Provisional Translation

Discussion Paper

Examination of the Regulatory Systems Related to Cryptoassets

April 10, 2025

Financial Services Agency

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I. Introduction

1. Status of Legal Framework Development for Cryptoassets

Regarding cryptoassets (formerly referred to as virtual currencies), regulatory frameworks were introduced in Japan ahead of other countries in 2016 through amendments to the Payment Services Act (hereinafter referred to as the "PSA"), in response to international demands[1][2] concerning anti-money laundering and countering the financing of terrorism, as well as bankruptcies of domestic service providers conducting exchange of cryptoassets to fiat currencies. These amendments (enforced in April 2017; hereinafter referred to as the "2016 Amendment") established a registration system for service providers carrying out such services as exchanging cryptoassets with fiat currencies. They also introduced regulations on anti-money laundering and countering the financing of terrorism, such as identity verification at the time of account opening, along with consumer protection measures, including the obligation to explain terms to users and to segregate user assets.

Subsequently, in light of the increasing awareness of issues, such as cryptoassets with high anonymity and other problems, inadequacies in internal management at cryptoasset exchange service providers (hereinafter referred to as "exchange service providers"), incidents of leakage or misappropriation of cryptoassets and money entrusted by users, and excessive advertising, further amendments were made to the PSA and the Financial Instruments and Exchange Act (hereinafter the "FIEA") in 2019 (enforced in May 2020; hereinafter the "2019 Amendment"). The 2019 Amendment[3] included requiring exchange service providers to report changes to the cryptoassets they handle in advance rather than after the fact and to mandate cold wallet[4] storage for users' cryptoassets in principle, and establishing advertising and solicitation regulations. Additionally, as a response to new transactions and unfair practices with cryptoassets, regulations were developed for derivatives trading involving cryptoassets and clarified that ICO tokens granting rights to receive distribution of profits fall under the scope of the FIEA. Unfair trading practices, such as price manipulation, were also prohibited.

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[1] At the G7 Elmau Summit Leaders' Declaration (June 2015), an international agreement was reached stating, "We will take further actions to ensure greater transparency of all financial flows, including through an appropriate regulation of virtual currencies and other new payment methods."

[2] In the Financial Action Task Force's (FATF's) guidance titled "Guidance for a Risk-Based Approach to Virtual Currencies" (June 2015), it was stated that countries should subject virtual currency exchange platforms that exchange virtual currencies for fiat currencies to registration or licensing requirements, and impose anti-money laundering and counter-terrorist financing obligations, such as customer due diligence.

[3] In this amendment, the legal term was changed from "virtual currency" to "cryptoassets."

[4] This refers to wallets that are not connected to external networks.

Furthermore, based on FATF recommendations, the Act on Prevention of Transfer of Criminal Proceeds was amended in 2022 (enforced in June 2023; hereinafter "2022 Amendment") to introduce the so-called "Travel Rule," requiring exchange service providers transferring cryptoassets on behalf of users to notify the receiving exchange service providers of identifying information regarding both the sender and recipient.[5]

Most recently, in 2025, a bill to amend the PSA was submitted to the Diet. This includes provisions enabling the authorities to order that exchange service providers should retain their assets within Japan to ensure that the assets are returned to domestic users even in such cases as insolvency and the creation of a new intermediary business type dedicated solely to mediating the sale and purchase of cryptoassets or exchange with other cryptoassets.

2. Purpose of This Document

Successive institutional reforms have been implemented to enhance the reliability of financial functions and protect users in relation to cryptoassets. However, with rapid technological advancements and changing environments, the Financial Services Agency (FSA) has conducted an examination of the regulatory systems related to cryptoassets, based on the current actual state of cryptoasset transactions.[6] This document is a discussion paper summarizing the results of that examination in order to broadly solicit public opinion (April 10, 2025 - May 10, 2025).

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[5] In addition, regulatory frameworks for so-called stablecoins were established through the amendment of the PSA in 2022 (enforced in June 2023).

[6] In conducting this examination, the FSA has been holding a study group with external experts since last autumn and received various valuable opinions from the following members:

<Members of the Study Group>

ARIYOSHI, Naoya	Partner, Nishimura & Asahi (Gaikokuho Kyodo Jigyo)
KATAYAMA, Ken	Senior Chief Researcher, Nomura Research Institute, Ltd.
KATO, Takahito	Professor, Graduate Schools for Law and Politics, The University of Tokyo
KAWAMURA, Kenji	Professor, Department of Law, Rikkyo University
SAKO, Kazue	Professor, Faculty of Science and Engineering, Waseda University
TONOMURA, Keiji	Partner, Nagashima Ohno & Tsunematsu
MATSUO, Kenichi	Professor, Graduate School of Law, Kyoto University
MATSUZAWA, Shota	Co-founder and Managing Director, Decima Fund / Web3.0 Business Expert, Digital Agency

II. Trends in Cryptoasset Transactions

1. Current Status of Cryptoasset Transactions

Cryptoassets are based on blockchain technology and represent property value transferable over the Internet. Their types and natures vary, depending on factors such as the presence or absence of specific issuers or centralized administrators, as well as their utility tied to specific projects, voting rights and other functions.

