

STOs in Japan

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3/30/2023

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1

What are the different kinds of digital tokens that you see in Japan?

What are the different kinds of digital tokens that you see in Japan?

1. Crypto-currency

2. Commodity tokens

e.g. tokens linked to the price of gold.

3. Utility tokens

e.g. tokenized rights provided by Tokyo Dome, such as membership rights related to its services.

4. Governance tokens

e.g. project by film directors where they work with fans to create new works of art.

5. Stablecoins

6. Digital securities (security tokens)

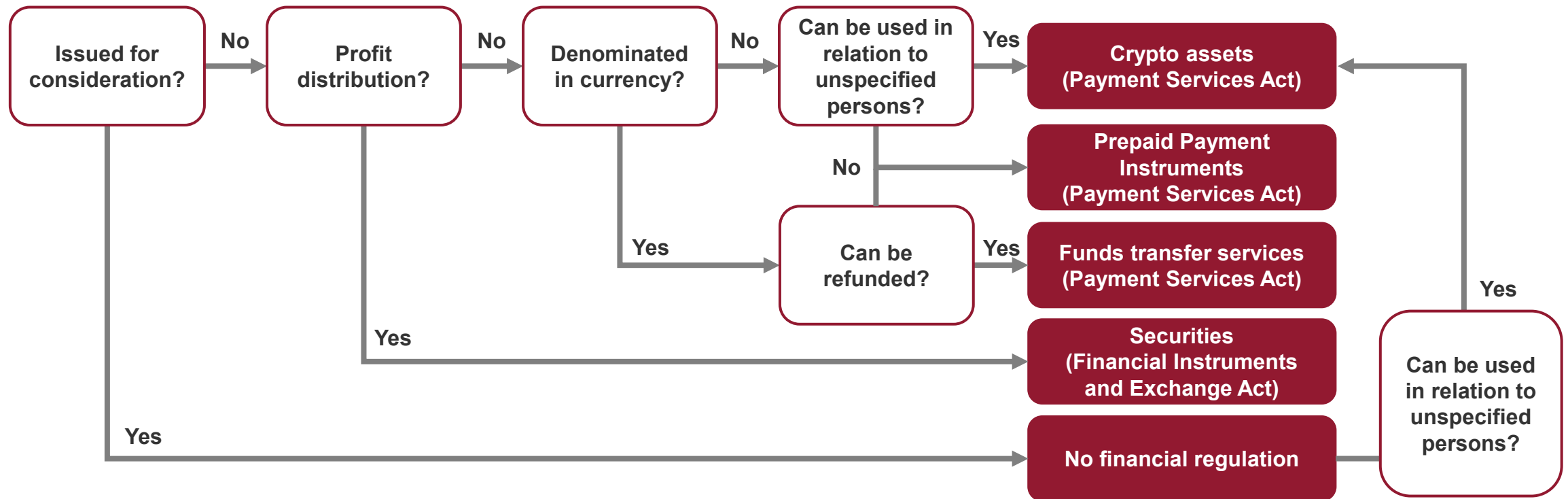
Test cases appear from 2020.

Types:

- Corporate finance – debt
- Asset securitization – fund interests, beneficiary rights

How are these classified and regulated?

- The laws applicable to tokens are quite complex. Regulation is determined mainly by:
 - the rights represented by the tokens
 - the manner in which they are transferred



- Also, there will be another framework for stablecoins: “electronic payment instruments”

2

What are some of the legal considerations for doing an STO?

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1. Only limited types of securities can be tokenized

- Securities that do not fit into the transfer restrictions practice
- Securities requiring delivery of certificates for transfer

➔ Cannot be tokenized

e.g. Shares

- • • Transfer restrictions need to be implemented to avoid transfers outside the blockchain (otherwise, they can be transferred by verbal agreement).

e.g. Preferred equity issued by a special purpose company under the Act on Securitization of Assets

- • • Required to deliver certificate for transfer

What are some of the legal considerations for doing a STO?

2. Disclosure Requirements

Primary

- Generally, a securities registration statement must be filed in advance when conducting an “offering of securities” under the Financial Instruments and Exchange Act (FIEA).
- Security tokens are deemed as “paragraph (1) securities” and are subject to more stringent disclosure requirements.
 - paragraph (1) securities: deemed as public offering if 50 or more persons are solicited
 - paragraph (2) securities: deemed as public offering if 500 or more persons become holders of securities
- ➔ Generally, an STO is considered as a public offering and therefore requires a securities registration statement.

Secondary (Continuous Disclosure)

- If a securities registration statement is filed for the issuance of tokens, there will also be subsequent continuous disclosure obligations.

What are some of the legal considerations for doing a STO?

