy Office and other concerned Offices of the FSA that may be involved depending on the specific issue. The Fintech Policy Office also maintains regular meetings with the Local Finance Bureaus regarding fintech supervisory issues (i.e., supervision of CESP and FTSP and PPIs) and provides regular training to staff in the Bureaus on fintech related matters, particularly regarding the crypto asset regulatory framework.

**25. The FSA supports its monitoring of fintech developments with participation in study groups and research to understand whether the regulatory perimeter remains appropriate.** The FSA established the Study Group on Digital and Decentralized Finance (DeFi), composed of members of the industry, academia and lawyers, and acts as the secretariat for the group. This group has met on average approximately every two to three months so far to analyze the developments in digital issues and DeFi and their impact on financial services, as well as to discuss the need for regulatory developments, which would then be brought to the attention of the Financial System Council for

consideration.<sup>22,23</sup> The FSA has also commissioned research and studies from private research companies in particular areas, to further inform their thinking around fintech and the need to adapt the regulatory perimeter. For example, they carried out commissioned research around the use of on-chain and off-chain data and technology risk in the trust chain in DeFi globally, but also more broadly on international regulatory trends, enforcement and market challenges related to unfair trading in crypto assets.

**26. The Fintech Policy Office also regularly meets with industry and SROs, as needed, to understand trends and developments.** This includes bilateral meetings with fintech participants, licensed entities, as well as regular meetings with industry associations and SROs, to discuss matters of interest, new market developments or regulatory challenges.

**27. The FSA does not carry out any data gathering initiative regarding fintech beyond information gathered from licensed firms.** However, it analyzes data received from licensed firms regularly to monitor any market developments. Particularly, data received from CESTs, PPIIs, and FTSPs provide valuable information in terms of market growth, user base and pace of development.

### Relevant Regulatory Initiatives

**28. The FSA has undertaken a number of initiatives to update the regulatory framework to ensure adequate coverage of fintech related issues.** This has been mostly done via the amendment or revision of existing legislation to accommodate new services and products and to adapt to changes in the provision of financial services due to technological innovation.

### Crypto Assets

**29. Due to investor protection concerns in early crypto asset activity in the country, this was one of the first areas where regulation was introduced.** Please refer to the next section of this Technical Note for details on the regulatory and supervisory approach for crypto assets developed by Japan.

**30. The Financial Instruments and Exchange Act (FIEA) was also amended to introduce the concept of Electronically Recorded Transferable Rights (ERTRs) or security tokens.** Security tokens are treated as "Electronically Recorded Transferable Rights<sup>24</sup>", which are further to this amendment, subject to the regulations under the FIEA. This means that issuers of security tokens must comply with the same regulations as issuers of traditional securities, including registration,

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<sup>22</sup> The Banking and Payment Registration Office of the FSA serves as secretariat for the DeFi Study Group. The DeFi Study Group was in charge of discussing a potential stablecoin regime and came up with a consultation report that was the basis for the 3<sup>rd</sup> amendment of the PSA that introduced the stablecoin regulation discussed in this note.

<sup>23</sup> The Financial System Council is the advisory board of the FSA and established under the Act for Establishment of the Financial Services Agency. When a financial regulatory framework is to be newly established or amended, in principle, they are to be deliberated at the council, whose members include academics and financial practitioners and whose secretariat is the FSA.

<sup>24</sup> The full term as per FIEA is "Electronically Recorded Transferable Rights to be Indicated on Securities, etc."

disclosure requirements, and compliance with securities laws. Issuance of these instruments has been so far very limited and activity restricted to the primary market (i.e., placement of the issuance).

**31. The FSA has also introduced prudential requirements for the financial sector intermediaries' holding of crypto assets.** Currently, banks and insurance companies are prohibited from acquiring crypto assets for the purposes of investment (both directly, as well as indirectly via derivatives or funds). There is no limitation on holdings of crypto or crypto derivatives for Type I Financial Instrument Intermediaries (FIBOs, Japanese securities firms), but currently there are no Type I FIBOs engaged in securities related business holding crypto assets. The Supervisory Guidelines for FIBOs also include the holding of crypto assets as a specific point of attention for supervisory purposes and contain the most relevant expectations on these firms should they hold crypto assets, including segregated management of the assets, as well as having a specific control environment for securing its financial soundness in light of crypto's particular risks.

### ***Digital Payments***

**32. Another area where the FSA has recently focused its regulatory activity is in digital payments.** The Payment Services Act (PSA), which came into effect in 2010, enabled entities to register with the FSA for the provision of fund transfer services (Fund Transfer Service Providers or FTSPs)<sup>25</sup> under certain conditions. In light of technological developments and the increasing demand for cashless payments, the Act was amended in 2021, with the aim of ensuring convenient and safe payment services in an increasingly cashless society. The amendments include reforms on the requirements for FTSPs, and certain enhancements to regulations on the issuers of prepaid payment instruments (namely, to enhance conduct of business).