Currently, under the PSA, regulations focusing on aspects such as the management of users' cryptoassets, the high volatility of prices, and their potential as a payment method are imposed on exchange service providers.

Meanwhile, the current situation surrounding cryptoassets has seen growing adoption among a wide range of holders.[7] Although some usage as a payment method can be observed, it is often pointed out that cryptoassets are predominantly bought and sold for investment purposes. Compared to the situation at the time of the 2019 Amendment, for example, the following changes have occurred:[8]

* The number of accounts[9] at exchange service providers exceeds 12 million, and the balance of user deposits[10] has reached over 5 trillion yen[11] (as of the end of January 2025).

* According to an investor sentiment survey conducted by the FSA, the rate of cryptoasset holders among Japanese individual investors with investment experience stands at 7.3%, surpassing FX trading and corporate bonds in terms of ownership rates.[12]

* In the U.S., more than 1,200 institutional investors are investing in spot Bitcoin ETFs (Exchange

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[7] Globally, the combined market capitalization of Bitcoin and Ether has reached 270 trillion yen (Source: Japan Virtual and Crypto assets Exchange Association, "Annual Report on Cryptoasset Trading for Fiscal 2023 (April 2023–March 2024)" [September 30, 2024]). Note that while the cryptoasset "Ether" is sometimes called "Ethereum," since "Ethereum" is actually the name of the blockchain program on which Ether is used, this document exclusively uses "Ether" to refer to the cryptoasset.

[8] In addition, regarding the changes of circumstances, it is possible to refer to such materials as the 2024 amendment to the Limited Partnership Act for Investment, which permits investment limited partnerships to supply funds to startups by investing in cryptoassets and positions cryptoassets as acceptable investment targets.

[9] The number of accounts includes both individual and corporate accounts. If a single individual opens accounts at multiple exchange service providers, each account is counted separately.

[10] This figure represents the total amount of cryptoassets (evaluated at market value in yen) plus cash and other funds held in custody by exchange service providers.

[11] Source: Japan Virtual and Crypto assets Exchange Association, "Monthly Report on Members' Crypto Asset Trading Activities"

[12] Source: Financial Services Agency, "Results of the Customer Sentiment Survey Pertaining to the Sale of Risk-Involving Financial Instruments" (July 5, 2024)

Traded Funds), and an expansion in investments, including that by long-term investors such as public pension funds, has been noted.[13] Moreover, spot Bitcoin ETFs have been listed on exchanges in countries like the U.S., Canada, and Australia, signifying an international trend towards the inclusion of cryptoassets as investment targets.

* A survey[14] shows that Japanese institutional investors also view investment in cryptoassets as an opportunity for portfolio diversification and are increasingly interested in investing in cryptoassets.

The reasons behind the growing investment in cryptoassets by institutional investors and others may be varied and it is pointed out that one of the reasons is the global advancement of digitization, which is expected to expand usage and increase demand for cryptoassets. Additionally, it is pointed out that Bitcoin, for example, is considered to have a low correlation with traditional assets like stocks,[15] to offer inflation resistance, and therefore to potentially be a valuable tool for portfolio diversification. While cryptoassets exhibit significantly higher volatility than traditional assets and generally lack backing assets to back their value, thus posing high investment risks, both domestic and international investors have already recognized cryptoassets as investment targets.

Furthermore, the sound development of Web3 business is expected to address societal issues and improve productivity in Japan. In particular, it is noted that blockchain technology used in Web3 business would contribute to

* provide low-cost and swift remittance methods compared to remittance involving multiple financial institutions, such as traditional international remittance,

* enhance transaction traceability due to publicly accessible and tamper-resistant transaction records in general and

* reduce settlement risks through smart contracts that enable simultaneous fulfillment of transactions.

From the perspective of developing the digital economy through effective utilization of blockchain technology, promoting the sound development of cryptoasset transactions is crucial. Broadly, cryptoassets can be categorized into two groups: (1) those widely circulated on foundational

[13] Source: Nikkei (November 30, 2024)

[14] Source: Nomura Holdings / Laser Digital Holdings AG, "Japan Market Survey on Digital Asset Investment Trends for Institutional Investors 2024" (June 2024)

[15] According to BlackRock Inc., although Bitcoin may exhibit short-term correlations in response to rapid shifts in factors such as dollar interest rates and liquidity, its low fundamental exposure to other macro variables suggests its low long-term average correlation with equities and other risk assets. ("Bitcoin: A Unique Diversifier" (September 17, 2024)).

blockchain networks (such as Bitcoin, Ether, and so-called meme coins), and (2) those issued for specific purposes (e.g., project operations), based on the circulation of the former group. Vitalizing transactions in the latter group could diversify funding methods for businesses and contribute to innovation through projects. On the other hand, the former group serves as the foundation for issuing and circulating the latter type, playing a vital role in exchanges between cryptoassets and fiat currencies due to their high liquidity. These two types of cryptoassets are closely interconnected technically and functionally. Therefore, growth of investment in the latter type may be considered to support the development and functional enhancement of the former type, which in turn promote investment in the latter.

Considering the high volatility of cryptoassets, investments toward such future possibilities demand a thorough understanding of risks and adherence to financial capabilities, especially within households. However, cryptoassets could become viable alternative investment targets for asset formation and, depending on investors' risk preference, allocating a portion of their funds to cryptoassets for diversification may also be considered.

