

SOUTH KOREA

Law and Practice

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CONTENTS

1. Blockchain Market and Business Model Overview	p.2	5. Capital Markets and Fundraising	p.10
1.1 Evolution of the Blockchain Market	p.2	5.1 Initial Coin Offerings	p.10
1.2 Business Models	p.2	5.2 Initial Exchange Offerings	p.11
1.3 Decentralised Finance Environment	p.3	5.3 Other Token Launch Mechanisms	p.11
1.4 Non-fungible Tokens	p.3	5.4 Investment Funds	p.11
2. Regulation in General	p.4	5.5 Broker-Dealers and Other Financial Intermediaries	p.11
2.1 Regulatory Overview	p.4	6. Smart Contracts	p.11
2.2 International Standards	p.5	6.1 Enforceability	p.11
2.3 Regulatory Bodies	p.5	6.2 Developer Liability	p.12
2.4 Self-regulatory Organisations	p.5	7. Lending, Custody and Secured Transactions	p.12
2.5 Judicial Decisions and Litigation	p.5	7.1 Decentralised Finance Platforms	p.12
2.6 Enforcement Actions	p.6	7.2 Security	p.12
2.7 Regulatory Sandbox	p.6	7.3 Custody	p.12
2.8 Tax Regime	p.6	8. Data Privacy and Protection	p.13
2.9 Other Government Initiatives	p.7	8.1 Data Privacy	p.13
3. Cryptocurrencies and Other Digital Assets	p.7	8.2 Data Protection	p.13
3.1 Ownership	p.7	9. Mining and Staking	p.14
3.2 Categorisation	p.7	9.1 Mining	p.14
3.3 Stablecoins	p.7	9.2 Staking	p.14
3.4 Use of Digital Assets	p.8	10. Decentralised Autonomous Organisations (DAOs)	p.14
3.5 Non-fungible Tokens	p.8	10.1 General	p.14
4. Exchanges, Markets and Wallet Providers	p.9	10.2 DAO Governance	p.15
4.1 Types of Markets	p.9	10.3 Legal Entity Options	p.15
4.2 On-Ramps and Off-Ramps	p.9		
4.3 KYC/AML	p.9		
4.4 Regulation of Markets	p.10		
4.5 Re-hypothecation of Assets	p.10		
4.6 Wallet Providers	p.10		

1. BLOCKCHAIN MARKET AND BUSINESS MODEL OVERVIEW

1.1 Evolution of the Blockchain Market

According to the research conducted by the Korean Financial Intelligence Unit (KoFIU), in December 2021 the Korean virtual asset market reached KRW55 trillion with 5.58 million participating users, and an average of four transactions were made per day per user. However, this research only covered 24 reported and authorised virtual asset service providers (VASPs), so the total size of the market is expected to be larger if other service providers and virtual asset-related services that are not subject to the reporting requirement are included. The operator of South Korea's "Upbit" virtual asset exchange, Dunamu, holds the largest market share among VASPs, with sales reaching KRW3.7 trillion in 2021. The Korea Institute of Science and Technology Information analysed data from MarketSandMarkets and Coinjournal, and expected the size of the Korean blockchain market to grow from KRW2.1 billion in 2016 to KRW356.2 billion in 2022.

In addition, various businesses are being actively fostered in emerging industries that utilise blockchains, including virtual assets, NFTs, etc, and blockchain businesses under the regulatory sandbox are also being implemented, such as blockchain-based mobile driver's licence verification services.

Until now, existing laws have been amended only for anti-money laundering and taxation purposes. Under the incoming government, however, the existing discussions on industry-specific laws focused on the incorporation of the virtual asset industry, fair market order and the protection of investors are likely to be expanded in order to promote virtual asset businesses and improve the existing financial system. Further-

more, initial exchange offering-related businesses are likely to be introduced to the market if the issuance of virtual assets is permitted, including initial exchange offerings through exchange platforms.

1.2 Business Models

Financial Sector

Blockchain technologies are currently used in payments, insurances, deposits/withdrawals, loans, asset management, capital fundings, etc; financial services such as blockchain-based peer-to-peer securities lending platforms through which individual investors will be able to borrow and lend securities will also be provided. Furthermore, inefficiencies in the existing banking system are expected to be resolved by using blockchain technology.

Logistics/Distribution/Manufacturing Sectors

From the initial stage of manufacturing to the final stage where the product reaches consumers, transaction data arising from the process of manufacturing/distributing/selling a product is provided to the parties involved. The manufacturer is able to trace the history and identify the demands of individual consumers from such data. In particular, retail platforms are beginning to utilise non-fungible token (NFT) technology with respect to authentication services and secondhand markets.

