

Report of the Financial System Council's Working Group on Crypto-asset Systems

1. Summary

❑ **Crypto-assets are increasingly being recognized as investment targets.**

- *According to a domestic survey, the ratio of crypto-asset holders among those with investment experience surpasses that of FX traders or corporate bond holders.*
- *The predominant motivation of crypto-asset holders (87%) is price appreciation in the long term.*

❑ Accordingly, **user protection should be improved** by developing regulations for crypto-assets as financial instruments, tailored to their characteristics to address the following issues.

❑ **This should not be interpreted as an endorsement** of crypto-assets investments.

Pressing Challenges related to Crypto-assets

• **Enhancement of Information Provision**

- ✓ Concerns over **unclear descriptions in white papers** (explanatory materials) and discrepancies between the described codes and the actual codes

• **Ensuring Appropriate Transaction / Addressing Unregistered Operators**

- ✓ **Numerous inquiries** received by the FSA **regarding fraudulent solicitations**

• **Addressing Inappropriate Conduct in Investment Advice**

- ✓ Cases of suspected engagement in **fraudulent activities through investment seminars and online communities**

• **Securing Fairness in Price Formation and Trading**

- ✓ **Recommendations by IOSCO** on insider trading regulations and **legislation in Europe and other regions**

• **Strengthening Cyber Security**

- ✓ Recurring incidents of **crypto-asset outflows caused by cyberattacks**

1. Summary

Overview of the recommended regulatory revision

1. Change of Legal Basis

- ❑ The governing law for crypto-assets should be changed **from the Payment Services Act (PSA) to the Financial Instruments and Exchange Act (FIEA).**

➤ *Non-Fungible Tokens (NFTs) and stablecoins that are not classified as crypto-assets under the current PSA will remain outside of the definition of crypto-assets under the amended FIEA.*

- ❑ **Crypto-assets should be classified under the FIEA as financial instruments distinct from securities.**

2. Information Provision Regulations

- ❑ **Crypto-asset issuers and crypto-asset exchange service providers (CASPs) should provide information to users.**

3. Regulations on Crypto-Related Business

- ❑ **CASPs should be subject to regulations comparable to those for Type I Financial Instruments Business.**
- ❑ Safeguards for users' crypto-assets should be enhanced through the strengthening of cyber security management, including the supply chain.
- ❑ **Penalties for unregistered business activities should be increased, and investment management and advisory services related to crypto-assets should fall under the regulatory framework.**

4. Market Abuse Regulations

- ❑ **Insider trading regulations involving crypto-assets should be established.**
- ❑ **Criminal investigative authority and an administrative monetary penalty system** under the Securities and Exchange Surveillance Commission (SESC) should be established.

2. Information Provision Regulations

1. Information provision upon initial listing

Crypto-assets with an identifiable issuer (e.g., IEO tokens)

- Need to eliminate information asymmetry between the issuer and retail holders
 - ✓ **The issuer should provide information** to users **when raising funds through the offering** of crypto-assets. However, the following offers should be exempted from this requirement:
 - Offers to a limited number of investors or qualified institutional investors
 - Offers of crypto-assets provided free of charge
 - Offers to the public that are automatically created as a reward for mining (validation of transactions)
 - ✓ CASPs should provide information to users when they handle crypto-assets without fundraising by the issuer
- Information provided includes:
 - ✓ Information about the issuer, planned use of the offering proceeds, the crypto-asset project
 - ✓ The characteristics and functionality of the crypto-assets, total number of the crypto-assets, underlying technology, rights and obligations attached to the crypto-assets, and associated risks

Other crypto-assets (e.g., Bitcoin)

- Need to eliminate information asymmetry between retail holders and experts in terms of the technical nature of and expertise regarding crypto-assets.
 - ✓ **CASPs should provide information** to users
- Information provided includes the characteristics and functionality of crypto-assets, total number of the crypto-assets, underlying technology, rights and obligations attached to the crypto-assets, and associated risks.

2. Information provision post-listing

- ❑ Issuers or CASPs should ensure **the timely provision of information** if an event occurs that may significantly affect trading judgment **as part of their post-listing information provision**.