On the other hand, while public recognition of cryptoassets as investment targets has grown, there have been rising concerns about fraudulent investment solicitations. The FSA's Financial Services Users Office receives an average of over 300 complaints and inquiries related to cryptoassets per month,[16] indicating increasing user damage and heightened needs for user protection.

There are also concerns that cryptoassets are being misused for the transfer of criminal proceeds from organized fraud, or that an unauthorized outflow of cryptoassets by hacking incidents involving service providers could facilitate the financing of terrorism.

2. Need for Environmental Improvement

Given these circumstances, while frameworks for user protection have been established, the further sound development of Japan's cryptoasset trading market requires enhanced user protection and the building of broad public trust in cryptoasset transactions. Without such trust, there is a risk that momentum toward innovation could be lost. Therefore, necessary improvements to the overall environment must be implemented to ensure continued progress. However, overly stringent regulations might suffocate domestic Web3 businesses, drive users and service providers to foreign markets including decentralized exchanges (DEXs), and undermine user protection effectiveness and

[16] For example, between October and December 2024, a total of 1,304 inquiries related to cryptoassets were received, accounting for approximately 10% of all inquiries received in that period.

Japan's competitiveness. Hence, while considering trends in international regulations, it is crucial to strike a balanced approach between user protection and the promotion of innovation.

Based on this understanding, it may be necessary to review laws and self-regulation related to cryptoassets from the following perspectives: ① enhancement of information disclosure and provision, ② user protection and responses to unregistered service providers, ③ responses to inappropriate conduct in investment management or advice and ④ ensuring fairness in price formation and transactions.

Given the rapidly changing Web3 business landscape, currently, dual governance of exchange service providers through laws and self-regulation by the Japan Virtual and Crypto assets Exchange Association (JVCEA) is in place.[17] However, differences in enforcement effectiveness between self-regulation and laws must also be noted.

① Enhancement of information disclosure and provision

It is pointed out that white papers accompanying new cryptoasset issuances in current practice—through which exchange service providers indirectly provide information based on the JVCEA's self-regulation—often contain unclear descriptions or discrepancies between the codes described in the white papers and actual codes over time. Furthermore, it is argued that, if capital is being raised for business ventures, the use of funds should be disclosed and subject to monitoring. Moreover, while exchange service providers are responsible for providing such information, the creators of white papers[18] are not obligated to ensure accuracy.

Considering these points, and taking into account international regulatory trends, it may be necessary to strengthen information disclosure and provisions regarding cryptoassets in order to eliminate information asymmetry between issuers and users, ensuring that users base investment decisions on accurate information about cryptoassets' functions and value.

② User protection and responses to unregistered service providers

[17] With respect to the content of the self-regulation, for example, there is an obligation for exchange service providers to provide information in connection with the issuance of new cryptoassets, a prohibition on loss compensation, a prohibition on the provision of special benefits and deceptive practices, and a prohibition on unauthorized trading, among other measures. In addition, according to the articles of incorporation of the JVCEA (Article 18, Paragraph 1), the JVCEA is authorized to impose disciplinary actions on members who violate self-regulation.

[18] In general, those who issue cryptoassets in order to raise funds create a white paper. However, unless the cryptoasset issuer is involved in the sale of the cryptoassets, registration as an exchange service provider is not required, and they are not subject to the regulations under the PSA pertaining to cryptoasset exchange services.

For users to engage safely in cryptoasset transactions, appropriate user protection measures must be in place. Given the recent emergence of service providers soliciting cryptoasset investments without exchange service providers registration (including overseas-based service providers), as well as numerous fraud-related inquiries received by the Financial Services Agency, it might be necessary to enhance user protection through more effective and stringent regulations while deterring illegal solicitations by unregistered service providers.[19]

③ Responses to inappropriate conduct in investment management or advice

Investment seminars and online communities providing information on cryptoasset transactions are increasingly common, and some of them are suspected of engaging in illegal activities, such as defrauding users of money.[20] From the perspective of protecting users, ensuring proper operation in investment management or advisory activities related to cryptoassets may be necessary.

④ Ensuring fairness in price formation and trading

International trends, including the listing of spot ETFs for Bitcoin and other cryptoassets in countries such as the U.S., Canada, and Australia, highlight the increasing inclusion of cryptoassets as investment targets. Ensuring fairness in the price formation and trading of such cryptoassets[21] may be required.

Regarding insider trading regulation of cryptoassets, in 2018, when the introduction of unfair trading regulations for cryptoassets was under consideration, it was decided not to introduce regulations similar to those applied to listed securities since it was considered difficult to clearly define the acts that should be prohibited by laws.[22] Instead, regulations were established to deter unfair trading detectable by exchange service providers and to prevent exchange service providers

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[19] Warnings have been posted on websites, such as the Government's public relations office (※1) and the Tokyo Metropolitan Government Consumer Affairs Center website (※2), regarding the solicitation of investment seminars and online communities, as well as fraud and malicious trouble facilitated through unknown service providers or persons met through matching apps.

※1 https://www.gov-online.go.jp/useful/article/201705/1.html [in Japanese]

※2 https://www.shouhiseikatu.metro.tokyo.lg.jp/kurashi/2211_12/soudan.html [in Japanese]

[20] See Footnote 19.

