

November 10, 2023

RWA Tokens under Japanese Law

So Saito
Kazuki Imanari
So & Sato Law Offices

I Introduction

Recently, Web3 companies often ask us whether they can issue and sell tokens linked to ownership or value of real world assets (“**RWA tokens**”) in Japan. The types of linked real assets include artwork, real estate, whiskey, vintage cars, government bonds, securities, gold, etc.

Applicable Japanese regulations to RWA tokens vary depending on the types of tokenized assets and the scheme. We will provide an overview of the applicable regulations to RWA tokens and then substantive legal issues of RWA tokens.

II Crypto Regulation

Japanese law differentiates crypto assets, which are regulated, and NFTs, which are not regulated, and most RWA tokens are structured as NFTs.

If RWA tokens fall under the category of crypto assets, selling and purchasing the tokens as a business requires a crypto asset exchange license. For example, Zipang Coins, which are RWA tokens representing gold and issued by a Japanese major trading company group, are structured as crypto assets, and only licensed exchanges can sell them as a business.

On the other hand, most RWA tokens are structured as NFTs. From the legal viewpoint, the difference between crypto assets and NFTs is whether they can be used as a payment method. FSA has submitted a guideline and answers to public comments and stated that if tokens satisfy the following requirements, they are not crypto assets and are not regulated under the Payment Service Act.

Required Factors to be considered as not regulated Crypto Asset but non-regulated NFTs

(i) the use as a means of payment to unspecified persons is prohibited, and (ii-a) the number of issued tokens is less than 1 million, or (ii-b) the transaction price is more than JPY 1,000.

III Fund Regulation

If RWA tokens are considered securities, to sell and purchase the tokens as a business requires a financial instruments business operator license. If the token holder has the right to receive a dividend or more than 100% principal redemption, they are generally considered

securities. The definition of the collective investment scheme (fund) in Japan is as follows. As the definition covers “all rights” that can receive a dividend or more than 100% principal redemption, you should carefully analyze whether the tokens are considered securities when its structure includes a profit distribution element.

Definition of the Funds under Japanese law

(A) (i) partnership contracts, (ii) silent partnership agreements, (iii) limited partnership agreements for investment, (iv) limited liability partnership agreements, (v) membership rights in incorporated associations, and (vi) other rights (excluding those under foreign laws and regulations).

(B) The Investor(s) receives the right to receive dividends of income or distribution of properties that arise from a business conducted by using money (including crypto assets) invested or contributed by the investor(s).

(C) None of the following

(a) the case where all of the investors are involved in the business subject to the investment (in the way specified by a Cabinet Order)

(b) the case where the investor(s) shall not receive dividends or principal redemption more than their investment

(D) Funds under Foreign Law (rights under foreign laws that are similar to the above rights)

IV Goods Deposit Transaction Regulation

Another regulation that is related to RWA tokens is the Goods Deposit Transaction regulation. In Japan, there have been some controversial transactions in which (i) a merchant sells some goods to buyers, (ii) the merchant accepts deposits of the sold goods from the buyers for more than 3 months, and (iii) the merchant promises to pay some fee such as a rental fee to the buyers or promises to buy-back the sold products more than the sales price. These kinds of transactions were often used as financial investments without regulation. The Goods Deposit Transaction regulation now regulates these kinds of transactions. The regulation requires an explanation to buyers if the transaction involves the above (ii) and (iii) elements and requires approval from the government if the transaction involves the above (i), (ii), and (iii) elements. Please note that there has been no case the approval was obtained yet, and, thus, no one knows the difficulty of obtaining the approval.

We are often asked the way to give economic benefit to RWA token holders. Simply giving

the economic in principle causes the issues of both or either of fund regulations and goods deposit transaction regulation and makes token issuance not feasible.

V Prepaid Payment Instruments

There are RWA tokens that give a right to acquire products or use products such as hotel rooms, etc. Issuance of tokens linked to the right to acquire or use real assets is, in principle, subject to prepaid payment instrument regulation under the Payment Services Act. Some RWA tokens give those rights to holders and are subject to the regulation. For example, Not A Hotel NFT, which gives a holder to stay in a luxury residence, is subject to the regulation.

There are two types of prepaid payment instruments. The first type is the private-type prepaid payment instrument, which can be used only against the issuer or its closely related persons. The issuer of the private prepaid instrument shall file a notification to the Finance Bureau and deposit half amount of the unused amount, except for the case when the issuer only issues instruments that have less than 6 months' expiration date or the unused balance at a certain reference date is 10 million yen or less.

The second type is the third-party type prepaid payment instrument, which can be used against other than the issuer or its closely related persons. The issuer of the third-party type prepaid payment instruments shall register with the Finance Bureau, except for the case when the issuer only issues instruments that have less than 6 months' expiration date.

VI Secondhand Goods Business Regulation

A business that sells, purchases, or exchanges once-used goods such as used cars, used bags, used jewelry, and published artwork is, in principle, subject to the secondhand goods business regulation. A person who conducts the secondhand goods sales and purchase business shall file a notification to the police agency and shall conduct KYC of its customers. It is conceivable, however, that this regulation would not apply to the division and sale of the right of secondhand goods, and thus RWA tokens, which related to the divided right of real goods, are exempted from the regulation.

VII Other Regulation

In addition to the above, sales, etc., of assets might require consideration of asset-specific regulations. For example, to sell alcohol needs an alcohol sale license, and the seller of RWA tokens UniCask, which relates to a barrel of whiskey, takes the alcohol sale license.

VIII Substantive Legal Issues

Compared to a simple sale of real world assets, RWA tokens require more careful

consideration of what rights will be transferred and how to perfect the transfer. Holding RWA tokens does not necessarily mean having ownership of real assets, and transferring RWA tokens does not necessarily mean automatically transferring the ownership of the real assets.

For example, when you transfer real estate, you need to file a real estate transfer registration, and without it, you cannot insist that you are the owner of the real estate to third parties, and just transferring tokens on a blockchain may not suffice this requirement. To transfer tangible property in Japan might be possible just by transferring tokens, but careful consideration is necessary. The law regarding the transfer and perfection of real assets may vary in different jurisdictions, and generally, the laws in the country where the real asset is located apply.

Disclaimer

The content of this article has not been confirmed by the relevant authorities or organizations mentioned in the article but merely reflects a reasonable interpretation of their statements. The interpretation of the laws and regulations reflects our current understanding and may, therefore, change in the future. This article does not recommend investment in RWA tokens. This article provides merely a summary for discussion purposes. If you need legal advice on a specific topic, please feel free to contact us.