**33. The amended PSA establishes three separate categories of FTSPs with different requirements.** Type I FTSPs have no maximum amount per transaction, Type II have a limit of JPY 1 million per transaction and Type III can carry out transactions of up to JPY 50,000.<sup>26</sup> Regulatory requirements differ for the three categories, with Type I FTSPs required to adhere to stricter standards in relation to the preservation of clients' assets and restrictions on retention of funds from clients. FTSPs are not subject to specific capital requirements, but all three types must preserve assets in an amount equal to or greater than the sum of outstanding obligations and refund costs. This requirement is met by depositing cash or highly liquid assets with the Official Depository (a government agency under the auspices of the Ministry of Justice), a trust bank/trust company or having a bank guarantee.<sup>27</sup> They must also comply with AML/CFT requirements, have adequate systems, and provide sufficient information to users, including disclosing that funds deposited with FTSPs are not subject to deposit insurance. While FTSPs are not required to have in place specific

<sup>25</sup> While "fund transfer services" could in the past only be provided by registered deposit-taking institutions, this requirement was lifted in 2009 with the enactment of the Payment Services Act (PSA), which enabled entities to register with the FSA for the provision of fund transfer services (FTSPs).

<sup>26</sup> Up until the recent PSA amendments, all FTSPs had to limit the maximum amount per transaction to JPY 1 million.

<sup>27</sup> Only Type III FTSPs are allowed to deposit funds with a commercial bank, in which case, users' funds should be segregated from FTSP's own assets.

plans for wind-down, they are obliged to give a 30-day notice to users when they decide to go out of business.

**34. The reform was introduced to accommodate the differentiation in services provided by FTSPs as the industry developed.** The main service provided by FTSPs is in the form of an e-wallet that allows the owner to pay at merchants or transfer funds to other e-wallets (some FTSPs are designed to directly pull funds from users' bank account while others require adding a balance for payments). However, some FTSPs were mostly used to submit remittances in larger amounts, for which the JPY 1 million was a limitation, while the majority were mostly used for small payments. All existing FTSPs were by default classified as Type II by the amended PSA, while two have already obtained licenses to operate under Type I- both licensees mainly cater to foreign nationals working in Japan and sending remittances abroad. No Type III license has been processed yet.

**35. Further legislative amendments introduced in 2023 enable individuals to receive salary payments via FTSPs.** Since April 2023, further to an amendment of subordinated legislation under the Labor Standards Act, Type II FTSPs can apply to the Ministry of Health, Labor and Welfare (MHLW) to be designated as a provider of electronic salary payments, if they satisfy a number of conditions, including the obligation to transfer any amount in excess of JPY 1 million to the employee's designated bank account, as well as to have a mechanism to guarantee its obligations to workers within six business days in the event of bankruptcy. To be able to have sufficient liquidity to comply with this requirement, designated FTSPs must obtain a guarantee (by a bank or some other financial sector entities) to cover their obligations towards workers.

**36. To date, no FTSP has been designated as a provider of electronic salary payments, although several have applied to the MHLW for this designation.** While the FSA plays no official role in the designation process, the FSA and the MHLW are in regular communication regarding these applications. Considering that this designation may increase the use of these providers and their accounts and balances, the FSA anticipates that any such designated FTSP would be placed under enhanced supervision. For those purposes, the FSA has already updated the FTSPs Supervisory Guidelines to reflect the higher expectations to be placed on these firms.

**37. The other type of major digital payment players is the Prepaid Payments Instruments Issuers (PPIIs), also regulated by the PSA.** These are issuers of prepaid cards, many now digital in the form of a smartphone app, either for their own-business (closed loop) or for third-parties (open or semi-open loop). They can be used for payment at merchants but not to transfer money to other users. The topped-up value of PPIs cannot be cashed out and for those in digital form, the topped-up value can only be transferable within the platform of the issuer.

**38. Some prudential requirements differ depending on whether the prepaid cards can be redeemed exclusively at the issuer or more broadly in third party merchants.** Third-party issuers are required to maintain net assets of JPY 100 million (no such requirement exists for issuers of self-issued cards). Both types are required to retain at least half of the funds received from users with the Official Depository, a trust bank/trust company or hold a bank guarantee. They are also required to have adequate management and IT systems and to provide appropriate disclosure of services to

users, including that issuers only have an obligation to at all times retain half of the funds received from users.

### ***Open Banking and Intermediation in Financial Services***

**39. In relation to banking services, a revision of the Banking Act in 2018 paved the way for open banking.** This reform required Japanese banks to develop systems for the introduction of open Application Programming Interfaces (APIs), and to date most banks have already done so. This reform of the Banking Act also introduced a license for Electronic Payment Service Providers (for entities providing gateway payment services using open APIs) and required banks to disclose their policies regarding collaborations with Electronic Payment Service Providers. There are a total of 118 licensed Electronic Payment Service Providers and currently almost all banks have contracts with one or more than one Electronic Payment Service Provider.

