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Japan: Trends & Developments

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Trends and Developments

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Digital Payroll Payments

Background and advantages of implementing digital payroll payments

Currently, salary payments in Japan are generally made by direct cash payments or bank transfers. However, in recent years, there has been a growing need for companies to introduce digital payroll payments – in which wages and salaries are paid into the account of a funds transfer service provider designated by the employee – as cashless payments are widely used and remittance services are diversified. In light of this need, the Ministry of Health, Labour and Welfare (MHLW) announced that the ban on digital payroll payments would be lifted from 1 April 2023.

Digital payroll payments are also expected to be used for payments to foreign workers, for whom it can be challenging to open a bank account. They are also advantageous to employers that pay salaries, as they require less paperwork and often have lower fees than bank transfers. Incidentally, the use of digital payroll payments with payroll cards is already widespread in the USA and other foreign countries.

Digital payroll payments and Japanese regulations

The Japanese Labour Standards Act requires wages and salaries to be paid in Japanese currency. The purpose of this requirement is two-fold:

- to prohibit payments in kind, which are of uncertain value and inconvenient to exchange; and

- to ensure that wages and salaries are paid in Japanese currency, which has been considered the most accessible means of exchange.

As such, digital payroll payments have not been allowed because they would have violated the Labor Standards Act.

However, since it is not feasible to pay all salaries in physical currency, non-currency payments are permitted as long as they are a reliable method of paying wages and salaries and are approved by a ministerial ordinance issued by the MHLW (the “Ministerial Ordinance”). Bank transfers to bank accounts have long been permitted by Ministerial Ordinance as a method of paying wages and salaries as a form of non-currency payments. And from April 2023, digital payroll payments will also be permitted by Ministerial Ordinance as other non-currency payment methods for wages and salaries. However, it should be noted that the payment of wages or salaries with non-cashable points or crypto-assets is not permitted.

Requirements for funds transfer service providers to handle digital payroll payments

In order to handle digital payroll payments, funds transfer service providers must possess the “Type II funds transfer services licence”, which involves only funds transfers with a maximum amount of JPY1 million per transfer. As of 31 December 2022, there are 83 funds transfer service providers – all of whom hold Type II funds transfer services licences. Fund transfer service providers must also fulfil the following requirements – which were established to address the

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question of whether digital payroll payments are as reliable as paying wages and salaries to employees by bank transfer – in order to be designated by the MHLW before they can handle digital payroll payments.

- Funds transfer service providers are required to set the maximum amount of funds that can be deposited to the account of employees receiving their wages and salaries at JPY1 million and, if the deposited amount exceeds JPY1 million, to promptly reduce the deposited amount to JPY1 million or less – for example, by promptly transferring the excess amount to a savings account designated in advance by the employee, thereby ensuring the total amount of funds in the employee's account does not exceed JPY1 million.
- Funds transfer service providers must have a mechanism in place to ensure the prompt payment of employees' salaries in the event of difficulties in making digital payroll payments, such as petitions for the commencement of bankruptcy proceedings, the commencement of rehabilitation proceedings, or the commencement of reorganisation proceedings.
- Funds transfer service providers must also have a mechanism in place to fully compensate employees if their funds are wrongfully withdrawn from their accounts by the funds transfer service provider used for receiving digital payroll payments as a result of unauthorised instructions not given by the employee (or given against the will of the employee) and if the employee is not at fault.
- Funds transfer service providers must have a mechanism to ensure that employees have access to their accounts for receiving wages and salaries for at least ten years after the last funds transfer was made to such accounts.

- Funds transfers to and from accounts must be made in units of JPY1.
- Measures must be in place to allow the withdrawal of funds in the funds transfer service provider's account in units of JPY1 at least once a month, without incurring fees or other charges, using methods such as automatic teller machines (ATMs) or cash dispensers – or by transferring the funds to a savings account.
- Funds transfer service providers must have a system in place to report promptly to the MHLW on the status of their operations and financial situation in relation to making digital payroll payments.
- Funds transfer service providers must also have the technical expertise to effectively and reliably provide digital payroll payment services and have sufficient public trust.

Requirements for employers to introduce digital payroll payments

Employers intending to introduce digital payroll payments must first obtain the individual consent of their employees after explaining the above-mentioned requirements to be met by funds transfer service providers. Employers must also offer their employees the option of using traditional non-currency payment methods, such as bank transfers, which have long been accepted for making such payments.

Web3/Crypto

Initiatives for developing Web3

The Japanese government is currently looking to Web3 and start-ups as engines of growth of the Japanese economy and it promoted various relevant government policies in 2022. The key trends among these policies were the intensive discussions at the government and private levels regarding the promotion of Web3 and the blockchain-based ecosystem in Japan, includ-

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ing non-fungible tokens (NFTs) and decentralised autonomous organisations (DAO).

