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Japan: Trends and Developments

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Trends and Developments

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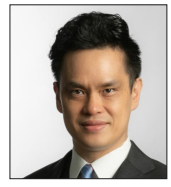

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Current State of AI Regulation in Japan

Overview

Japan does not currently have comprehensive, cross-sectoral legislation specifically dedicated to AI, but discussions are underway regarding possible legislation in the near future.

Since May 2023, the government has been working on a strategy to strengthen competitiveness and ensure safety in the field of AI, as outlined in the "Interim Summary of Issues Related to AI" (AI Strategy Council) and "Approach to AI Systems" (AI Strategy Team), and the "Integrated Innovation Strategy 2024" (Cabinet Decision). In addition, in April 2024, the Ministry of Internal Affairs and Communications and the Ministry of Economy, Trade and Industry jointly released the "AI Business Operator Guidelines (Version 1)", which set out their approach to the development, provision and use of AI systems. Further, in July 2024, the government established the AI Regulation Study Group under the AI Strategy Council to explore how AI should be governed, including whether legislation is necessary. The draft interim report drafted by the AI Regulation Study Group was released in December 2024 subject to the public consultation process.

Outline of the draft interim report

Basic framework for regulation

The interim report envisions three primary actors that could be subject to regulation – "AI developers", "AI providers", and "AI users" – and states explicitly that foreign-based entities are also subject to the regulation. With regard to AI, while it is necessary to promote innovation through support for research and development, the development of data and computing resources, and the development of human resources, it is also necessary to address the risks associated with AI, such as the generation of false information. While utilising existing laws (such as the Personal Information Protection Act and the Copyright Act), it is necessary to establish the appropriate rules in case new risks emerge. The interim report proposes a policy that combines measures based on soft law (eg, guidelines) and legislation as appropriate to the situation, but the basic policy is to respect the autonomy of business and to limit measures based on legislation to those cases where it is not possible to expect appropriate measures based on the autonomous efforts of business. It also emphasises alignment and interoperability with international frameworks such as the Hiroshima AI Process and OECD AI Principles.

Specific policy directions

The interim report emphasises the importance of government as a "control tower" that can coordinate policy and develop a comprehensive strategy. Proposed measures include creating mechanisms for information sharing among businesses, exploring certification systems for AI solutions, and instituting government-led investigations and public disclosures when serious incidents occur.

It suggests that the government itself should take the initiative in using AI to promote its use in Japan. There is also discussion of clarifying procedures for the safe and secure use of AI by developing government procurement guidelines.

Although existing legislation may cover certain areas – such as medical devices, autonomous vehicles, and social infrastructure – further development of regulation may be required as AI technology advances. The interim report also highlights the importance of preparing for systemic risk (arising from multiple interconnected AI systems), as well as exploring measures to address potential threats involving chemical,

biological, radiological and nuclear (CBRN) or cybersecurity concerns.

Future steps

To achieve a balance between promoting innovation and managing risks, the government will first develop guidelines for AI in general, and encourage businesses to proactively ensure transparency and proper practices. At the same time, the government will study and understand risks related to life and physical safety and national security, and in the event of a serious problem, the government is required to take measures and provide support by utilising existing laws and regulations. Furthermore, in addition to voluntary efforts by businesses, legislative measures are needed to ensure effectiveness. However, it is necessary to proceed with the development of legislation while taking care not to stifle innovation. Ultimately, the interim report proposes the development of an AI-related regulation that will most facilitate AI research and development and implementation, and serve as a model for other countries.

The above is only an interim draft report, and while it remains uncertain whether legislation will be enacted, it is important as it outlines the current direction of AI regulation in Japan.

Amendment to Data Protection Law

Overview

The Japanese Act on the Protection of Personal Information (APPI) is expected to be reviewed and amended, if necessary, every three years after its enactment (this review is called "The Every-Three-Year Review"). For this purpose, the Personal Information Protection Commission (PPC) has been conducting studies since November 2023, and in June 2024, the PPC published the "Interim Report on the Every-Three-Year Review of the Act on the Protection of Personal Information" ("Interim Report"). Furthermore, based on the Interim Report, the PPC established a study group to consider the issues that required special consideration, and in December 2024, the study group published the "Report of the Study Group on the Every-Three-Year Review of the Act on the Protection of Personal Information" ("Study Group Report").

It is unclear whether an amendment to the APPI will be made in 2025 and what the content of the amendment will be, but the Interim Report and the Study Group Report indicate the issues that the government believes should be addressed in the next amendment.