Cultural and Creative Sectors

As NFTs are applied to the art industry, the music industry, car sharing services, real estate transactions, gift cards, etc, and blockchains are applied to the process of uploading copyrighted pictures, videos and photos, etc, onto the internet and cloud services where digital contents are being exchanged, "blockchain-based content management services" from which creators can directly benefit are gaining attention. Gaming companies are also actively entering the virtual asset and NFT market.

Proof of Concept

There is no particular “proof of concept” that is most promising. However, the Ministry of Science and ICT (MSIT) and the Korea Internet & Security Agency (KISA) are currently promoting a “blockchain development project” to use the advantages of the blockchain technology, in which MSIT and KISA select and support the industries that have the most far-reaching impacts. In 2021, MSIT and KISA selected the following five industries:

- online voting;
- donations;
- social welfare;
- renewable energy; and
- postal and financial services of the Korea Post.

1.3 Decentralised Finance Environment

Individual investors are calling for regulation of the major decentralised finance (DeFi) models in Korea, as companies that have created DeFi models have generated considerable revenue whereas individual investors have suffered losses. Although individual investors are interested in foreign DeFi models in the short term, in the long run such interest can serve as a driving force in implementing regulations on DeFi models in Korea.

While the total value locked across all DeFi services worldwide has reached USD108 billion (KRW120 trillion), the market size of DeFi services in Korea is relatively insignificant due to various regulations. According to the available research data, only 15% of the USD150 billion (KRW176 trillion) of virtual assets that entered the Korean market were transferred to DeFi protocol, and the Korean DeFi market represents a mere 3% of the world market (KRW120 trillion), even when domestic assets are combined (KRW4 trillion). Participants in the Korean DeFi market include:

- KLAYswap (KRW1 trillion), which is based on the blockchain platform Klaytn (a Kakao affiliate); and
- Mirror Protocol (KRW2 trillion) and Anchor Protocol (KRW1 trillion), operated by Korean blockchain start-up Terra.

With respect to P2P investments, the Act on Online Investment-Linked Financial Business and Protection of Users (the P2P Financing Act), which proposed to regulate online investment-linked financing, protect investors/borrowers, etc, came into effect on 27 August 2020. Under the Act, virtual assets were prescribed as high-risk products that cannot be traded on P2P platforms; as a result, any loans and investments secured by virtual assets were prohibited, regardless of whether or not companies obtained lending business licences.

On the other hand, the Committee on Financial Informatisation Promotion established by the Bank of Korea and financial companies enacted the Standard for the Management of Decentralised ID services in the Financial Sector on 24 December 2021. Decentralised ID is a blockchain-based digital identity verification mechanism in which users can manage, select and submit their own digital identity. Various decentralised ID services have been negotiated, but a standard framework that can be applied to financial businesses was incomplete before such standard was created. As such, the process of using and submitting identification information, etc, became standardised for reference by individual financial companies upon implementing decentralised ID services.

1.4 Non-fungible Tokens

The Act on Reporting and Using Specified Financial Transaction Information (the Specified Financial Information Act) broadly defines virtual assets as “electronic certificates (including all rights thereto) that have economic value and that

can be traded or transferred electronically”, and excludes the cases already prescribed by the existing law or cases where the need for regulation is relatively low, including “electronic certificates or information about such certificates that cannot be exchanged for money, goods, or services, etc, and the place and purpose of use of which is restricted by the issuer”, “tangible and intangible results obtained through the use of game products”, “electronic prepayments means and electronic currency”, etc.

The Financial Services Commission has taken the position that NFTs in general cannot be considered as virtual assets under the Specified Financial Information Act, except for cases where NFTs are used as means of payment or investment. The report submitted by the Korea Institute of Finance to the Financial Services Commission, titled “NFT Characteristics and Regulatory Measures”, concluded that, under the premise that NFTs used as means of payment or investment can be regarded as virtual assets, NFT artworks do not fall under the definition of virtual assets as they are not traded for the purpose of payment or investment.

The current law does not specifically regulate NFT marketplaces, platforms or data storage solutions. The Korea NFT Content Association was established on 19 January 2022, in order to vitalise the relevant market by establishing future-oriented industrial policies and to implement measures against copyright infringement following the expansion of the illegal online and offline markets. Upbit is currently providing services including NFT Drops and Marketplaces through Upbit NFT beta, and Kakao is currently providing services including the issuance, transfer, exchange and gifting of NFTs through Klip Drops. Many companies, including game developers that produce their own contents, are paying closer attention to NFT marketplaces.