3. Measures to ensure the accuracy of information and protect retail holders

- ❑ **Provision for criminal penalty, civil liability, and administrative monetary penalty** for material misstatements and non-provision of information.
- ❑ **Enhancement of the gatekeeping function** of CASPs and a self-regulatory organization (SRO), particularly setting up an independent committee or an independent organization at the SRO to enhance the neutrality and independence of listing examination.
- ❑ Setting an **investment cap** on retail investors if the issuer is not subject to an audit.

3. Regulations on Crypto-related Business

Basic principles

- ❑ **CASPs should be subject to regulations comparable to those for Type I Financial Instruments.**
 - *Safeguarding regulations under the PSA (e.g., cold wallet storage for users' crypto-assets in principle) should be incorporated into the FIEA.*
- ❑ **The regulatory framework should be strengthened to deter illegal solicitation by unregistered service providers.**
 - *Increasing penalties for unregistered business, making such activities subject to emergency court injunctions, and empowering the SESC to petition for such injunctions.*
- ❑ **Investment management and advisory services** related to crypto-assets **should be subject to regulations.**
- ❑ Measures should be implemented to **prevent crypto-assets from being used as a means of payment for fraudulent investment solicitation.**
 - *Establishing a deliberation period in which users are prohibited from transferring their crypto-assets to unhosted wallets (accounts not managed by registered CASPs) after opening a new account.*

Overview of Regulations on Crypto-related Business

Establishment of an Operational Control Framework

- ❑ The framework for **examining crypto-assets handled, ensuring client suitability, and monitoring trading activity,** should be enhanced.

Safeguarding of Users' crypto-assets

- ❑ **Holistic cybersecurity management,** including the supply chain, **should be advanced.**
- ❑ New regulations, such as **advance notification and system security measures, should be introduced for vendors of critical systems** for crypto-assets.

Liability Reserves

- ❑ **Liability reserves should be set aside to cover compensation for customers** in the event of unauthorized outflows.

Borrowing of crypto-assets

- ❑ **Regulations should be introduced for governing businesses that conduct staking** and related activities **using crypto-assets borrowed from users.**

Treatment by banks and insurance companies

- ❑ **Issuance, purchase and sale of crypto-assets by banks and insurance companies themselves remain subject to careful consideration.**
- ❑ **Holding crypto-assets for their own investment purposes should be permitted on condition that they have an appropriate framework in place to manage associated risks.**
- ❑ Issuance, purchase and sale of crypto-assets by **subsidiaries** of banks and insurance companies **should be permitted** under the newly introduced regulations on financial instruments business.

Decentralized Exchange (DEX)

- ❑ The examination of balanced regulatory approaches, tailored to the technical characteristics of DEXs and related services, should continue, while regulatory developments in other jurisdictions are closely monitored.

Cybersecurity initiatives

- ❑ Advancement of cybersecurity management should be achieved through a combination of self-help, mutual assistance, and public support. In particular, **the development of industry-wide mutual assistance initiatives would be essential,** and the authority should support these efforts.

4. Market Abuse Regulations

□ Insider trading regulations

- The current FIEA does not directly regulate insider trading practices involving crypto-assets.
 - *With regard to unfair trading practices involving crypto-assets, the FIEA provides other rules similar to those for listed securities, including a general regulation prohibiting wrongful acts and a regulation prohibiting the use of fraudulent means and market manipulation.*
- Considering international trends, **insider trading regulations involving crypto-assets should be established** to ensure fairness in transactions.
 - *Specifically, provisions should be introduced based on insider trading regulations for listed securities, while the distinct features of crypto-assets are taken into account.*

<u>Scope of Crypto-Assets</u>	Crypto-assets admitted or under application for admission to trading on domestic CASPs Irrespective of whether transactions take place on a trading platform (including transactions taking place on DEX and P2P transactions)
<u>Material Facts</u>	Enumerating events that clearly constitute material facts , such as issuer bankruptcy, listing or delisting, and large volume trades, supplemented by basket clauses
<u>Insiders</u>	Parties related to issuers of crypto-assets, CASPs, and large volume traders
<u>Exemptions</u>	Exempting insider trading regulations where the person who engaged in the trade proved that the trade would have been made even without knowledge of material facts

- **Criminal investigative authority and an administrative monetary penalty framework should be established** under the SESC to address market abuse involving crypto-assets.
- **To ensure effective enforcement** of market abuse regulations, **trade monitoring by CASPs and market surveillance framework by SROs and the SESC should be strengthened.**