In March 2022, the project team responsible for NFT policies within the Digital Society Promotion Headquarters of the Liberal Democratic Party, the ruling party in Japan, announced the “NFT White Paper: Japan’s NFT Strategy for the Web3 Era” (the “NFT White Paper”). In response to the NFT White Paper and governmental policies, the Web3 Study Group was established under the Digital Agency. This group conducted hearings and held discussions with regard to creating an environment for the promotion of Web3, leading to the publication of a report by the group in December 2022. The report presents basic guidelines for the healthy development of Web3 and introduces discussions on:

- digital assets;
- DAO;
- Decentralised Identity (DID);
- relationship with the metaverse; and
- user protection and legal enforcement.

In addition to discussions at the government level, private-level discussions are also moving forwards. Industry associations related to cryptocurrency/NFT businesses in Japan are discussing issues and working on designing rules through the development of self-regulatory guidelines – for example, the Japan Cryptoasset Business Association published an update to the Guidelines for NFT Businesses in March 2022. The Council for Sports Ecosystem Promotion, an industry association for sports, also published a guideline on NFT package sales using sports content and the establishment of secondary markets (the “NFT Guideline”) in September 2022. The NFT Guideline explains the possibility that NFT package sales, together with the establishment of secondary markets,

may not fall under gambling under Japanese law and can be legally developed while considering consumer protection. It also outlines the legal framework for returning a part of the sales from the secondary market to a content holder who minted an NFT. Although these guidelines are non-binding soft law, they should be referred to when considering conducting NFT package sales.

Developments relating to Stablecoins in Japan

In recent years, stablecoins such as USDC, USDT and BUSD have been widely circulated internationally through the blockchain. Stablecoins are designed to maintain stability in their value, unlike other volatile cryptocurrencies such as Bitcoin. In order to achieve this stability, stablecoins are often pegged to the value of a stable asset, such as the US dollar or other fiat currency.

The legal status of stablecoins was unclear under Japanese law, owing to the lack of an established regulatory framework in their circulation. In order to clarify the legal status of stablecoins in Japan, the Payment Services Act and other laws were amended in June 2022. This amendment established a regulatory framework for stablecoins. In December 2022, drafts of regulations related to the Payment Services Act (including Cabinet Office Ordinances and guidelines) were also published. It is anticipated that these regulations will be officially introduced in 2023, solidifying the regulatory framework for stablecoins.

The amendments to the Payment Services Act and other laws will result in certain stablecoins being classified as the “electronic payment instruments” (EIs). In the case of EIs, there are regulations for issuers and those for intermedi-

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aries. Generally, entities that issue and redeem EIs are required to hold either a banking services licence or a funds transfer services licence, as they are considered to be engaged in funds transfer transactions that require those licences. However, amendments to the Payment Services Act and related laws will allow certain trust companies that meet the requirements of the Act to issue stablecoins in the form of beneficiary interests in trusts. The issuers of these stablecoins will be subject to the regulations that apply to the respective licences they hold.

On the other hand, under regulations for intermediaries, those who are involved in the buying, selling or brokering of stablecoins regarded as EIs are generally required to register as “electronic payment instrument trading service providers (EISPs)” under the Payment Services Act and must comply with the regulations applicable to EISPs. By way of an example, EISPs are required to segregate EIs deposited by users from their own assets. In addition, EISPs are required to enter into an agreement with the issuer of EIs that the EISP is buying, selling or brokering, in relation to the sharing of liability for damage to users in the event of such damage.

EISPs may also handle stablecoins issued outside Japan if certain requirements regarding foreign EIs are met. If EISPs handle stablecoins issued outside of Japan, for example, the published draft of the Cabinet Office Ordinance provides that they must implement asset security measures such as ensuring that they have the capacity to purchase all the EIs they hold on behalf of users.

Moreover, according to the published drafts of guidelines, even if the issuer of stablecoins holds a licence equivalent to a funds transfer services licence in a foreign country, such licence alone

does not permit the solicitation of the issuance or redemption of such stablecoins in Japan.

The draft of the Cabinet Office Ordinance concerning stablecoins has yet to be finalised and, as such, its and other regulatory developments should be continuously monitored.