2. REGULATION IN GENERAL

2.1 Regulatory Overview

On 25 March 2021, a series of amendments to the Specified Financial Information Act were implemented, setting forth reporting obligations to the KoFIU, anti-money laundering obligations, etc, for VASPs. Pursuant to the amendments, a person engaging in the sale, purchase, exchange, transfer, storage or management of virtual assets, as well as acting as a broker, intermediary or broker for the aforementioned activities, etc, was prescribed as a VASP, and required to report to the KoFIU and comply with anti-money laundering requirements (eg, customer due diligence, reporting suspicious activities, storing relevant data), among other requirements (eg, separating the transaction data of each customer). As of the end of December 2021, 29 of the 42 VASPs that submitted their reports to the KoFIU are conducting their businesses in accordance with the Specified Financial Information Act.

In order to prevent money laundering using virtual assets, a so-called “travel rule” was implemented on 25 March 2022, which obliges a VASP to provide the transaction information of senders and recipients if it transfers virtual assets worth more than KRW1 million to another VASP upon the request of the customer. In performing its obligations under the travel rule, a VASP is required to store such transaction information for five years from the end of the transaction; a fine of up to KRW30 million may be imposed for any breach of such obligations. Other sanctions that may be imposed on a VASP for breaching its obligations related to the travel rule, according to the results of the investigation, include institutional warnings, orders for corrective measures, disciplinary measures against employees/officers, etc.

As of today, neither blockchain technology nor cryptocurrencies are governed by any sector-specific laws or regulation.

2.2 International Standards

In order to prevent the misuse of virtual assets for money laundering and other criminal activities, the G20 and the Financial Action Task Force (FATF) revised the global standard for the virtual assets sector and urged countries to abide by the global standard. As such, the amended Specified Financial Information Act came into effect on 25 March 2021 in order to comply with the FATF's Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers and to prevent criminal activities such as money laundering. Most of the provisions under the Specified Financial Information Act, including the reporting of suspicious transactions and customer due diligence by financial companies, are in compliance with the FATF standard.

The KoFIU published a "Casebook on the Authoritative Interpretation of the Anti-Money Laundering System", providing that obligations under the Specified Financial Information Act must be complied with in accordance with the FATF standard.

2.3 Regulatory Bodies

The KoFIU under the Financial Services Commission is responsible for overseeing and investigating reports filed by VASPs, and for investigating money laundering activities and the financing of terrorism.

The Ministry of Culture, Tourism and Sports plans to implement guidelines to prevent copyright infringement during NFT transactions/distributions, and plans to review and regulate the terms and conditions of NFT marketplaces, etc.

2.4 Self-regulatory Organisations

There is no self-regulatory organisation or trade group that performs a regulatory or quasi-regulatory role with respect to businesses or individuals using blockchain.

2.5 Judicial Decisions and Litigation

Regarding whether virtual assets constitute property interests, the Supreme Court of Korea ruled that: "Virtual assets constitute property interests, as they are not controlled by the state and their economic value, which is granted by encrypted distributed ledger such as blockchain, is digitally represented. Virtual assets are different from fiat currency in that only the address of the digital wallet that stores the virtual asset can be known while the information of the user using such address cannot be known and that persons other than the transacting party must be involved when transferring such assets as transaction data are recorded in a distributed ledger. Since virtual assets are currently not treated as legal tender, as regulations on legal tender are different from regulations on virtual assets, and since transactions using virtual assets involve certain risks, virtual assets should not be protected at the same level as legal tender when applying the Criminal Act" (Supreme Court Decision dated 16 December 2021; 2020Do9789).

In addition, regarding the appropriateness of confiscating virtual assets, the Supreme Court ruled that: "Since the defendant's breach of the Act on Promotion of Information and Communications Network Utilisation and Information Protection (distribution of obscene material) and the setting up of places for gambling constitute serious crimes as prescribed in the Act on Regulation and Punishment of Criminal Proceeds Concealment, and since Bitcoins should be construed as intangible asset having property value, Bitcoins earned illegally by the defendant can be confiscated" (Supreme Court decision dated 30 May 2018; 2018Do3619).

2.6 Enforcement Actions

From 2015 to March 2021, the Korean Ministry of Justice seized approximately KRW14.7 billion of virtual assets, including 210 Bitcoins, as criminal proceeds. The National Police Agency ordered 80.56 Bitcoins (approximately KRW6.2 billion) from 2019 to 2020 as criminal proceeds for preservation before prosecution.

The National Tax Services recovered KRW36.6 billion of unpaid taxes from 2,416 tax evaders who used virtual assets for tax evasion, and a comprehensive investigation was conducted on 222 of such tax evaders who were found guilty of additional evasion activities, such as concealment of assets, etc.

2.7 Regulatory Sandbox

Korea has operated a regulatory sandbox within six sectors since 2019:

- ICT convergence;
- industry convergence;
- innovative finance;
- regulatory free zones;
- smart cities; and
- research and development zones.