The Interim Report

In the Interim Report, the following issues were raised and discussed.

(1) Establishing new arrangements for biometric data

Given the importance and sensitivity of biometric data, it may be necessary to introduce stricter regulations for biometric data. Possible provisions include a more specific purpose of use and a more flexible possibility for the data subject to request the suspension of the use.

(2) Clarification of "prohibition of inappropriate use" and "proper collection"

Article 19 of the APPI provides for the "prohibition of inappropriate use" of personal information and Article 20 provides for the "proper collection" of the same. Since these terms seem to be ambiguous, it may be necessary to concretise these terms and categorise these concepts in order to establish clearer rules.

(3) Tightening of regulations on the transfer of personal data to third parties

Article 27 paragraph 2 of the APPI provides for an "opt-out" procedure for the transfer of personal data to third parties without the consent of the data subject. Since this "opt-out" system can be used by malicious name list vendors, it may be necessary to impose additional restrictions (including a stricter duty of care to confirm that the personal data was obtained in compliance with the APPI).

(4) Strengthening protection of children's personal information

Under the APPI, children's personal information does not receive special protection. As it is a global trend to protect children's personal information and there are some cases where the protection of children's personal information is at issue, special protection may be given to children's personal information.

(5) Remedies (establishment of a class action system)

Although the data subject has the right to claim suspension of the processing or transfer of personal information under the APPI (Article 35), such remedial measures may not be effective enough to remedy the inappropriate use of personal information. In order to protect personal information more effectively, the introduction of additional remedies (such as a class action system) may be possible.

(6) Introduction of administrative fines and review of recommendations and orders

In addition to the criminal fines currently provided for as a sanction for violation of the APPI, the introduction of administrative fines may be possible. Also, at present, the PPC can generally issue an order only after issuing a recommendation, but this principle may need to be reviewed to enable the PPC to enforce the APPI in a more timely manner.

(7) Criminal punishment

Currently, criminal sanctions are only imposed when a party violates the PPC's orders. In order to enforce the APPI more effectively, consideration should be given to providing for criminal penalties for violations of the APPI itself.

(8) Review of leakage report and notification

Currently, processors of personal data may be required to make a leakage report even if the number of affected data subjects is small or regardless of whether the processor is responsible for the leakage. Such leakage reporting rules may need to be reviewed to be proportionate to the level of risk associated with such leakage.

(9) Possibility of using personal data without obtaining consent

In order to balance the protection of an individual's right to his/her personal information and the social interest of utilising personal data, it may be worth considering expanding the use of personal data. In particular, it may be possible, as an exceptional rule, to use personal data without obtaining the consent of the data subject for the benefit of society.

(10) Encouraging voluntary initiatives in the private sector

According to the APPI, Privacy Impact Assessment (PIA) and the appointment of a Data Pro-

tection Officer (DPO), the person in charge of processing of personal data, are not mandatory but voluntary processes that are recommended as good practices for the appropriate management of personal data. The report mentions that these processes should be encouraged more.

The Study Group Report

Among the issues discussed in the Interim Report above, the Study Group Report (December 2024) took up and examined two of them – the introduction of administrative fines and the class action system.

(1) Introduction of administrative fines

The study group discussed prospective triggers to impose administrative fines and factors to take into account when calculating the amount of administrative fines, but the study group did not reach a conclusion as to whether the administrative fines should be introduced or not.

(2) Introduction of a class action system

In order to provide a viable option to remedy the problems, the study group examined the possibility of giving consumer organisations qualified by the Prime Minister the power to bring actions on behalf of consumers for injunctive relief and/or damages. The study group does not seem to have reached a conclusion on whether qualified consumer organisations should be granted such a power, and it is unclear whether such a revision is likely to be included in the next amendment to the APPI.

Ride-Hailing

In Japan, ride-hailing services using private vehicles has only been allowed in very limited cases. However, due to the shortage of taxis, discussions on the use of private vehicles and non-professional drivers are rapidly advancing. On 29 March 2024, the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) established a new regime which allows the provision of paid transportation services by local private vehicles and non-professional drivers under the management of taxi business operators ("Private Vehicle Utilization Business"). MLIT also issued a guideline ("Guideline") regarding permits for the Private Vehicle Utilization Business under the Road Transport Act.

It is important to note that the Private Vehicle Utilization Business regime would be operated by taxi business operators, not non-professional drivers. In other words, ride-hailing services using private vehicles operated by non-professional drivers are still generally not allowed in Japan.