**40. Also, to facilitate non-financial firms providing agency services across sectors, a new intermediation license was introduced.** A reform of the Act on Sales, etc. of Financial Instruments (renamed “Act on the Provision of Financial Services”) in 2021 introduced a new license that enabled entities to obtain authorization from the FSA to intermediate in multiple financial services under a single license (i.e., entities were no longer required to request separate agency licenses to intermediate in banking, securities and insurance services). There are currently 8 Financial Services Intermediaries. Also, although the bank agent license is not new, the number of bank agency licenses has been increasing in the last 3 years for entities seeking to collaborate with digital banks. Out of a total of 77 bank agency licenses, 37 have been granted in the last 3 years.

### **Findings and Recommendations**

**41. The FSA monitors fintech developments through different channels and responds as needed with targeted regulatory initiatives.** The institutional arrangements for fintech oversight seem adequate and the FSA actively engages with industry and analyzes reporting data from licensed firms to stay abreast of developments that may warrant changes in the regulatory framework.

**42. As fintech continues to grow, a more systematic approach to data gathering and analysis of domestic trends would be a welcome step.** In the absence of a clear definition and taxonomy, the collection of data on fintech is challenging. The FSA has carried out several research initiatives, but mostly regarding trends from a global perspective. An analysis of the current status of fintech in Japan across sectors supervised by the FSA would provide a good baseline for the development of a more systematic approach to data gathering going forward. This could also inform a more dynamic forward looking market monitoring and financial stability analysis.

**43. The fast pace of growth in digital payment services may warrant intensified monitoring of developments and enhanced supervision of most relevant players.** While it is understood that steadily transitioning to cashless payments is a government priority, authorities need to ensure that this does not come at the expense of potential risks.

- a. **PPIIs:** While the retention of 50 percent of funds transferred by clients has in the past experience of the FSA proved sufficient to cover liabilities in case of insolvency, this has been untested in the digital age. Authorities should analyze whether this requirement remains adequate, in light of growth and the digital availability of prepaid cards (e.g., by gathering data regarding average outstanding unused balances and prevalence of digital cards, analyzing client distribution across providers, surveying client behavior, etc.) and consider expanding the requirement to cover 100 percent of funds, at least for third-party PPIs.<sup>28</sup>
- b. **FTSPs:** The FSA should monitor developments in this sector closely to determine whether the current regulatory safeguards remain sufficient. In the absence of specific capital requirements for FTSPs, they may also consider requiring entities to develop wind down plans for the event of failure of the FTSP. Enhanced supervision of most relevant players will also be key.
- c. **Use of SuperApps:** The FSA should also monitor the development of SuperApps by digital payment service providers and how this could impact their pace of growth, as well as any potential implications beyond the payments sector that could be relevant from the supervision perspective.

**44. The FSA should continue to work with the LFBs to ensure an adequate supervision of fintech-related registrants.** In particular, the FSA should ensure that supervisory priorities and potential areas of concern are communicated to LFBs and that LFBs are well informed and educated in the potential risks from fintech related firms as the industry continues to grow and develop. The FSA should continue to provide training to LFB staff on fintech related matters on a regular basis to ensure that all supervisors have an adequate level of understanding.