Considering the characteristics of blockchain, any regulatory sandbox within these sectors, where blockchain technology could be applied or used, would be applicable to blockchain-based projects.

As an example of a regulatory sandbox geared towards blockchain-based projects, Korean mobile operators (SKT, KT and LG U+) obtained authorisation from the Ministry of Science and ICT within the regulatory sandbox for a “PASS mobile driver’s licence verification service” that enables mobile driver’s licences to have the same effect as physical driver’s licences. The mobile operators jointly launched a system to sync with the driver’s licence server, operated

by the National Police Agency and Road Traffic Authority, and began to offer the service in July 2020. Blockchain technology can prevent any attempt to forge driver’s licences, since the “PASS mobile driver’s licence verification service” and the driver’s licence system operated by the National Policy Agency are synced together and the photographs of the actual licence registered with the National Police Agency and Road Traffic Authority is uploaded to the application.

In addition, services designated as innovative financial services are offered, including services in which beneficiary certificates of real estate management/disposal trusts are issued electronically and traded using blockchain distributed ledger technology as well as unlisted stock trading brokerage services using blockchain.

2.8 Tax Regime

An amendment to the Income Tax Act and the Corporate Tax Act aimed at imposing tax on proceeds from transferring or lending virtual assets under the Specified Financial Information Act is scheduled to take effect on 1 January 2023.

Pursuant to this amendment, with respect to residents, the proceeds from virtual assets are calculated by subtracting the actual acquisition price of virtual assets and incidental costs from the proceeds of the transfer/lending of virtual assets (Article 37(1)-3 of the Income Tax Act). However, income tax will not be imposed when the proceeds from virtual assets are less than or equal to KRW2.5 million (Article 84(3) of the Income Tax Act).

Proceeds generated in Korea by non-residents or foreign corporations by transferring/lending virtual assets shall be taxed as domestic source income (Article 119(12)-ta of the Income Tax Act, Article 93(10)-ka of the Corporate Tax Act). If such non-resident or foreign corporation is a resident of a country that has entered into

a tax treaty with Korea, they may benefit from non-taxation or tax exemption by submitting an application for non-taxation or tax exemption to the VASP (Article 156(2) of the Income Tax Act).

The Adjustment of International Taxes Act came into effect on 1 January 2022, and provides that virtual asset accounts fall within the scope of foreign financial accounts subject to reporting requirements, and that residents and domestic corporations having foreign virtual asset accounts are required to report to the head of the tax office with jurisdiction over the place for tax payment if the balance of such account exceeds KRW500 million (Articles 52(2) and 53).

2.9 Other Government Initiatives

The Ministry of Science and ICT and the Korea Internet & Security Agency are researching the advantages of blockchain technology and supporting relevant industries by promoting “blockchain technology expansion projects” and hosting “blockchain week” events.

In order to support discussions within the financial sector regarding the utilisation of blockchain technology, the Financial Services Commission launched the “Blockchain Council” and operated the “Blockchain Consortium for the Financial Sector”, although such efforts have now been discontinued. In a press release dated 15 December 2021, the Financial Services Commission stated that it will set up an environment for offering innovative financial services by amending regulations in order to apply blockchain technology in the financial sector and by reducing procedures and costs. As the virtual assets market is expanding, the Financial Services Commission also stated that its utmost priority in institutionalising virtual assets would be protecting users.

3. CRYPTOCURRENCIES AND OTHER DIGITAL ASSETS

3.1 Ownership

As there is no case law or authoritative interpretation from the Korean government, it is a matter of some controversy whether virtual assets can be a subject of ownership as a “thing” (ie, corporeal things, electricity, and other natural forces that can be managed), as defined under the Civil Act. Although the Supreme Court recently ruled in a criminal case that virtual assets constitute property interests, it is hard to conclude that the court regarded virtual assets to be not a “thing” under the Civil Act, as it was a criminal decision.

Since the controversy over whether virtual assets can be a subject of ownership has not yet been completely resolved, issues regarding the acquisition of ownership and the transfer of such ownership are also just beginning to develop, so it is difficult to assess any dominant view regarding such issues.

3.2 Categorisation

Since July 2021, the Financial Services Commission (FSC) has classified virtual assets into several categories depending on their characteristics; it is preparing the classification criteria for each category. Although the FSC has not made any official announcement, the classification criteria prepared by the FSC are expected to refer to the classification criteria already implemented in the EU and other countries, by classifying virtual assets into payment tokens, securities tokens and utility tokens.

3.3 Stablecoins

There are no laws that specifically regulate stablecoins in Korea. However, as stablecoins share certain characteristics with general virtual assets, they can be construed as virtual assets under the Specified Financial Information Act.