[21] In Japan, under current laws, cryptoassets are not classified as "specified assets" that may serve as the primary investment target for investment trusts, and therefore ETFs targeting cryptoassets cannot be constituted (see Article 3 of the Order for Enforcement of the Act on Investment Trusts and Investment Corporations).

[22] FSA, "Report from Study Group on Virtual Currency Exchange Services" (published December 21, 2018).

themselves from engaging in such misconduct.[23]

In recent years, the International Organization of Securities Commissions (IOSCO) has issued recommendations aimed at deterring unfair trading,[24] and there have been international trends, such as the enactment of insider trading regulations in Europe[25] and South Korea.[26] Moreover, considering that law enforcement actions against insider trading of cryptoassets, for instance the Coinbase case, have emerged in the U.S., there may be an increasing need to strengthen measures against insider trading in Japan as well.

[23] As restrictions on prohibited conduct by exchange service providers or their officers/employees, refer to Item (4) of Article 63-9-3 of the PSA and Item (11) of Article 20 of the Cabinet Office Order on Cryptoasset Exchange Service Providers.

[24] IOSCO: "Policy Recommendations for Crypto and Digital Asset Markets," Final Report, November 2023.

[25] Markets in Crypto-Assets Regulation (MiCA).

[26] The Act on the Protection of Virtual Asset Users.

III. Basic Principles for Regulatory Review

1. Overview

When considering the review from the perspectives described in II.2., one possible direction is the establishment of a comprehensive legal system for digital assets. However, to address current issues promptly, it is important to explore solutions within the framework of existing legislation.

The issues identified earlier include those related to information disclosure, investment fraud, and fairness in price formation and trading. Since these issues align closely with problems traditionally addressed by the FIEA, leveraging the mechanisms and enforcement under the FIEA may therefore be considered as one option. Such an approach would also be beneficial from the perspective of enhancing the functionality of cryptoassets as payment methods through user protection.

Regardless, when considering regulatory reviews, it is essential to fully understand the nature and unique characteristics of cryptoassets. Given that the same cryptoassets are traded globally, the international consistency of regulations must also be considered.

2. Scope of Regulatory Review

In reviewing regulations for cryptoassets, it may be appropriate to divide them based on their functions described in II.1, considering regulation tailored to their characteristics[27][28]:

- Fundraising/Business Activity Type Cryptoassets (Type 1)

[27] In addition to cryptoassets under the PSA, there are also tokens, such as security tokens and NFTs (Non-Fungible Tokens). Security tokens that can generate income gains, such as through revenue distributions, are already regulated as 'securities' under the FIEA. On the other hand, for NFTs that do not qualify as either cryptoassets or securities, whether they should be regulated as investment targets must be considered based on what the NFT represents. In this regard, it has been pointed out that, at present, many NFTs represent rights related to certain goods or services and are traded for that purpose. Furthermore, because the characteristics of individual NFTs vary significantly, careful consideration is required to subject them uniformly to financial regulation. Therefore, at present, it may be considered appropriate to review regulations based on the current scope of cryptoassets under the PSA. On the other hand, given the expanding use cases of NFTs, it may be necessary to continuously monitor the need for institutional measures as a future challenge.

[28] So-called stablecoins (similar to digital money) are what are issued at a price linked to the value of a fiat currency and are redeemable at the same issuance price (or something equivalent). While they have the potential to be widely used as a means of remittance and settlement, they are currently not considered likely to be traded as investment targets, and thus, the necessity to review regulations is deemed low at this time.

Cryptoassets issued as a means of fundraising, with proceeds used for projects, events, community activities, etc. (e.g., certain utility tokens).

- Non-fundraising/Non-business Activity Type Cryptoassets (Type 2)
  Cryptoassets not falling under Type 1 (e.g., Bitcoin, Ether).

From the perspective of actual conditions, cryptoassets such as Bitcoin and Ether (Type 2) have high circulation volumes. It may be crucial to develop environments to ensure safe transactions of such cryptoassets for users, such as by applying appropriate standards. Fraudulent solicitations related to so-called meme coins or Bitcoin investments may be also frequently associated with Type 2 cryptoassets. Therefore, there may be a high need to protect users by regulating a wide range of cryptoassets, not limited solely to Bitcoin and Ether. Type 1 cryptoassets can expect financial returns through capital gains like Type 2 and, additionally, businesses are conducted using funds raised from issuing Type 1 cryptoassets. Addressing the asymmetry of information between issuers and users regarding how the funds will be used and the details of the project to which the funds will be allocated is deemed necessary.

In this context, when classifying cryptoassets, a crucial point is which type of cryptoassets individual cryptoassets are classified into, and it is required to carefully assess each cryptoasset based on its nature and practical use.[29] Special consideration is also needed for Type 1 cryptoassets to maintain a balance with regulations under the FIEA for security tokens. Additionally, changes in the design of cryptoassets may lead to increased decentralization of blockchain network authority, resulting in a transition from Type 1 to Type 2. This shift should be carefully addressed.

These classifications of cryptoassets also provide the framework for considering each regulatory system discussed later. In reviewing regulations, it is necessary to develop an appropriate regulatory framework that takes into account the fact that cryptoassets possess different characteristics from traditional securities, such as stocks. The framework should ensure that the regulations are both necessary and sufficient, while also providing clarity for those subject to regulation and addressing the potential for regulatory evasion.