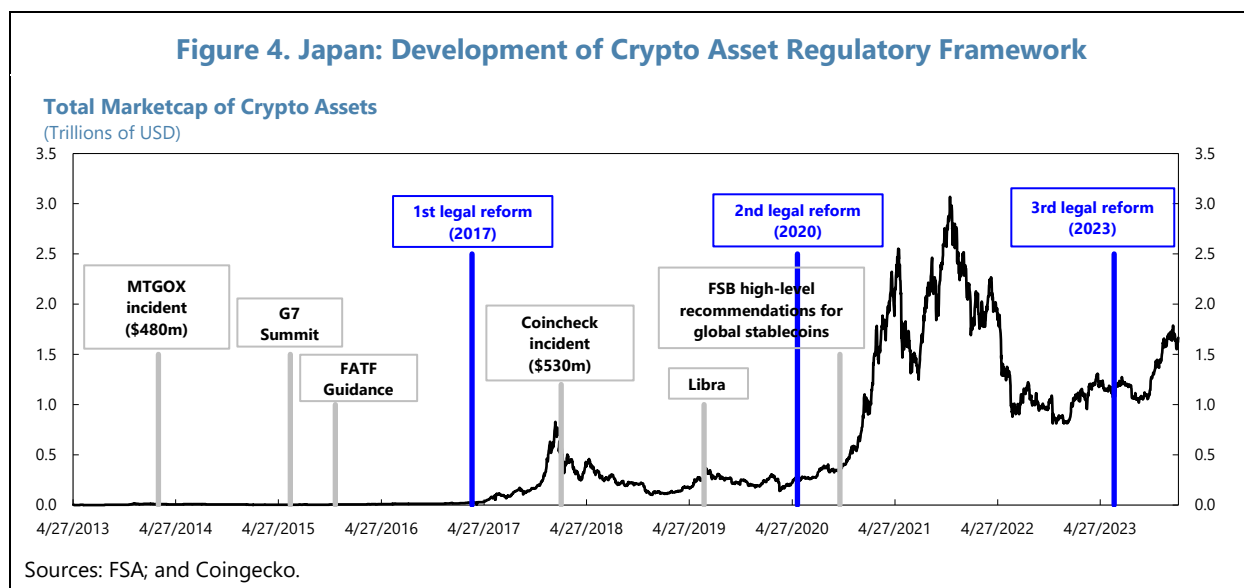
## REGULATION AND SUPERVISION OF CRYPTO ASSETS

### A. Regulatory framework

**45. The regulatory framework for crypto assets in Japan stems from the Payment Services Act (PSA).** The PSA was first amended to introduce specific regulation for crypto assets in May 2016, with a reform that entered into force in April 2017 (Figure 4). This initial framework introduced a new category of exchange operators of crypto assets (the PSA initially referred to “virtual currencies”, but this terminology was later changed to “crypto assets” to match the global approach) to be registered as Crypto Asset Exchange Service Providers (CESP). Significantly, it also introduced an incipient conduct and prudential framework, which included certain disclosure requirements, rules on minimum capital and net assets, external audit of financial statements, asset segregation requirements and system security management requirements. The Act on Prevention of Transfer of Criminal Proceeds, which was enacted at the same time, included AML/CFT measures like identity verification at the time of opening an account, record keeping requirements and reporting of suspicious transactions.

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<sup>28</sup> This would be in line with international best practice. Examples include the EU, Singapore, and the U.K.



**46. A subsequent reform of the PSA (and other relevant Acts) introduced a more comprehensive framework and stricter requirements for CESTs in 2020.** Further to the FSA's early oversight of new registrants in the crypto space,<sup>29</sup> new enhancements were introduced to the Act, to ensure potential risks could be better managed. In particular, the requirement for crypto assets to be managed in an offline environment (cold wallet) was introduced, as well as a requirement to establish a system to prevent conflicts of interest.<sup>30</sup> The activity of "management" of crypto assets (wallet services) was included within the definition of CEST (i.e., entities willing to carry out wallet services also need a CEST license). The Act further required that exchanges notify the authorities prior to adding new crypto assets for trading and introduced market integrity measures like prohibiting manipulation of prices, rumor spreading and other unfair acts. Additionally, marketing and solicitation requirements were also set.

**47. More recently, the PSA has also been amended to introduce a regime for stablecoin issuers and exchanges.** This third reform of the PSA was enacted in 2022 and entered into force in June 2023 and enables trust banks/companies and FTSPs to issue stablecoins,<sup>31,32</sup> and creates a separate license for stablecoin exchanges: Electronic Payment Instruments Exchange Service Providers (EPIESP). Entities with a CEST license that want to trade stablecoins will also need to apply to the FSA for a separate EPIESP license.

<sup>29</sup> Particularly, a significant security incident in a large exchange supervised by the FSA in 2018, prompted the introduction of strict safeguards regarding the handling of crypto assets.

<sup>30</sup> See Box 1 on the impact of some of these requirements in the case of FTX Japan.

<sup>31</sup> Further to the amended PSA, those stablecoins that are issued at a price linked to the value of the legal currency and that promise redemption at par have been defined as "electronic payment instruments" and can be issued and traded in Japan further to the newly introduced regulatory framework.

<sup>32</sup> Commercial banks are also allowed to issue stablecoins, but only in permissioned platforms and taking the form of tokenized deposits.



### Box 1. Japan: The Case of FTX

**FTX Trading Ltd. (FTX) led one of the largest crypto asset exchange businesses in the world when it collapsed in November 2022.** Domiciled in the Bahamas and with local operations in several countries, including the US and Japan, FTX offered a variety of products and services. These included leveraged trading and futures contracts. It issued its own token, FTT, and was affiliated with Alameda Research, a crypto hedge fund owned by the main shareholder of FTX.

**When news of financial difficulties emerged in early November 2022, massive withdrawals prompted FTX to suspend trading and users were locked in.** In the events that unfolded it became apparent that there were massive governance issues at FTX and that investors' funds and tokens had been used to finance debts at Alameda Research. After failed attempts to have a third party acquire the company, FTX filed for bankruptcy in the US on November 11, 2022.