Trends in Japanese cryptocurrency regulations

In November 2022, FTX Trading Ltd, a major international cryptocurrency exchange, was filed in Chapter 11 bankruptcy protection along with approximately 130 affiliated entities. FTX Japan KK, a Japanese crypto-asset exchange, is part of the group of legal entities affiliated with FTX Trading Ltd. As a result, FTX Japan KK is subject to FTX Trading Ltd’s Chapter 11 bankruptcy proceedings. In response to reports of credit-related issues with FTX Trading Ltd, on 10 November 2022, the Kanto Local Finance Bureau (KLFB) issued a one-month business suspension order to FTX Japan KK in order to promptly suspend new transactions by FTX Japan KK crypto-asset exchange users and to ensure that its assets are not transferred to an affiliated company outside of Japan, which could be potentially harmful to users. Subsequently, on 9 December 2022, the KLFB extended the business suspension order until 9 March 2023. However, if the Japanese regulator confirms that FTX Japan KK has a proper system in place for conducting all aspects of its crypto-asset exchange services, it can promptly return the fiat currency and crypto-assets it holds on behalf of its users and the suspension period would be over.

On December 29, 2022, FTX Japan KK announced that users should be able to make withdrawals from mid-February 2023. FTX Japan KK is registered as a crypto-asset exchange services provider (CAESP) in Japan and is subject

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to various regulations to protect users under the Payment Services Act. In particular, CAESP must segregate the funds held for users from their own funds and entrust them to a trust company or similar entity. In addition, CAESP must hold users' crypto-assets separately from their own crypto-assets and private keys must be stored in a cold wallet that is not connected to the Internet at any time.

According to publicly available materials on FTX Japan KK dated 7 February 2023, FTX Japan KK holds more than the deposit balances of users' various crypto-assets in cold wallets and it is anticipated that users' assets will be returned to them.

In light of past incidents, such as the Mt GOX and Coincheck cases, strict regulations have been established for CAESP in Japan. It seems that these strict regulations were effective in protecting users in the FTX case.

AML/CFT

Amendment to the Foreign Exchange and Foreign Trade Act

In response to the international situation following the invasion of Ukraine in February 2022, Japan has imposed economic sanctions against specific individuals and entities in Russia and Belarus. There is concern that such economic sanctions may be bypassed or their effectiveness impeded by the use of digital assets. Therefore, in order to enhance the effectiveness of payment and capital transactions regulations under the Foreign Exchange and Foreign Trade Act (the "Foreign Exchange Act"), the amendment of the Foreign Exchange Act came into effect on 10 May 2022.

The amended Foreign Exchange Act subjects transactions involving crypto-assets to capital

transaction regulations. It also imposes confirmation obligations on CAESPs regarding asset-freezing measures.

Amendments to AML/CFT applicable laws and regulations in response to FATF recommendations

Japan has been enhancing its AML/CFT and anti-proliferation measures in response to the Fourth Round Mutual Evaluation Report of Japan released by the Financial Action Task Force (FATF) on 30 August 2021. Japan promulgated amended laws on 9 December 2022, primarily aimed at strengthening its asset-freezing measures, AML measures, and crypto-assets handling measures.

Amendments aimed at strengthening the handling of crypto-assets include the following:

- Amendments to the Act on Prevention of Transfer of Criminal Proceeds (APTCP) require CAESPs to inform the transferee CAESP of the sender and recipient information when transferring crypto-assets (ie, the "travel rule").
- Amendments to the Foreign Exchange Act require CAESP and banks, among other institutions, to establish a framework for properly implementing asset-freezing measures.
- Amendments to the Foreign Exchange Act have strengthened asset-freezing measures for transactions involving residents and non-residents relating to stablecoins.

AML/CFT regulations relating to prepaid payment instruments issuers

As regards prepaid payment instruments (PPIs), there is currently no requirement under the APTCP to verify the identity of individuals in transactions (ie, the KYC process is not required) or to report suspicious transactions involving

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PPIs. As a result, PPIs that involve a considerable amount of funds – or that can be transferred – have a high risk for money laundering and terrorist financing. In light of this, concerns about the absence of the above-mentioned requirement were raised in terms of AML and CFT regulations.

In response to these concerns, the Payment Services Act and the APTCP were amended to create a category of “high-value electronically transferable prepaid payment instruments”. This category applies to third-party PPIs that are capable of electronic transfer and that meet certain monetary thresholds. The amendments require that these instruments be subject to identity verification at the time of transaction and to reporting requirements for suspicious transactions. Moreover, issuers of high-value electronically transferable PPIs must also apply for registration and submit a business implementation plan.

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has always been regarded as a pioneer in the Japanese finance market, having been involved in numerous innovative and epoch-making transactions. The firm's fintech team consists of experienced lawyers from a wide variety of practice fields, including financial regulations, M&A/corporate, IT, tech, IP, data protection, cybersecurity, antitrust and tax. NO&T provides its clients with innovative and comprehensive solutions suited to the fast-developing fintech field.

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