Three major policy perspectives for financial regulators regarding crypto-assets

(Tomoko AMAYA, Vice Minister for International Affairs, Financial Services Agency, Japan, published in the Eurofi Magazine on September 7, 2022)

There are three major policy perspectives for financial regulators to consider concerning crypto-assets: financial stability, user protection, and AML/CFT. Crypto-asset related AML/CFT measures have been developed by FATF (Financial Action Task Force) since 2015. On the other hand, international regulatory discussion is still at an early stage in the areas of financial stability and user protection. In Japan, partly in response to the cases of massive hacking and spread of speculative transactions, a regulatory framework has been developed from all three policy perspectives. Most recently, amendments of relevant laws have been enacted and will enter into force by June 2023 to provide a regulatory framework for digital-money type stablecoins (e.g. fiat-currency backed stablecoins and equivalent ones).

Financial Stability

From the perspective of financial stability, particular attention should be paid to stablecoins, which are, or are claimed to be, linked to a fiat currency, since they are susceptible to runs. To address the risk of a run, policy measures need to be taken to ensure redemption at par and price stabilization.

To this end, in Japan, only banks, fund transfer service providers, and trust companies are entitled to issue stablecoins, and each is subject to the requirement to ensure redemption, as follows.

- Banks issue stablecoins as deposits. They are already subject to prudential regulations and stablecoin holders are protected by deposit insurance in the same manner as conventional bank deposits.
- Fund transfer service providers issue stablecoins as claims on outstanding obligations. They are required to secure the obligation through either money deposits with official depositaries, bank guarantees, or segregated safe assets, such as bank deposits and government bonds.
- Trust companies issue stablecoins as trust beneficiary rights. They are required to hold all the trusted assets in the form of bank deposits.

In the Japanese regulatory framework, tokens that do not meet the above requirements are categorized as “crypto-assets,” the same category as bitcoins. As explained later, crypto-asset exchange service providers are subject to advertising and solicitation regulations and are required to explain the risk of price fluctuations to customers. They may handle so-called stablecoins, but they have to explain that the prices are not necessarily stable. As of now, DAI is the only token, or so-called stablecoin, circulated in Japan.

Other policy measures to ensure financial stability include capital requirements for stablecoin intermediaries. In addition, traditional financial institutions’ involvement in crypto-asset business is limited because of the scope of business regulations and supervisory guidance. The various user protection measures below also serve financial stability by enhancing confidence.

User Protection

User protection consists of various aspects, including the protection of user assets and the provision of sufficient information to users. From this perspective, crypto-asset exchange service providers, including custody service providers, should be subject to proper regulation and supervision and maintain proper internal control systems.

From the viewpoint of the protection of user assets, in Japan, service providers are obligated to preserve user assets, to have proper segregation of assets and financial statements audited, and to maintain system security. In particular, in response to the experience of major hacking incidents, service providers are required to manage crypto-assets deposited by customers in an off-line environment (so-called cold wallet), in principle.

From the viewpoint of the provision of sufficient information, crypto-asset exchange service providers are subject to advertising and solicitation regulations and prohibited from deceptive advertisement as well as solicitation enticing speculation. Furthermore, in order to avoid highly leveraged speculative transactions, a minimum margin of 50% is required for CFD transactions by retail users.

Stablecoin intermediaries are subject to similar requirements to protect user assets. In addition, they are required to enter into contractual agreements with issuers that stipulate the sharing of liability for losses in order to ensure proper coordination between the issuers and intermediaries in case of accidents.

Globally, the recent turmoil in crypto-asset markets has crystallized the vulnerabilities of crypto-asset markets and risks to financial stability as well as user protection. The FSB and international standard-setting bodies are intensively working on regulatory and supervisory approaches to address the risks posed by crypto-assets, including stablecoins. This is a matter of urgency and JFSA will actively contribute to the discussion.