Finally, it is important to note that investment in cryptoassets primarily involves seeking capital

[29] For instance, Ether was issued by the development team, at least in its early stages, as a means of fundraising. However, if the funds raised were used solely for the development of Ether itself and not for the business activities of other projects, it is considered that it would not fall under Type 1.

gains from changes in supply and demand. Unlike traditional assets such as stocks, cryptoassets generally do not generate income gains such as dividends.

It may be argued that cryptoassets are purely speculative, given their lack of backing assets. However, they are already recognized as tools for alternative investment for portfolio diversification. Moreover, the expectation of returns from price fluctuations may satisfy the investment criteria (A financial instrument (i) involving financial contribution, possessing the potential for redemption in cash or similar forms, (ii) is linked to assets or benchmarks (iii) and is invested in by taking on risk in anticipation of higher returns (economic utility))[30] debated at the time the FIEA was enacted.[31]

Therefore, it is necessary to proceed with caution and careful analysis when reviewing regulations related to cryptoassets. With this in mind, if a classification into Types 1 and Type 2 is implemented and the regulatory systems are reorganized, the following measures could be considered.

3. Approach to Information Disclosure and Provision Regulation

For Type 1 cryptoassets (Fundraising/Business Activity Type), the disclosure and provision of information that influences trust in and the value of cryptoassets are important when users consider investing. This information may include the rules and algorithms associated with the cryptoasset, summaries of the blockchain that underpins the cryptoassets, information on the parties involved with the cryptoassets, information regarding projects funded through the issuance of the cryptoassets, and risks concerning cryptoassets. The entities conducting business activities through fundraising from cryptoasset issuance are best suited to accurately disclose and provide such information. Therefore, rather than relying on indirect information provision by exchange service providers under current self-regulation, it may be appropriate to impose direct regulatory obligations on the issuer of the cryptoasset to address the asymmetry of information between issuers and users. In the case of cryptoassets issued overseas but sold in Japan, it may also be necessary to consider requiring information disclosure and provision under certain circumstances.

In token business, considering that startups sometimes issue cryptoassets with professional investors participating, and in light of the fact that anyone can freely issue new cryptoassets, rather than

[30] FSA, "-For Establishment of Investment Services Act (Provisional)- Report of the First Subcommittee of the Financial System Council" (published December 22, 2005)

[31] Under the FIEA, even highly speculative investment products (e.g., binary options) are subject to regulation to protect investors.

imposing a uniform regulation on all cryptoasset issuances, it might be advisable to regulate only issuances of the cyptoassets involving the solicitation of a broad base of retail investors (for example, the point in time at which services concerning exchange trading or over-the-counter transactions by exchange service providers are launched) and likely to circulate frequently.

The methodology and content of information disclosure and provision must ensure that users receive timely and appropriate information for their investment decisions. However, it must reflect the unique characteristics of cryptoassets, and careful consideration is important to avoid stifling the development of token business in Japan, such as forcing domestic projects to seek listings overseas. Regarding the items to be disclosed or provided, while a uniform description would make comparison easier, considering the nature of cryptoassets, allowing for a certain degree of descriptive flexibility might also be considered. Therefore, it is necessary to pay careful attention to the balance between these approaches. The necessity to ensure the accuracy of disclosed information through verification by a third party is another key issue. While it is pointed out that external audits (e.g., by audit firms or code auditors) may not be realistic, it might be one option to conduct a certain level of verification by exchange service providers handling the cryptoassets or self-regulatory organizations.

Furthermore, as noted earlier, even if a cryptoasset initially has a centralized administrator that conducts business activities with the funds raised through the issuance of the cryptoasset, it is possible that its design could later be changed to become sufficiently decentralized.

For Type 2 cryptoassets (Non-fundraising/Non-business Activity Type), many lack identifiable issuers, making direct obligations on issuers unsuitable. Instead, exchange service providers handling these cryptoassets could be obligated to explain relevant information and required to provide information that may significantly impact price fluctuations[32] for investors.

It is necessary to carefully consider to what extent continuous information disclosure should be required from exchange service providers that are not directly involved in the issuance or design of cryptoassets. In addition, it is necessary to consider factors such as the fact that exchange service providers have no choice but to rely on publicly available information when providing information about cryptoassets for which no identifiable issuer exists, and numerous exchange service providers handle the same cryptoasset.

It should be noted that the approach implemented through exchange service providers is based on their present role as gatekeepers for a significant proportion of user-conducted cryptoasset

[32] The information might include proposals by stakeholders for modifications to the design of cryptoassets and the outcomes of the corresponding votes, for example.

transactions. In the future, however, there is the possibility that transactions using non-custodial wallets via DEXs without centralized administrators may become common among general users, thereby necessitating careful attention to future practical developments.

4. Approach to Business Regulation

Under current laws, service providers that conduct the purchase, sale, or exchange of cryptoassets are subject to both the statutory regulations applicable to exchange service providers and the self-regulation established by the JVCEA. Within this framework, regulations that address the investment aspects taking into account the price volatility risks of cryptoassets are also imposed. Taking these regulations as a whole, including self-regulation, it appears that a regulatory framework for exchange service providers has been established that is broadly similar to the framework applied to financial instruments business operators under the FIEA.