Under the Private Vehicle Utilization Business, taxi business operators conduct the relevant transportation business and are responsible for managing and supervising non-professional drivers. Also, the Private Vehicle Utilization Business is not allowed throughout Japan, but it is limited to specific areas and times and a certain number of vehicles because it was introduced due to the shortage of taxis and is permitted in a situation where there is a shortage of taxis.

In order to conduct the Private Vehicle Utilization Business, taxi business operators are required to apply for permission to the competent transport bureau authority. Upon receiving the application, it will be examined to determine whether it meets the following requirements; if it is found to meet these requirements, permission will be granted.

- Target areas, periods, time slots, number of shortage of vehicles.

- Qualification (ie, licence of taxi business operator).
- Management and operational systems.
- Financial capacity for damages.

The details of each requirement are provided in the Guideline. The competent authority may impose several conditions on the applicants when granting permission, and the permission is valid for two years. Violation of these conditions inhering in the granted permission may result in administrative penalties such as suspension of business or revocation of permission.

Although the Private Vehicle Utilization Business is limited to taxi business operators, discussions on the legal framework of ride-hailing for non-taxi operators are ongoing. It is essential to continue monitoring the progress and direction of, and legislative developments issuing from, these discussions.

Web3

LLC-type DAO

The Japanese government has been looking to Web3 as an engine of growth of the Japanese economy and therefore took several measures in 2024. Among them, the legislation of DAO (decentralised autonomous organisation) is particularly noteworthy. On 22 April 2024, the amendments to the Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act ("DAO Amendments") came into effect.

As a result of the DAO Amendments, tokenised equity interests in DAOs in the form of GKs ("*godo kaisha*") that satisfy the statutory requirements may now be classified as Article 2(2) Securities, which are more relaxed regulations than Article 2(1) Securities under the Financial Instruments and Exchange Act. It is expected that establishing DAOs would be accelerated under the DAO Amendments.

Stablecoins

At the private-sector level, companies' efforts regarding stablecoins have progressed. In 2022, the amendments to the Payment Services Act introduced new regulations on "electronic payments instruments" and stablecoins may be issued as electronic payments instruments under the Payment Services Act. Although stablecoins in compliance with the Payment Services Act have not been issued yet, several companies have already announced stablecoins projects. For example, on 5 September 2024, Progmat, Inc., which is a Web3 start-up invested in by major banks, announced a project of a cross-border payment platform using the API of Swift. Some stablecoins projects under the Payment Services Act are expected to be launched in 2025.

Start-Ups

In the TMT area, start-ups play an important role in accelerating innovation and the Japanese government has been supporting start-ups. The highlights of the government's initiatives for start-ups in 2024 are as follows:

- amendments to the Limited Partnership Act for Investment;
- introduction of "Venture Capitals: Recommendations and Hopes"; and
- amendments to taxation of tax-qualified stock options.

Amendments to the Limited Partnership Act for Investment

The Limited Partnership Act for Investment has been amended to expand the scope of investment to allow the limited partnership to invest in cryptocurrency and equity interests in GK. These

amendments encourage the fundraising of Web3 start-ups through the issuance of cryptocurrency. Also, investment in equity interest in GK may increase investment in start-ups because many start-ups also choose GK although the most popular corporate form for start-ups is the limited stock company (*Kabushiki-Kaisha*).

Introduction of "Venture Capitals: Recommendations and Hopes"

The Financial Services Agency and the Ministry of Economy, Trade and Industry jointly held the "Expert Panel on Venture Capital (VC) Funds" to smoothly provide VCs with funds from domestic and overseas institutional investors. On 8 November 2024, the Expert Panel finalised and published "Venture Capitals: Recommendations and Hopes" to be used by limited partners and general partners for their VC fundraising and management practice. The items listed as "Recommendations" and "Hopes" are below.

Recommendations

Fiduciary responsibility and governance

- The VC funds managers (GPs) are fully aware of their fiduciary responsibilities and fulfil their accountability to investors (LPs).
- Establish a sustainable management system that enables key persons to concentrate on fund management.
- Ensuring a compliance management system at VCs.
- Providing other LPs with information about an entitlement to a specific LP that could have a material adverse effect on those LPs.

Management of conflicts of interest, etc

- A conflict of interest management system shall be established at VCs, and in the event of a conflict of interest between LPs and GP, appropriate measures shall be taken, such as consulting with the LPs.
- Make arrangements to align the interests of LPs and GP, such as by making a commitment to invest in the VC.