**FTX had acquired an FSA-licensed CESP earlier in 2022 and was providing services to Japanese clients under the brand FTX Japan.** This entity was under the supervision of the FSA and subject to regular reporting and monitoring. It kept adequate books and records of transactions and clients' assets, and further to existing regulation, it kept clients' funds segregated in a trust account and crypto assets in cold wallets.

**As FTX local IT systems were dependent on FTX global, trading halted simultaneously for all FTX operations.** FTX Japan suspended customers' withdrawals on November 8, 2023 (US time). On November 10, the Kanto LFB took administrative action on FTX Japan and issued three administrative orders: an order to suspend business, except for the redemption of clients' assets, an order to retain assets in Japan and a business improvement order to ensure adequate identification of users, preservation of the assets and information disclosure. On November 14, FTX Japan announced that it held excess assets, holding sufficient cash to pay out all users.

**Due to the regulatory segregation of FTX Japan clients' assets, it was determined that these would not be part of FTX's estate under US bankruptcy procedures and could be returned to clients.** Given IT systems dependencies, however, while FTX Japan could announce the non-applicability of the "automatic stay" of Japanese clients' assets in the bankruptcy as early as December 1, it could not resume operations to return clients' assets until February 21, 2023. As of the date of this note, FTX is in the process of steadily returning assets to the clients as requested by them.

**The FSA is still monitoring FTX Japan as it continues to hold some clients' crypto assets.** The company still has private keys to some clients' assets that have not requested redemption, and continues to operate as a wallet.

**The case evidenced the safeguards provided by the Japanese regulatory framework for CESTPs and also flagged challenges that can emerge from global operations.** Besides the IT dependencies, there was some uncertainty regarding the bankruptcy remoteness of Japanese clients' assets with relation to US bankruptcy procedures. While FTX Japan had safely secured sufficient assets to return all of its clients' funds, it took several weeks to clarify that those assets could be kept separate from the insolvency estate.

**The FSA has amended its Guidelines to introduce additional requirements for global CESTP operations.** Further to the new requirements, entities have to make sure that they have adequate IT systems and processes to enable clients' redemptions irrespective of the operations of their overseas businesses. Additionally, entities have to notify their clients about the potential impact of foreign regulatory frameworks and the risk of uncertainty of clients' assets remoteness in the case of foreign insolvency procedures.

### ***Key Elements of the CESP Regime***

**48. The requirements for CESPs are mainly detailed in the PSA, the Cabinet Office Order on Crypto Asset Service Providers and further in Japan Virtual and Crypto Assets Exchange Association (JVCEA) Guidelines.** Additionally, the FSA has issued Guidelines for Supervision of CESPs that provide more granularity on the expectations of the FSA for these entities.

**49. In particular, the framework sets detailed requirements for CESPs around the following areas:**

- **AML/CFT:** The framework includes requirements for know your customer (KYC) and identity verification at the time of opening an account, record keeping requirements as well as measures to identify and report transactions that could be suspicious of being connected to money laundering activities.
- **Capital requirements:** CESPs must have a minimum capital of JPY 10 million and net assets must not be negative. They must have annually audited financial statements.
- **Governance and conflicts of interest:** The regulatory framework requires firms to have in place internal rules concerning the services of the CESP and carry out regular monitoring and verification to ensure appropriate business practices in accordance with laws and regulations. CESPs also need to put in place a system to enable it to detect, manage and adequately disclose any conflicts of interest that may arise in the provision of services. CESPs need to formulate and publicly disclose their internal management policy for the management of conflicts of interest.
- **Order handling and trade disclosures:**
  - CESPs are expected to act in the best interest of their users and are required to publish policies and methods for executing transactions under the best terms and conditions for each type of crypto asset.
  - Before entering into any transactions, CESPs are obliged to disclose to the user whether a trade is to be executed in the exchange or whether the CESP will be a counterparty to such trade. They must also provide information regarding latest contract and reference price of the crypto asset, as well as latest sale and purchase price of the crypto asset if the exchange is trading with the user out of its own inventory.
  - CESPs are also required to provide complete information regarding the CESP, including trade name and address, license details, applicable fees, and relevant contact details to direct any complaints and consultations.

