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## Staking/Restaking under Japanese Law

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### 1. Introduction

As seen in Ethereum network, staking—the process of locking a certain amount of crypto assets on a blockchain for a set period to contribute to transaction validation (Proof of Stake), earning rewards in return—is gaining traction globally as well as in Japan. Major Japanese crypto asset exchanges now offer staking services, contributing to its expansion. This paper outlines key legal issues related to staking under Japanese law and briefly addresses the concept of restaking, which is a mechanism in which existing staked crypto assets or staking rewards are staked again to earn additional rewards, with the aim of enhancing network security and enabling new services.

### 2. Legal Issues Related to Staking Under Japanese Law

Regulatory applicability depends on the manner in which staking is conducted and its legal framework.

Relevant regulations include those governing Crypto Asset Exchanges and Funds as referenced and further explained below.

Staking one's own crypto assets remains unregulated under such regulations, therefore, this discussion focuses on cases where a service provider stakes on behalf of users. To summarize the key conclusions in advance:

Staking Structure and Legal Framework	Applicability of Crypto Asset Exchange Regulations / Fund Regulations as per Japanese Law
Service provider does not receive the user's private key (only delegation)	No applicable regulations
Service provider receives the user's private key	
Legal structure: "Custody"	Crypto Asset Exchange regulations apply (registration as a Crypto Asset Exchange)
Legal structure: "Investment"	Fund regulations apply (registration as a Type II Financial Instruments Business Operator)
Legal structure: "Lending"	No applicable regulations

Custody, Investment, and Lending are key legal classifications in the regulatory framework for staking services. While details will be discussed later, these terms can be briefly defined as follows:

- ✓ Custody refers to the management of crypto assets on behalf of users. Possession of private keys is a key factor in determining regulatory applicability of Custody. If structured as Custody, it falls under Crypto Asset Exchange regulations under the Payment Services Act (PSA).
- ✓ Investment refers to a scheme where users contribute funds (including crypto assets) to a service

provider, which then utilizes them for business operations (e.g., staking) and distributes profits to the users. If structured as Investment, it falls under Fund regulations governed by the Financial Instruments and Exchange Act (FIEA).

- ✓ Lending refers to an arrangement where users lend their crypto assets to a service provider, which manages the crypto assets at its discretion and returns them after a specified period. If recognized as a Lending agreement, it is generally not subject to PSA or FIEA regulations.

### **3. A Short Introduction to Crypto Asset Exchange Regulations and Financial Regulations**

Under Japanese law, Crypto Asset Exchange regulations under the PSA, Article 2, Paragraph 15, apply to the following activities:

1. Buying, selling, or exchanging crypto assets.
2. Intermediating, brokering, or acting as an agent for these activities.
3. Managing users' funds related to 1 and 2.
4. Managing crypto assets on behalf of others.

Among these, staking is particularly relevant to Item 4., which refers to the Custody services.

Regarding "managing crypto assets on behalf of others" (hereinafter referred to as "Custody"), the Financial Services Agency (FSA) guideline<sup>1</sup> states:

*"[...] in a case where the business operator is in a state in which the business operator is able to proactively transfer a Crypto-Asset of a user, such as a case where the business operator holds a secret key [Author's Note: referring to a private key] sufficient to enable the business operator to transfer the Crypto-Asset of the user without any involvement of the user, either alone or in cooperation of an affiliated business operator, such a case falls under the management of Crypto-Assets."*

This indicates that possession of private keys is a key factor in determining regulatory applicability of Custody.

Additionally, staking may also be subject to Fund regulations governed by FIEA (Article 2, Paragraph 2, Item 5). This FIEA applies where users contribute funds (including crypto assets) to a service provider, which then utilizes them for business operations and distributes profits to the users.

#### **(a) Case where the service provider does not hold the user's private key**

If a service provider only receives delegation from users without holding their private keys<sup>2</sup>, it does not qualify as a Custody activity under the FSA guideline as quoted above and is not subject to Crypto Asset Exchange regulations under the PSA. Additionally, in this case, since users do not contribute

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<sup>1</sup> <https://www.fsa.go.jp/common/law/guide/kaisya/e016.pdf>

<sup>2</sup> Artzt/Richter (ed.), International Handbook of Blockchain Law, 2<sup>nd</sup> edition, 2024, at 21.

funds to the service provider —given that the service provider cannot transfer the crypto assets for business operations without possessing the private key— it does not constitute an "Investment" and therefore, Fund regulations under the FIEA do not apply either.

**(b) Case where the service provider holds the user's private key**

If a service provider holds the user's private key, it may be classified as a Custody activity under the PSA. Additionally, depending on the legal structure of the arrangement, the user's contribution could be considered an "Investment," making it subject to Fund regulations under the FIEA.

First, if the arrangement is structured as a "Custody," the provider is deemed to be managing the user's crypto assets on their behalf. This qualifies as a Custody activity under Crypto Asset Exchange regulations and falls under the Payment Services Act (Article 2, Paragraph 15, Item 4).