On the other hand, there may be issues as to whether stablecoins constitute financial investment instruments (such as securities or derivatives) under the Financial Investment Services and Capital Markets Act (the FSCMA), depending on how the stablecoins are issued.

In particular, it might be necessary to examine whether stablecoins that are pegged to legal tender would violate the Foreign Exchange Transactions Act in light of the exchange method with legal tender.

3.4 Use of Digital Assets

There are currently no laws directly regulating payment services using virtual assets in Korea. As such, issues regarding whether such virtual assets-based services, similar to other payment services, must comply with the existing laws regarding financial transactions (including the Electronic Financial Transactions Act) may arise.

Although there is no case law or official authoritative interpretation from supervisory authorities regarding such issues, in practice the FSS does not authorise the issuance of virtual assets and the registration of businesses if the electronic prepayment means are virtual assets. However, according to recent press coverage, the financial authority convened a law interpretation committee in April and determined that virtual assets cannot be construed as electronic prepayment means as their value can be volatile. As such, the financial authority concluded that payment services using virtual assets cannot fall under the definition of electronic financial businesses; however, no official announcement has been made, and it is necessary to continue monitoring such matter.

On the other hand, the reporting of VASPs under the Specified Financial Information Act may be required if the sale, purchase, exchange, storage, management, etc, of virtual assets are

involved in the process of providing payment services. For instance, Company “A” provided payment services using virtual assets and filed a registration report with the financial authority as a VASP (wallet/depository service provider), and the financial authority approved such registration. The financial authority explained that its affiliates must also file reports as VASPs in order to continue their activities under the current business structure, as they were also deemed to be involved in the business of selling and purchasing virtual assets in the course of carrying out payment settlement with merchants (press release from the financial authority dated 21 April 2022).

3.5 Non-fungible Tokens

The legal nature of NFTs and the necessity of institutionalising and regulating NFTs are being actively discussed in Korea, but there are currently no laws that regulate NFTs. As such, the marketing and sale of NFTs may be subject to the existing laws, including the Act on Fair Labeling and Advertising and the Act on the Consumer Protection in Electronic Commerce, which are applicable to the marketing and online sale of products in general.

In addition, NFTs may be regarded as securities under the FSCMA, depending on the specific method of creating (minting) such NFTs, and may be subject to regulations under the FSCMA. Furthermore, if certain NFTs fall under the definition of virtual asset under the Specified Financial Information Act, parties involved in the creation of such NFTs may be subject to the reporting requirement as VASPs under the same act.

However, as president-elect Suk-Yeol Yoon has pledged to vitalise the virtual asset market by implementing a regulatory framework with respect to NFT transactions, future legal trends should be closely examined.

4. EXCHANGES, MARKETS AND WALLET PROVIDERS

4.1 Types of Markets

Virtual asset exchanges are regarded as VASPs that act as a broker, intermediary or agent in the sale/exchange of virtual assets. Among them, there are exchanges that provide transactions between legal tender and virtual assets, and there are exchanges that only provide coin markets (for instance, purchasing coins with Bitcoins or USDC).

However, with respect to non-custodial exchanges, the KoFIU has taken the position that reporting as VASPs is not necessary if an exchange only offers trading platforms where proposals for sale and purchase can be posted. Although not prevalent, some decentralised exchanges are beginning to emerge in Korea.

At the time of writing, security tokens (in other words, if virtual assets are deemed as securities under the FSCMA) cannot be distributed in Korea. In order to distribute securities under the FSCMA, a registration statement must be submitted; however, in practice, registration statements regarding virtual assets are not accepted. Furthermore, an authorisation of exchange is required to establish a market for trading securities, and only Korean exchanges are authorised to operate. As such, the distribution of security tokens is not feasible practically (unless exempted from such regulation under the FSCMA by being designated as an innovative financial service).

Issues regarding whether NFTs constitute securities/virtual assets and the criteria for the assessment of NFTs remain unclear. If NFTs are construed as virtual assets depending on their structure and purpose, they may be governed by the Specified Financial Information Act. If NFTs are construed as securities, the sale of

such NFTs would be difficult, unless they are exempted from the regulation under the FSCMA by being designated as an innovative financial business.

4.2 On-Ramps and Off-Ramps

Legal tender and virtual assets are traded on a virtual asset exchange servicing trade in Korean Won (Won Market). The exchange of virtual assets and legal tender is prescribed as a virtual asset business under the Specified Financial Information Act, as is the exchange between virtual assets, and both require the reporting of VASPs. With respect to VASPs servicing exchange between virtual assets and legal tender (like Won Market), partnerships with banks are mandatory as transactions must be made by using real-name verified bank accounts.

Although the financial authority has not yet published an official announcement on how to treat virtual assets under the Electronic Financial Transactions Act, electronic funds transfer services are defined under such act as transfers through accounts opened in financial companies (eg, banks), so the probability of virtual assets falling under such definition is relatively low.