- **Record keeping requirements:** CESTPs are required to maintain adequate records of all transactions, including those executed off-chain,<sup>33</sup> for a period of at least 10 years. Specific details such as transaction dates, users' identification, transaction types, details of crypto asset, quantities, prices, and fees must be recorded.
- **Listing of assets:** Before CESTPs can list a new crypto asset, they have to undergo a screening process that is carried out by JVCEA. CESTPs have to provide a detailed explanation regarding the structure of the asset, assumed uses, distribution, technology, as well as risks that may arise from the handling of the crypto asset, including for AML/CFT, IT system risks, etc. The JVCEA then carries out a review to determine whether the asset can be listed from the viewpoint of protecting users and ensuring proper conduct of business. To streamline this process JVCEA has recently started maintaining a "green list" of those crypto assets that are already more widely distributed in Japan (listed in at least 3 CESTPs), and that CESTPs can list without carrying out the above-mentioned listing process.
- **Market integrity:** the regulatory framework contains detailed provisions regarding the prohibition to engage in market abuse conducts, including spreading of rumors, manipulation of prices, use of inside information, etc. CESTPs are required to have systems and processes in place to carry out adequate surveillance of their market to identify suspicious transactions.
- **Custody of funds and crypto assets**
  - CESTPs must keep funds and crypto assets of the users' separate from those of the CESTP and must undergo external audits of the status of this segregation requirement by a certified audit accountant, at least annually.
  - CESTPs must manage users' crypto assets in an offline environment (cold-wallet). Less than 5 percent of the crypto assets can be handled in a hot wallet, in which case the CESTP should separately hold the same type and same value of its own crypto assets in a cold wallet.
  - If the CESTP can borrow crypto assets from its users, it needs to take measures to clearly indicate that the borrowing does not fall within the scope of custody services of the CESTP, and assets could be therefore comingled with assets from the CESTP. It must also establish a system for appropriately managing the outstanding balance of the obligations borne by the CESTP, so as to avoid a situation where it bears excessive obligations due to the borrowing of crypto assets and could face difficulties repaying these obligations.
- **Use of leverage:** CESTPs can carry out margin lending services under limited conditions, in particular, individual investors are only allowed to borrow up to twice their initial investment for trading crypto assets. The leverage ratio for corporates is set weekly by the JVCEA and varies for each type of crypto asset. The historical high has been around 10 times a user's initial

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<sup>33</sup> Based on information gathered from the industry, many CESTPs appear to execute most of trading off-chain (only when the crypto asset is traded with a third-party wallet are transactions recorded on chain).

investment. Further, to be able to offer OTC derivatives over crypto assets, CESP s must obtain a separate license under the Financial Instruments and Exchange Act (FIEA) as a Type I Financial Instruments Business Operator (Type I FIBO, or securities intermediary).

- **IT and operational risk:** CESP s must take measures to ensure sufficient control of the electronic data processing system handling the crypto asset exchange services, as well as to prevent the leaking, loss, or damage of information with regard to the safe management of information it handles on users.
- **Marketing activities:** CESP s are required, when advertising their services, to provide clear and adequate information regarding the particulars of crypto assets, including the fact that crypto assets do not constitute legal tender, the risk of losses from fluctuations in the value of the asset and the fact that crypto assets can only be used as payment with the consent of the party receiving such payment. The framework also prohibits CESP s to make unsolicited contact with clients and from carrying out other abusive marketing initiatives.

### ***Key Additional Elements of the Stablecoin Framework***

**50. The recently developed framework for stablecoins considers requirements for the issuers of stablecoins as well as for exchanges.** No separate license is required to issue stablecoins, but the issuer must already be licensed as a trust bank/company or a Fund Transfer Service Provider. The issuance of stablecoins is governed by the specific requirements of each of those licenses (e.g., Type II FTSP s are bound by the limit of JPY 1 million per transaction) and have therefore slightly different requirements. Underlying reserve assets for trust bank/company issued stablecoins are to be held under a trust agreement, with entrusted assets held by means of bank demand deposits. For stablecoins issued by FTSP s, the requirement is that reserve assets must be either deposited with the Official Depository, covered by a bank guarantee or a trust agreement, under which the entrusted assets must be cash, bank deposits and/or highly liquid assets such as government and municipal bonds. All issuers are required to have a structure and processes in place to be able to respond to demands for redemption directly from users. Issuers also have an obligation to provide users with information about the functioning of the stablecoin, although this requirement can also be fulfilled by the exchange where the stablecoin is listed.

**51. The framework for EPIESP s is similar to that of CESP s.** Entities willing to carry out exchange or wallet services for stablecoins need to request an EPIESP s license from the FSA and comply with similar requirements regarding AML/CFT, capital, asset segregation, record keeping, governance, disclosure, leverage, system security management and advertisement to those listed above for CESP s. The screening process for listing new stablecoins is also similar to that followed in relation to unbacked crypto assets, with exchanges providing the necessary information for the relevant SRO to verify.<sup>34</sup> Due to the novelty of the regime, however, the FSA anticipates being more

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<sup>34</sup> No SRO has been certified by the FSA yet, regarding stablecoins.

involved in the screening process than for that of unbacked crypto assets, until the SRO has gathered sufficient expertise to lead the process.