3. Licensing requirements for financial instruments businesses

- Registration under the FIEA is required for the trading and other transactions of security tokens and for investment management activities.
- For securities firms that are already registered, an amendment to the registration is required.

[Services and necessary licenses]

Underwriting Handling of offerings Acceptance of security deposits	Type-I Financial Instruments Business
Self-offering of fund interests	Type-II Financial Instruments Business

- The registration process is lengthy as an audit of system aspects by the Japan Security Token Offering Association is required in addition to regulatory review/approval by the Japan Financial Services Agency. To date, the registration of major securities firms has been completed.

3

What are some of the key risks involving STOs

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1. Exit options for investors are very limited

- Currently, there is almost no secondary trading platform for security tokens.
- Only certain securities firms provide exit opportunities through over-the-counter transactions.

[Three types of license requirements]

Financial instruments exchange	License for financial instruments exchange operator
Proprietary Trading System (PTS)	Type-I Financial Instruments Business + license for PTS
Over-the-Counter	Type-I Financial Instruments Business

- PTS licenses being sought (but difficulties).
 - There is no clear legal framework for PTS for STs.
 - The Japan Securities Dealers Association and the Japan STO Association are currently discussing the development of a self-regulatory rules for PTSs.

What are some of the key risks involving STOs

2. Disclosure of information in the secondary market

- Japan has two sets of disclosure regimes:

Financial Instruments and Exchange Act	Annual Securities Report Extraordinary report
Stock Exchange Rules	Earnings Report Timely Disclosure (Press Release)

- STs are not listed on a stock exchange and are only subject to disclosure under the FIEA.
 - ➔ Under discussion whether additional disclosure on STs should be required, and if so, what kind.

What are some of the key risks involving STOs

3. Perfection requirements of transfer

- The perfection requirements for the transfer of certain types of security tokens cannot be met online.
 - Instruments bearing a certified date are required in some cases.
 - ➔ The perfection requirement cannot be met in the system, because the instruments must be prepared in person at a notary office.
- e.g. Interests in silent partnership (*Tokumei Kumiai*)
 - One of the schemes for asset securitization
 - Perfection for transfer requires an instruments bearing a certified date.
 - ➔ Transfer of records on the blockchain can effect a transfer of silent partnership interests, but this alone does not satisfy the perfection requirement.
- Recent amendment to Act on Strengthening Industrial Competitiveness
 - An exception that allows the perfection requirement to be completed in the system.
 - The business operator providing the system for this purpose must be certified by the authorities.

4

What is the outlook for STOs in Japan?

What is the outlook for STOs in Japan?

- **Progress in practice under the framework of the revised FIEA**

- Increased number of more commercial initiatives from test cases
- Diversification of cases

- **Movement toward further evolution of the legal system**

- Practical use of information systems to meet the perfection requirements under the Act on Strengthening Industrial Competitiveness
- Establishment of a PTS for secondary trading of security tokens
 - ➔ Given this situation, we expect to see the emergence of even more highly practical projects, projects combined with stablecoin.

Lawyer profile



Masayuki Ishibashi

Partner

admitted in Japan, 2010

in New York, 2017

Daini Tokyo Bar Association

New York State Bar Association

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Practice Area

- **Fintech and Financial Regulations**
Advising companies and financial institutions on a wide range of issues related to STOs, crypto assets, exchange operator registration, compliance issues and other fintech-related matters.
- **Finance / Capital Markets**
Involved in fundraising projects for domestic and foreign companies, including equity and debt offerings, rights offerings, and third-party placements.

Background

- The University of Tokyo (B.S.Econ., 2007)
- The University of Tokyo, School of Law (J.D., 2009)
- New York University School of Law (LL.M., 2016)
- New York University Stern School of Business (Advanced Professional Certificate in Law and Business, 2016)
- with Simpson Thacher & Bartlett, New York, Tokyo (2016-2017)

Recent Award

- Ranked as Rising Star Partner by IFLR1000's 32nd edition

Major Activities

- Member of Nippon Finance Association
- Member of Study Group on Proprietary Trading Systems (PTSs) for Unlisted Securities, Etc., Japan Securities Dealers Association and Japan Security Token Offering Association (2022-)
- Study Group on Utilization of Digital Bonds in ESG Investing, JPX Market Innovation & Research, Inc. (2022-)

Recent Publications

- "Instruction for Security Token Offering of Tokenized Property Fund Interests" (2022)
- "Crypto-Asset Trading, STO and Related Misconduct" (2022)
- "Comprehensive Analysis of M&A Laws of Japan, 2nd edition" (2022)
- "The Theory and Practice of Equity Finance [3rd ed.]" (2022)
- "Legal Transformation; Business Rule Change 2022" (2022)
- "Cryptoassets Law" (2020) and others