On the other hand, certain self-regulatory rules cover matters that are stipulated at the statutory level under the FIEA. From the perspective of user protection, it may be necessary to consider the difference between self-regulation and statutory regulation. However, given that technology and business related to cryptoassets are rapidly evolving fields, it is considered essential to strike an appropriate balance between statutory regulations and self-regulation capable of adapting to actual circumstances flexibly.

Furthermore, in formulating these business regulations, although it is essential to build a suitable framework for protecting users, it is equally important to take into account the unique features of the burgeoning token business in order not to inhibit its innovation. Therefore, the regulatory framework should be carefully scrutinized in light of the distinction between Type 1 and Type 2 cryptoassets. In addition, the FIEA provides for relaxed measures, such as easing entry restrictions based on the nature of business operations and relaxing conduct regulations according to customer attributes. In reviewing the regulations, it might be appropriate to pursue this kind of "flexible structuring of the regulatory framework."

As noted earlier, under the current laws, exchange service providers are required to manage users' cryptoassets in cold wallets in principle in response to incidents of cryptoasset outflows. Moreover, regulations on anti-money laundering and countering the financing of terrorism, such as identity verification at the time of account opening (the 2016 amendment) and the so-called travel rule (the 2022 amendment), are introduced. In light of advancements in cryptoasset-related technology, it is expected that practical initiatives will continue to be undertaken to ensure the sound and proper

operation of exchange service providers.

Moreover, to deter illegal solicitations by unregistered service providers, it might be necessary to consider more effective and stringent regulations.[33] In addition, as investment seminars and online communities providing information on cryptoasset transactions are increasingly common, and with fraud and malicious troubles also arising through these mediums, from the perspective of protecting users, it might be considered to regulate investment management and advisory services related to spot cryptoassets that do not fall under cryptoasset exchange services in order to enhance user protection.

Regarding the necessity of establishing regulations for token businesses that are not currently subject to regulation under the existing system, one might consider the following.

First, in the case of so-called staking services,[34] if an exchange service provider receives cryptoasset deposits from users for staking purposes, registration as an exchange service provider is required. In Japan, staking services are often provided by exchange service providers in practice.

Staking services can also be provided by borrowing cryptoassets from users.[35] In such cases, no deposits are received, and therefore registration is not required. However, including these cases, there may not yet have been any incidents of user harm associated with staking services. Taking these factors into account, it may be considered to continuously examine the need to regulate staking services as a future challenge. On the other hand, with respect to staking services, since there may be liquidity risks in that users cannot withdraw their cryptoassets at any time and risks of so-called slashing[36], exchange service providers that offer staking services should appropriately explain these risks that users would

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[33] Under current law, a person who provides cryptoasset exchange services without registration is subject to imprisonment for not more than three years, a fine of not more than three million yen, or both (PSA, Article 107, Item 12). On the other hand, under the FIEA, a person that has conducted financial instruments business without registration is subject to punishment by imprisonment for not more than five years, a fine of not more than five million yen, or both (FIEA, Article 197-2, Item 10-4). Furthermore, a person who posts an indication that a financial instruments business is being conducted or solicited without registration is subject to imprisonment for not more than one year (FIEA, Article 200, Item 12-3). Additionally, financial instruments business operators are subject to inspections by the Securities and Exchange Surveillance Commission, and it is also possible to file (a petition for) an emergency injunction with the court against unregistered business operators (FIEA, Article 192).

[34] "Staking" is a mechanism that allows receiving rewards in cryptoassets as compensation for contributing to the stable operation of a blockchain. "Staking service" is a service in which users transfer cryptoassets (including in cases where the cryptoassets are deposited in custody) for staking purposes, and the staking rewards earned are then distributed to the users.

[35] If cryptoassets are borrowed from users for staking purposes, since this does not involve managing cryptoassets on behalf of others, it is possible under current law to provide such services without obtaining registration as an exchange service provider.

[36] Slashing is the confiscation of the cryptoassets provided for staking as a penalty for fraudulent activities or other misconduct during staking.

bear.[37]

Additionally, regarding the issue of MEV (Maximal Extractable Value), which is the actions of validators and similar entities to maximize the value they obtain from order approvals, it has been pointed out that by exploiting the mechanisms of cryptoasset trading, order approvers (such as validators) can ensure that their own orders are approved at more favorable rates than those of other orders.[38] Such actions are not issues that occur in off-chain transactions at exchange service providers where most general users participate; rather, they may be directly related to the mechanisms of orders and trading on DEXs. If any regulatory measures are to be applied to such actions, considering that validators and similar entities are dispersed overseas, an international approach would likely be necessary to ensure regulatory efficacy. Meanwhile, since the risks borne by users due to MEV stem from the approval processes of cryptoasset transactions, it may be advisable to adequately inform users of these risks through exchange service providers or industry associations, for example.[39] Moreover, the authorities should continuously monitor to ensure that unfair practices[40] do not become widespread.

Furthermore, considering the characteristic of cryptoassets in that transactions are executed programmatically, the necessity of regulating DEXs becomes a point of discussion. However, taking into account the general nature of DEXs, which often lack a clear operational entity or a host country, it may be considered that even if Japan alone were to establish regulations, ensuring their effectiveness would be challenging.