**52. Foreign stablecoin issuers can also request the trading of their stablecoins in Japan, provided their regulatory framework is similar.** The issuer would have to demonstrate that it is subject to a regulatory regime similar to the Japanese and the FSA would check, in particular, whether issuers can redeem at par at users' requests, and how the stability mechanism works. Additionally, the EPIESP listing relevant foreign stablecoin in Japan would have to set aside sufficient cash to be able to return funds to clients in the event of insolvency of the foreign issuer. No foreign stablecoin is yet available for trading in Japan.

## B. Registration

**53. The CESP Monitoring Office is in charge of the registration of CESTPs.** Since the framework was introduced in 2017, a total of 34 licenses have been granted and there are currently 29 licensed CESTPs in operation. A team of approximately 6 staff is involved in the registration process, consisting of at least three staff from the CESP Monitoring Office plus a legal expert, an AML/CFT expert and an IT expert from the Fintech Policy Office. The registration process takes on average over one year.

**54. The registration process includes documentation review, interviews with management and an onsite visit.** Applicants for a CESP license have to complete and submit a questionnaire to the FSA providing information on their compliance with the requirements under the regulatory framework; upon reception and review of this questionnaire, the FSA would carry out interviews with the directors of the applicant to understand business plans and their overall systems and processes. This is supplemented by a review of all documentation submitted by the applicant to provide evidence of their frameworks and compliance with regulatory requirements (e.g., relevant documentation to support the establishment of a framework to segregate users' assets, including details of contracts for the custody of assets, etc.). The process is completed by an onsite visit to the applicant, where further interviews are carried out, as well as verification of the effectiveness of internal regulations and management systems.

**55. No formal application has been submitted under the new framework for EPIESTPs but a similar screening process will be followed.** Several entities have been in contact with the FSA in relation to their stablecoin projects from an issuer perspective, and some CESTPs have also notified the FSA of their intention to apply for an EPIESTP registration. Entities will have to fill up a screening questionnaire and go through a similar verification process than for the CESP license. As issuers proceed in their stablecoin projects, official applications for EPIESTP licenses are expected later this year. The FSA is expected to approve projects by issuers before they can go off to list their stablecoins.

## C. Supervision and enforcement

**56. CESTs are subject to supervision by the FSA and Local Finance Bureaus.** The CESP Monitoring Office of the FSA is in charge of formulating offsite monitoring policies for all CESTs: The most significant entities are designated for supervision by the FSA, while the less significant ones are dealt with by the LFBs.<sup>35</sup> Out of the 29 currently registered CESTs, about one-third are under the direct supervision of the FSA while the rest are primarily in the hands of the LFB. Onsite inspections of all CESTs are mainly conducted by the LFBs, although it is common for staff of the FSA to join LFB inspections, especially in relation to IT systems and AML/CFT.

**57. The offsite monitoring framework includes regular reporting of information by CESTs to both the JVCEA and the FSA.** CESTs report to JVCEA transaction data on a monthly basis, including trading volume for spot and margin transactions, user deposit and margin balances. This information is aggregated by JVCEA and submitted to the FSA on a monthly basis. CESTs also draft an annual Regulatory Business Report which includes detailed information on proprietary trading volume and value of own crypto assets by type, trading volume and value of crypto assets on users' accounts and value of own assets and users' assets, as well as number of outsourced operations. Information is also provided annually on details of business offices, employees, sales, costs, operating income, borrowing etc. Quarterly, CESTs also submit a report on the status of segregated management of users' funds and crypto assets. The CESP Monitoring Office reviews reported information for all licensed CESTs and carries out interviews or hearings on specific issues when needed. The results of analysis of all reporting information, together with additional information obtained via interviews and the results of onsite inspections are taken into consideration for the purposes of identifying risks and supervisory priorities.

**58. The LFBs and FSA carry out onsite inspections of CESTs.** Firms are chosen based on a number of criteria, including, for example, significance and complexity of business, concerns regarding governance, previous issues, etc. Each onsite visit is completed by a notification and an inspection report. The report would include any issues for improvement, which the CEST is expected to follow up on with the LFB and the FSA, by submitting periodic reports. Additional hearings are also sometimes conducted when required for follow up of recommendations.

**59. The FSA has crafted detailed guidance for supervision of CESTs and determines supervisory priorities for every fiscal year.** The Guideline for Supervision of CESTs is a very detailed manual that provides support and direction in relation to what issues supervisors need to be looking out for to identify whether CESTs are adequately complying with their expected requirements. These Guidelines are updated as needed, to incorporate supervisory findings and clarify regulatory requirements. They are published in the FSA's website.

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<sup>35</sup> Local Finance Bureaus are distributed throughout the country and are responsible for supervision of firms within their demarcation. All CESTs are currently in the Kanto and Kinki area, so under supervision of the Kanto and Kinki LFBs.