4.3 KYC/AML

The revised Specified Financial Information Act that reflects the FATF guidelines came into effect on 25 March 2021, and VASPs are accordingly obliged to prevent money laundering through methods such as verifying customer identities and reporting suspicious transactions. Specific matters are further stipulated in the Business Regulations on Anti-Money Laundering and Combating the Financing of Terrorism.

VASPs shall verify a customer's identity when said customer opens an account or makes virtual asset transactions in an amount equivalent to at least KRW1 million, and further verify the purpose of a financial transaction and the source

of funds for transactions where it is likely that a customer will commit money laundering or the financing of terrorism, including where it is doubtful that the customer is the actual owner. In this respect, VASPs shall identify and evaluate the risks related to money laundering and others, and use the same in customer verification.

In addition, VASPs shall report suspicious transactions where there are any reasonable grounds to suspect that an asset that has been received in relation to any financial transaction is illegal, and where KRW10 million or more in cash is paid to or received from the other party.

Furthermore, due to its obligation under the provision of wire transfer information (Travel Rule), a VASP that transfers virtual assets in the amount of KRW1 million or more to another VASP shall provide information on the remitter and remitee, including their name and the address of the virtual assets.

4.4 Regulation of Markets

The KoFIU is in charge of managing and supervising VASPs. For reference, the KoFIU recently announced its plan to conduct an on-site inspection of VASPs, and it is understood that on-site inspections are underway on some virtual asset exchanges, such as Coinone.

However, there are currently no laws in place to prohibit market price adjustments, the use of non-public information or unfair trading, although a number of virtual asset-related laws containing regulations on such have been proposed in the National Assembly.

4.5 Re-hypothecation of Assets

In Korea, there is no specific regulation applicable to the re-hypothecation of virtual assets. However, the virtual asset-related legislation and amendments proposed to the National Assembly include potential obligations to deposit vir-

tual assets received by VASPs, so it will be necessary to examine related content in the future.

4.6 Wallet Providers

As a person who stores, manages and transfers virtual assets, a wallet provider may fall under the definition of a VASP under the Specified Financial Information Act. However, the KoFIU takes the position that a service provider – similar to a hardware wallet service manufacturer such as a cold wallet – that only provides a program that preserves and stores personal encryption keys and has no independent control and thus no involvement in selling, purchasing and exchanging does not fall under a VASP that needs to be reported under the Specified Financial Information Act. Therefore, if a wallet provider does not have control over the private key, it is not subject to reporting requirements, and regulations under the Specified Financial Information Act shall not be applicable.

5. CAPITAL MARKETS AND FUNDRAISING

5.1 Initial Coin Offerings

There are currently no laws regulating the issuance of virtual assets in Korea, but the financial authorities are of the view that domestic initial coin offerings (ICOs) shall not be allowed due to the negative perception of virtual assets (while no clear legal basis has been provided therefor). Since this remains the case even after the enforcement of the revised Specified Financial Information Act, which imposes the obligation to prevent money laundering in connection with virtual assets, the financial authorities maintain the position that domestic ICOs are not allowed.

On the other hand, if a virtual asset falls under the category of securities, it must follow the procedures under the FSCMA, but since a registration statement is not accepted as described above,

it is practically impossible to issue virtual assets corresponding to securities. However, the financial authorities recently designated real estate fractional investment services similar to security tokens in nature as an innovative financial service, and recognised several special cases on beneficiary certificates under the FSCMA. Furthermore, according to the press release dated 20 April 2022, the financial authorities decided that, in relation to the music copyright fractional investment platform, the divisional right to receive a share in the profits arising from the “author’s economic right or neighbouring right” of a specific sound source is an investment contract security under the FSCMA, and the platform operator is subject to sanctions because a registration statement was not submitted, as required to protect investors in recruiting and selling the same.

In the press release, the financial authorities also stated that they will soon announce guidelines for new securities businesses such as fractional investment, which are expected to include guidelines on the issuance of such securities.

5.2 Initial Exchange Offerings

As noted in **5.1 Initial Coin Offerings**, coin issuance is not currently permitted in Korea.

However, newly elected president Suk-Yeol Yoon has expressed his view that ICOs should be allowed in stages (with initial exchange offerings to be first as they are less risky), so it is necessary to keep an eye on policy changes.

5.3 Other Token Launch Mechanisms

There is no law in Korea that separately regulates an airdrop or similar things.