Regardless, as stated in 3. above, this approach of business regulation is based on the current situation in which exchange service providers play the role of gatekeepers. Given the possibility that transactions on DEXs based on non-custodial wallets may expand in the future, it is necessary to

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[37] When an exchange service provider provides cryptoasset-related services that are not subject to the regulations governing cryptoasset exchange services, it is necessary to take care to ensure that users do not mistakenly assume that user protection is automatically secured by regulation simply because the service is offered by an exchange service provider.

[38] It is generally cited as front-running; however, since validators typically do not enter into contractual relationships with the users of exchange service providers, the situation is considered to be distinct from front-running as it occurs in the trading of securities.

[39] Since these risks pertain to the entire trading mechanism rather than to individual services, it is pointed out that careful attention must be paid to the fact that their nature differs from the information required to be provided to users by financial service providers under the current system.

[40] While it has been argued that actions involving MEV may fall under the category of unfair trading as defined in Article 185-22 of the FIEA, it is also argued that if users conduct trades with an understanding of the risks associated with MEV, such classification might not be warranted. Additionally, it is pointed out that the MEV issue is inherent to the trading mechanism, and that it may not be inappropriate to penalize actions that merely adhere to that system.

remain attentive to future developments in practice.

5. Approach to Market Operating Regulations

When providing a platform that facilitates collective transactions with a large number of counterparties, it is important to ensure fair price formation and neutral, proper business operations. For this reason, under the FIEA, trading platforms are subject to market operating regulations. With respect to cryptoassets, in the case of margin trading, some service providers are conducting order matching between customers. However, under the interpretation that such platforms are not regarded as a "market" defined under the FIEA, these providers are not required to obtain a license as a financial instruments exchange.

In spot trading of cryptoassets as well, there are exchange service providers conducting order matching between users. While these matching systems can serve a price formation function to some degree, given that the same cryptoasset is often traded across numerous exchanges (including exchanges operated by exchange service providers), including overseas exchanges, the price formation function of any individual exchange is considered limited. Furthermore, for cryptoassets that are also traded on exchanges operated by other exchange service providers, even if one exchange service provider goes bankrupt, users still have alternative venues available for trading. Additionally, even if a cryptoasset is not traded on any exchange operated by exchange service providers other than the bankrupt one, it can still be traded off-exchange without involving an exchange service provider.

Given these features, at this time, it does not appear necessary to impose market operating regulations, such as requiring a license as a financial instruments exchange or regulations for proprietary trading systems (PTS) under the FIEA, on cryptoasset exchanges. However, since these platforms provide a venue for collective trading among multiple counterparties, they should at least ensure proper trade management and system infrastructure. As cryptoasset investment continues to grow, it will be necessary to consider whether price formation and trading fairness are being adequately secured even more.

6. Approach to Insider Trading

For the sound development of the cryptoasset trading market, it is essential to ensure investor trust in cryptoasset trading. This requires efforts to deter unfair trading practices that harm fairness in transactions.

Currently, with regard to unfair trading practices involving cryptoassets, the FIEA provides some rules similar to those for listed securities. These include a general regulation prohibiting wrongful acts, a regulation prohibiting spreading rumors, using fraudulent means and etc., and a regulation prohibiting market manipulation. However, the FIEA does not directly regulate insider trading practices involving cryptoassets. Furthermore, under the recognition that the economic significance of cryptoassets trading differ from those of listed securities trading, no equivalent supervisory system has been established.

In this context, to enhance the deterrence against insider trading of cryptoassets, various regulatory options, such as those outlined below, can be considered. On the other hand, each option presents its own issues that require careful consideration. It seems necessary to further consider how a regulatory framework appropriate to the characteristics of cryptoassets should be structured. Furthermore, alongside the consideration of regulatory approaches, it should be considered how to enhance enforcement effectiveness, including consideration of market supervisory system.

(1) Options considered as regulatory approaches

(A) The introduction of formal crime provisions that specify violation types as specifically as possible

It is one option to introduce specific formal crime provisions similar to those that apply to insider trading regulations for listed securities[41] (e.g., FIEA, Article 166). In this case, it would be necessary to explicitly define terms, such as "material facts,"[42]" "insiders,[43]" and "publication.[44]"

If such provisions were established, it would be necessary to thoroughly consider, in view of the characteristics of cryptoassets, whether material facts and insiders[45] can be defined without excess or deficiency. Furthermore, with regard to the publication standards for material facts, especially including the treatment of cryptoassets for which a specific issuer cannot be identified, it would be necessary to carefully consider whether these standards can be clearly defined in a manner

[41] For listed securities, "insiders," who have become aware of undisclosed "material facts," are prohibited from conducting transactions prior to the "publication" of such facts.

[42] It refers to facts that could have a material influence on investors' investment decisions.

[43] It refers to those who are considered to be in a special position of having access to undisclosed material facts.

[44] Even when a person knows material facts, if those facts have already become public, there is no need to restrict transactions, so only transactions prior to the "publication" are restricted.