If the legal structure is such that the provider receives "Investment" of crypto assets from users, it does not meet the Custody regulation requirement of "managing crypto assets on behalf of others," as the assets are received for business use rather than for custodial management on behalf of users. Therefore, Custody regulations under the PSA do not apply. However, since the provider uses the contributed funds to operate a business (staking) and distributes the revenue to users, it is likely subject to Fund regulations under FIEA.

If the arrangement is structured as Lending, where the user lends crypto assets to the service provider, which manages them at its discretion and returns them after a specified period, rather than making a Custody (where assets are held and managed on behalf of the user) or an Investment (where assets are contributed with an expectation of return), no specific regulations apply. However, according to the aforementioned FSA guideline<sup>3</sup>, "*The borrowing of Crypto-Assets [...] falls under the management of Crypto-Assets [...] if a business operator substantially manages a Crypto-Asset on behalf of another person under the name of the borrowing of a Crypto-Asset such that the user can receive the return of the Crypto-Asset borrowed at any time at the request of the user.*"

Therefore, regulatory authorities may classify such circumvention schemes as a Custody activity, making them subject to Custody regulations under the PSA.

Thus, even when a service provider holds the user's private key and conducts staking, the applicable regulations vary depending on the legal structure of the arrangement. However, in practical business operations, the distinction between "Custody", "Investment" and "Lending" is not always clear. To determine the applicable regulations, it is useful to analyze the staking scheme based on the following factors:

1. Whether the rewards are received by the service provider and then distributed to the user, or

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<sup>3</sup> <https://www.fsa.go.jp/common/law/guide/kaisya/e016.pdf>

- are they directly distributed to the user.
2. If the service provider receives the rewards first and then distributes them to the user, and whether the distribution is fixed or linked to revenue.
  3. Whether the slashing risk, which refers to the risk of staked assets being partially or fully slashed if a validator violates network rules or engages in misconduct, is borne by the service provider or the user.

Based on these factors, the conclusions for typical cases are summarized as follows. However, if a case does not fit within these typical scenarios, determining whether it qualifies as Custody service or a Fund Investment can be challenging.

- If the amount of rewards paid by the service provider to the user is predetermined and the user does not bear the slashing risk: Custody regulations (i.e. PSA) apply.
- If the amount of rewards paid by the service provider to the user is linked to the staking rewards earned by the service provider, and the user bears part of the slashing risk (i.e., there is no principal guarantee): Fund regulations (i.e. FIEA) apply.
- If the arrangement is structured as a crypto assets Lending agreement, and in substance, it is recognized as a Lending rather than a demand payment or similar arrangement (i.e., one where users can request repayment at any time, meaning the service provider cannot manage the crypto assets at its discretion for a specified period, thereby lacking a key element of Lending): Neither PSA or FIEA apply.

The licenses required for service providers under each scheme are summarized as follows:

- If classified as a Custody activity, registration as a Crypto Asset Exchange is required.
- If classified as a Fund, registration as a Type II Financial Instruments Business operator is required.
- If classified as Lending, no registration is required. However, if a financial instruments business operator engages in a Lending business, approval for ancillary business under the FIEA is required.

#### **4. Legal Issues Related to Restaking Under Japanese Law**

##### **(1) Structure of Restaking**

Restaking is a scheme where crypto assets that have already been staked are staked again in another protocol.

The demand for restaking arises from two key factors: enhance security of certain decentralized finance (DeFi) protocols and similar services and enabling users to obtain higher yields. If a DeFi service uses its own Proof of Stake token for validation of transactions and hence its security, its

effectiveness may be limited due to low token value or poor distribution and can be open to security vulnerabilities through holding a significant number of the related tokens. Restaking solves this by reusing staked crypto assets (e.g., ETH) to provide the security of major public blockchains like Ethereum. In return, DeFi services share rewards with crypto assets holders, who also bear slashing risks. This allows holders to earn additional rewards on top of their staking returns, boosting overall yields.

## **(2) Legal Issues Related to Staking Under Japanese Law**

The key legal issues related to restaking under Japanese law include:

1. Whether the holding of users' crypto assets by a restaking service qualifies as a "Custody" service, potentially making them subject to custody regulations (i.e. PSA).
2. Whether the distribution of rewards to users, along with their exposure to slashing risk, could fall under Fund regulations (i.e. FIEA).

Regarding Custody regulations, the applicability of Custody regulations depends on the structure of the restaking service. However, based on the previously mentioned stance of the FSA on Custody, if the crypto assets are managed by a smart contract and the restaking service provider does not have the technical ability to transfer the crypto assets, Custody regulations would not apply.

Regarding Fund regulations, the application of Fund regulations requires that the contributed assets be used to conduct a business. In the case of restaking, if crypto assets are merely locked as a form of collateral to cover potential penalties from slashing, rather than being allocated for business operations, it would not meet the legal definition of an Investment. Therefore, Fund regulations would not apply. Note that, as with staking, the applicable regulations may vary depending on the specific structure of the restaking scheme.