5.4 Investment Funds

There is no law in place that specifically regulates a collective investment scheme that invests in virtual assets. Since the FSCMA sets

the objects of collective investment as “investable assets with property value”, a collective investment scheme that invests in virtual assets is also expected to be subject to the FSCMA. Therefore, the management of funds into virtual assets is not currently prohibited, and there is no law in place prohibiting such activity. However, it should be noted that virtual assets should be managed in a way so as not to fall under the definition of unsound business activities of a collective investment business entity under the FSCMA.

It is worth noting that the financial authorities currently take a negative position on financial companies’ virtual asset-related businesses. In a press release of 13 December 2017, the financial authorities banned financial institutions from “holding, purchasing, acquiring as collateral, and investing in equity of virtual currency”. Asset management itself is not included in the list of prohibited acts, but asset management companies do not seem to be considering virtual assets as the objects of management on their own.

5.5 Broker-Dealers and Other Financial Intermediaries

A person who exchanges virtual assets or acts as a broker or an intermediary for the purchase and sale of virtual assets is likely to fall under a VASP under the Specified Financial Information Act and need to report as a VASP, and the obligation to prevent money laundering is imposed, pursuant to the Specified Financial Information Act.

6. SMART CONTRACTS

6.1 Enforceability

There is no special law or regulation in place in Korea regarding the enforceability of so-called “smart contracts” (ie, private contractual arrangements made in whole or in part utilis-

ing agreed-upon computer code that executes across multiple “nodes” on a blockchain-based network), and it is understood that there are no court precedents directly related to this.

In addition, academic papers dealing with legal issues related to smart contracts are starting to appear, but no general view has yet been established on the enforceability of smart contracts.

6.2 Developer Liability

There is currently no special law in place regulating whether a developer or node of blockchain-based networks is likely to bear its obligations as “fiduciaries” in the relationship with users of the network. In this regard, it is considered to be necessary to determine whether the fiduciary duty applies, including whether the trust under the Trust Act can be applied as per the Trust Act and related precedents, in consideration of the facts and contractual relationship involved in each case.

7. LENDING, CUSTODY AND SECURED TRANSACTIONS

7.1 Decentralised Finance Platforms

The Act on Online Investment-Linked Financial Business and Protection of Users came into effect on 27 August 2020, and established a legal basis for P2P financial business and legislated user protection.

However, as the Act defines virtual assets as high-risk instruments that cannot be handled on a P2P platform, the handling of P2P loans and P2P investment instruments with P2P-type virtual assets as collateral is restricted regardless of the acquisition of a credit business licence.

However, in October 2021, the FATF announced that DeFi is also subject to regulation as a VASP,

but it is still unclear whether domestic financial regulatory authorities will also include DeFi as a VASP.

7.2 Security

As discussed in 7.1 **Decentralised Finance Platforms**, the Act on Online Investment-Linked Financial Business and Protection of Users restricts the handling of P2P loans with virtual assets as collateral, so P2P-type loans with virtual assets as collateral are not possible in Korea.

In addition, financial regulators have recently suspended the acceptance of a VASP report by a company that is said to provide a loan service in Korean Won with coin as collateral, in fact refusing to allow a loan service in Korean Won with payment tokens like coin as collateral on the grounds that it could be used in money laundering.

7.3 Custody

The Specified Financial Information Act stipulates that a person who keeps or manages virtual assets as a business is a VASP. In addition, the VASP report manual refers to a company safe-keeping and/or administrating virtual assets as an example of a VASP.

Therefore, the following must occur in order to provide services that keep or manage virtual assets in Korea:

- reporting should be made to the head of the KoFIU;
- a real-name account must be secured (excluding cases where there is no exchange of virtual assets and money); and
- according to the Travel Rule, a VASP that transfers a virtual asset equivalent to KRW1 million or more to another VASP is obliged to provide the name and address of the virtual asset of the customer who remits the virtual

asset to the receiving VASP, alongside the name and the address of the virtual asset of the customer who receives the virtual asset.

In addition, a VASP is obliged to prevent money laundering through methods such as verifying customer identities and reporting suspicious transactions, pursuant to the Specified Financial Information Act, including verifying the identity of a customer that opens a new account or makes a one-time financial transaction in an amount equivalent to at least KRW1 million, and verifying the purpose of a financial transaction and the source of funds for transactions where it is likely that a customer will commit money laundering or the financing of terrorism, including where it is doubtful that the customer is the actual owner.

8. DATA PRIVACY AND PROTECTION

8.1 Data Privacy

In Korea, the Personal Information Protection Act (the PIPA) is a general law on data privacy, and the Credit Information Use and Protection Act (the Credit Information Act) is a special law applied to personal credit information. As yet, there seems to be no authoritative interpretation from a regulatory agency nor any court precedent on how the processing of data stored in the blockchain should be regulated according to the existing PIPA and Credit Information Act. If the processing of data through blockchain can be viewed the same as the processing of personal (credit) information under the current PIPA and Credit Information Act, the main obligations of the person who processes such data are as follows.