[45] Although they differ from formal crime provisions, for example, MiCA (Article 89(5)) and South Korea's Act on the Protection of Virtual Asset Users (Article 10(1)) conduct the limitative listing of categories of people subject to insider trading regulations concerning cryptoassets.

consistent with business practices.[46]

(B) The introduction of abstract, material crime provisions

Next, to introduce abstract, material crime provisions is another option. Rather than explicitly enumerating material facts, it is conceivable to define them abstractly, for instance, as "facts that could significantly influence investors' investment decisions," and to regulate transactions for which violators "use" such facts.[47]

On the other hand, if such provisions were adopted, it would be necessary to carefully consider issues, such as whether the limitative listing of insiders (as seen in EU and South Korean regulations) is required and what is considered "publication" of material facts.

Furthermore, if a requirement of such provisions is the "use" of material information, there is probability that the burden of proof will increase, as well as probability that the foreseeability of what conduct constitutes a violation will decrease, potentially resulting in a chilling effect. Additionally, it should be taken into account the indication that a reasonable explanation will be required for differences in regulation approaches from the specific, formal crime provisions applied to insider trading in listed securities.

(C) Utilization of the general regulation prohibiting wrongful acts (FIEA, Article 185-22)

Under the 2019 amendment, it is prohibited to use "wrongful means, schemes, or techniques" in a purchase and sale of cryptoassets, just as it is for the purchase and sale of securities. Considering that insider trading of listed securities which involves particularly egregious actions falling under "wrongful means, schemes, or techniques" may be subject to the general regulation under Article 157 of the FIEA[48], one possible approach, similar to U.S. regulations, is to utilize the

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[46] In the case of Non-fundraising/ Non-business Activity Cryptoassets, there is often no specific issuer, making it difficult to identify the entity that should disclose accurate information regarding the occurrence of material facts. Therefore, rather than prescribing a specific method of publication, it is conceivable to interpret "publication" as meaning, for example, "when an unspecified and large number of people have become available to the material facts." However, this may result in a lack of clarity regarding what is considered "publication" of material facts. Moreover, it is necessary to take into account the reality that information that could be regarded as "material facts" about cryptoassets is frequently disseminated via social media and other channels.

[47] For example, MiCA does not specify insider information by category but defines it abstractly, requiring "use" of the information as an element (MiCA Article 89(1)).

[48] Insider Trading Regulation Research Group, "Q&A Insider Trading Regulation" (Japan Institute of Business Law, 1988) pp.18-19

general regulation by specifying in guidelines those forms of egregious insider trading in cryptoasset transactions that fall under “wrongful means, schemes, or techniques” in order to enhance regulatory effectiveness.[49]

In this case, taking into account the mechanism of cryptoassets and the diversity of stakeholders, it is necessary to consider how clearly and specifically such egregious acts can be enumerated.

(2) Enhancing enforcement effectiveness

For trading listed securities, effective market surveillance is carried out through the coordinated approach of securities firms, financial instruments exchanges (including their self-regulatory services), and the Securities and Exchange Surveillance Commission. For trading cryptoassets, to pursue more effective enforcement against unfair trading such as insider trading, it is important to coordinate trade surveillance by exchange service providers and self-regulatory organization with market surveillance by authorities.[50]

Therefore, to strengthen deterrence against unfair trading, including insider trading practices, of cryptoassets, it may be significant to consider and implement measures on two fronts: strengthening the trade surveillance system by exchange service providers and self-regulatory organizations, as well as enhancing market surveillance by authorities.[51]

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[49] It is pointed out that if the scope of application is clarified through guidelines that set forth specific examples of egregious conduct—focused on elements such as use of material information, profit acquisition, and planning—and if Article 185-22 of the FIEA is effectively utilized, there is no lag in cryptoasset regulation compared to foreign jurisdictions.

[50] Currently, regarding transactions which “cryptoasset-related information” is used for, each exchange service provider only tracks "information acquirers" (i.e., individuals identified as possessing cryptoasset-related information through user reports or through information obtained by members) and merely reports to the JVCEA when an information acquirer or someone deemed highly likely to be an information acquirer places an order for cryptoassets associated with cryptoasset-related information that they either possess or are highly likely to possess (Regulation on the Establishment of Management Systems for Cryptoasset-Related Information in Cryptoasset Exchange Service Providers, Article 15; Regulation on the Prevention of Unfair Trading in Cryptoasset Exchange Services, Article 22). JVCEA has not yet reached the stage of auditing the trading surveillance systems of each exchange service provider with respect to transactions which such cryptoasset-related information is used for. In addition, cross-industry data collection and trading surveillance by JVCEA are currently given low priority from the perspective of system costs and other factors, indicating a need to strengthen these efforts with a medium- to long-term perspective.

[51] Given that cryptoasset transactions can be conducted on platforms such as DEXs without going through exchange service providers, it is necessary to consider market surveillance approaches while taking into account the administrative imperative and costs to ensure the fairness of cryptoasset transactions.

IV. Outlook and Future Considerations

In reviewing regulation going forward, it is essential to strike an appropriate balance between user protection and the promotion of innovation. Furthermore, moving forward, while fully taking into account the diverse characteristics of cryptoassets and the practical business practice of cryptoasset trading, and also bearing in mind regulatory trends in international regulations and the opinions submitted regarding this document, it is necessary to further deepen the consideration of the aforementioned issues.