Disclosure

- Provide information to LPs after assessing the fair value of assets held by VCs.
- Provide LPs with financial information for the VC fund on a quarterly basis.

Hopes

Improving the corporate value of investee companies

- VCs communicate sufficiently with investee start-ups to ensure that the investment agreement contributes to the growth of the start-ups.
- VCs provide management support to investee start-ups, such as help with recruiting and provision of know-how.
- VCs continue to provide capital policy support after investment (excluding follow-on investment, fund term extension, consideration of optimal exit method and exit timing including M&A).
- Fully consider the timing and method of sale shares after the investee start-up is listed (also consider crossover investment).

Other

- Manage funds with ESG and diversity in mind.

Although the items listed in "Venture Capitals: Recommendations and Hopes" are only recommendations or desirable matters, not mandatory requirements, it is expected that compliance with "Venture Capitals: Recommendations and Hopes" would be evidence of having improved

governance and, for overseas investors, it would be one of the factors to be considered for investment decisions in Japanese VCs.

Amendments to taxation of tax-qualified stock options

In Japan, even if the market price of granted stocks exceeds the price required for exercise of tax-qualified stock options, taxation on such difference would be deferred at the time of exercising tax-qualified stock options. There are several requirements for tax-qualified stock options, one of which is the maximum amount that can be exercised in a year. Before the amendments to the Income Tax Act, such maximum amount was JPY12 million. On 28 March 2024, the amendments to the Income Tax Act were enacted and the maximum amount has changed to JPY24 million (less than five years since establishment of the company issuing stock options) and JPY36 million (more than five years since establishment). Such amendments would provide more incentives for managers and employees in start-ups.

Japan's Current State of Social Media Content Moderation

Since the advent of the internet in Japan, illegal postings on online bulletin boards have been recognised as a persistent problem. More recently, with the surge in popularity of social networking sites, problems have arisen not only with content that violates individual rights, but also with the dissemination of false and misleading information, fake advertising, and impersonation.

The Provider Liability Limitation Act (PLLA), enacted in 2002, exempts service providers from liability for damages to affected individuals and users for alleged infringement if certain conditions are met. This exemption applies to information posted on bulletin boards or social networking sites. The PLLA also allows those whose rights have been infringed to request that providers disclose sender information, and it establishes judicial procedures to facilitate such requests. However, the PLLA does not impose direct obligations on platform operators to moderate content – for example, it does not require the removal of unlawful postings.

In recent years, whereas online defamation on social networking sites has become increasingly severe, there has been criticism that arbitrary or excessive takedowns by platforms may stifle freedom of expression. In light of this, the PLLA was amended in May 2024 (to take effect within a year) and renamed the Information Distribution Platform Countermeasures Act (IDPCA). This amendment introduces an explicit framework to encourage platforms to proactively moderate content. Under the amendment, certain large platforms will be required to establish and disclose procedures for handling user takedown requests alleging infringement, develop and publish removal standards, designate dedicated personnel to handle these requests, make timely decisions and notify users of removals within specified timeframes, notify original posters when their content is removed, and publish periodic reports on the status of the above measures.

While these provisions create procedural responsibilities, they do not require platforms to proactively monitor all content or remove unlawful or harmful content. The primary reason for this is that Japan's Constitution provides strong protections for freedom of expression, and such mandated obligations could unduly restrict that freedom. However, a report released in September 2024 by the "Study Group on Ensuring the Soundness of Information Distribution in Digital Space", established by the Ministry of Internal

Affairs and Communications, also considers a moderation framework for disinformation and misinformation, which do not necessarily constitute rights-infringing information.

In addition to cases of defamation on social media, fraudulent or fake advertisements and advertisements involving impersonation have recently become major social issues. Since such advertisements do not always involve infringement, and some advertisements that may be inappropriate do not necessarily fall within the scope of the IDPCA, regulation is not entirely straightforward. On the other hand, under certain constitutional interpretations in Japan, advertising is classified as commercial speech, which may be subject to greater restrictions than general freedom of speech.

Based on these considerations, the Study Group recommended that regulations to moderate illegal or inappropriate advertising should encourage platforms to pre-screen ad content by developing and publishing clear pre-screening standards and establishing transparent ad screening systems. In addition, regulations should require the removal of ads deemed illegal or inappropriate after they have been posted.

However, the approach to regulation remains a topic of intense debate, and the government organised a new study group in October 2024 to continue these discussions.

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