**60. The FSA also decides a plan to monitor CESTPs on an annual basis and publishes its main points in the “JFSA Strategic Priorities”.** In the Program Year 2023 (July 2023-June 2024) the FSA focuses on better understanding business models of CESTPs, as well as the appropriateness of the business management and internal control systems, including for AML/CFT and cybersecurity. Along with these priorities, the FSA will work with JVCEA to improve the screening of new crypto assets and provide strong response to unregistered CESTPs.

**61. In case of infringement of laws and regulations, the FSA can also impose administrative measures.** These can take the form of business improvement orders, business suspension orders or registration revocation orders. In case an inspection manifested a violation of the regulatory framework, staff would open an investigation to identify the root cause of the violation and whether it points to broader governance or other issues within the entity and issue a business improvement order, or a business suspension order depending on the severity and nature of the infringement. The FSA cannot impose monetary penalties. It has imposed approximately 30 administrative measures since 2017, most of them in the form of business improvement orders. The JVCEA can also take disciplinary actions against its members in the event of breach of laws, regulations, or SRO rules. The disciplinary actions can be reprimands, imposition of fines, suspension or limitation of SRO member rights or expulsion.<sup>36</sup> Both FSA’s administrative orders and JVCEA’s disciplinary actions are published on their respective websites (the JVCEA has not taken any disciplinary actions yet).

**62. The FSA carries out horizon scanning of non-licensed entities and issues warnings of those found providing services to Japanese clients.** The FSA regularly screens social media, consumer complaints and other sources to monitor any activity of crypto trading platforms which are not licensed to provide services in Japan, yet solicits Japanese customers. In those cases, the FSA publishes alerts in its website notifying the public of the lack of license and the importance of engaging in crypto services exclusively with entities that have been granted a CESP license by the FSA. In the last five years, it has issued three warnings regarding domestic non-registered CESTPs and 13 regarding foreign non-registered CESTPs. The FSA is also collaborating with law enforcement and the Consumer Affairs Agency to raise awareness regarding unregistered exchanges and fraud around crypto assets. It does not currently have any other investor education initiative to educate the general public on the risks of crypto assets and the safeguards provided by the existing regulatory framework.

## D. Findings and Recommendations

**63. Japan has developed a comprehensive conduct and prudential regulatory framework for CESTPs.** Prompted by market developments and findings from FSA’s own supervision of firms, the regime has gradually evolved to incorporate key user protection, prudential and conduct of business

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<sup>36</sup> The JVCEA can impose fines of up to JPY 100 million, and if the violation of laws, regulations or SRO rules is significant, it would be up to JPY 500 million. On top of that, if the amount equivalent to the unjust enrichment can be reasonably calculated, such amount can be added to the limit (JPY 100 million or JPY 500 million).

requirements and currently constitutes a comprehensive and detailed approach to the regulation and supervision of CESP, providing safeguards in relation to the most prominent risks, particularly through strict asset segregation requirements and compulsory use of cold wallets.

**64. The framework also provides detailed screening at the time of licensing new service providers and listing new crypto assets and offsite and onsite supervision of licensed firms.**

The FSA devotes sufficient time and resources to CESP licensing and supervision, as well as screening of new crypto assets for listing, in collaboration with the JVCEA and the LFBs. For a broader background of staff, the CESP Monitoring Office may benefit from incorporating a securities secondary markets expert into the team.

**65. The FSA should work with the industry and other stakeholders to continue to fine tune its regulatory framework.**

While the framework is very comprehensive, certain areas could benefit from more tailored requirements for the particularities of crypto asset trading, like the measures to prevent market abuse. The FSA could engage with the industry to identify ways to improve the market surveillance approach of CESP so that it more adequately addresses the specificities of crypto asset markets to facilitate better identification of market abuse conducts.

**66. Broadening the investor education approach regarding crypto assets would be a welcome step.**

It would be helpful to expand the user education's efforts beyond the publication of warnings for non-licensed firms and alerts on unregistered CESP: the FSA should consider a broader approach to customer education, including on the overall risks of crypto assets and the safeguards provided by the regulatory framework. Given that enforcement of onshoring requirements for CESP licensing is very challenging and resource intensive, reducing the number of users that access the unregulated market via educational efforts can offer some assistance.

**67. Reviewing the strength of the authorities' enforcement approach could assist in better deterring the provision of services by unregistered firms.**

Particularly, it should be considered whether giving the FSA the ability to impose monetary penalties could assist in preventing unlicensed CESP from providing services to Japanese clients. While it is understood that traditionally monetary penalties are not necessarily considered as more deterring than public reprimands for Japanese firms, this may not be the case for foreign firms, for which the threat of a fine could incline them towards avoiding Japan for their provision of services. As mentioned above, enforcement in an intensively cross-border industry is challenging and authorities should consider whether additional measures are warranted in this particular context. Going forward, the FSA should also ensure that the SRO's enforcement program is strong enough and that it has the capacity and willingness to use its enforcement powers, including imposing penalties when warranted.