- Collection, use and provision of personal (credit) information: a person who collects, uses or provides personal (credit) information shall, in principle, obtain prior consent from

the data subject for such, unless there is an exception prescribed by law.

- Outsourcing of personal (credit) information processing: a person who outsources the processing of personal (credit) information shall disclose the details thereof regarding the privacy policy, etc. In certain cases, the person who outsources the processing of personal credit information is obliged to report to the Financial Services Commission.
- Exercise of rights by data subjects: unless there are exceptions prescribed by the Acts, the personal information controllers and the credit information providers and users shall comply with the data subjects' exercise of their right to access personal (credit) information, withdraw consent and demand correction and/or deletion. However, there is no clear authoritative interpretation or court precedent on how the exercise of the rights of such data subjects can be implemented in a blockchain environment, and relevant discussions are underway.
- Obligation to destroy: unless there are exceptions prescribed by the Acts, the personal information controllers and the credit information providers and users shall destroy the personal (credit) information if it becomes unnecessary – eg, if the purpose of the processing is achieved. However, as it is virtually impossible to permanently delete some information due to technical characteristics in blockchain, in some cases there is an ongoing discussion on revising the laws so as to allow the destruction obligation to be fulfilled in other ways, such as making it impossible to restore.

8.2 Data Protection

The PIPA and the Credit Information Act specifically stipulate measures in their subordinate statutes to be implemented to protect personal (credit) information. However, there seems to be no authoritative interpretation from a regula-

tory agency nor any court precedent on whether safeguards for personal (credit) information prescribed by the existing PIPA and Credit Information Act can be applied equally to the data stored in the blockchain to date.

Assuming that safeguards under existing laws and regulations are applied equally, the main contents of safeguards for personal (credit) information to be implemented are as follows:

- establishing and implementing an internal management plan for the safe processing of personal (credit) information;
- controlling access to personal (credit) information and restricting access rights;
- applying encryption technology or corresponding measures to safely store and transmit personal (credit) information;
- keeping access records to respond to personal (credit) information breach incidents and measures to prevent forgery or alteration;
- installing and renewing security programmes for personal (credit) information; and
- implementing physical measures such as establishing storage facilities or installing locks for the safe storage of personal (credit) information.

9. MINING AND STAKING

9.1 Mining

Cryptocurrency mining using the “proof of work” mechanism is allowed in Korea.

As mining virtual assets itself is unlikely to be a virtual asset business, it is unlikely to be subject to the regulations on VASPs, such as the Specified Financial Information Act.

However, the amendment to the Income Tax Act scheduled to take effect on 1 January 2023 stipulates the taxation of virtual assets, and an

income tax rate of 20% (22% including local taxes) is expected to be imposed on income generated in the process of transferring and lending virtual assets to the extent that such amount exceeds KRW2.5 million, which is the basic deduction amount.

9.2 Staking

It is believed that there is no clear regulation on the staking instruments of virtual assets in the “proof of stake” mechanism. However, if a third-party business operator promises to pay for and transfers virtual assets to investors, it is not completely without risks of falling under the securities under the FSCMA as per the structure of the specific rights concerned, and the act of taking over and operating virtual assets from members may fall under a trust business under the FSCMA, but it seems that a clear position has not yet been announced by the financial regulatory authorities.

Currently, VASPs such as Coinone, Dunamu (Upbit) and Korbit – which have reported as VASPs and passed the review by the KoFIU – are currently providing staking services in Korea.

10. DECENTRALISED AUTONOMOUS ORGANISATIONS (DAOS)

10.1 General

Although DAOs have recently been attracting attention as new organisations in the domestic virtual asset industry, they are still at a nascent state. In particular, investment DAOs that have been organised to conduct investment are not active yet. A representative example is the so-called “National Treasure DAO”, which was recently formed with the purpose of issuing NFTs after winning a bid in relation to the National Treasure Auction of the Art and Culture Foundation. The DAO promoted a project

to raise money in the form of NFT issuance fees (minting fees) through smart contracts, but failed due to raising insufficient funding. For reference, the National Treasure DAO has been purchased by “Heritage DAO”, which was led by a Singapore-based financial company. It may be difficult to see a DAO as running its own business, but attempts are being made to operate the token ecosystem in a truly decentralised way by having DAOs composed of token holders make decisions related to the operation of the token ecosystem for the domestic tokens.

On the other hand, since there is no law in place that regulates DAOs specifically, they will be subject to the existing laws, but it may not be ideal at this stage to pinpoint the law to be applied to DAOs in general as the laws to be applied will vary depending on the legal nature of each DAO and the contents of the project.

10.2 DAO Governance

As mentioned in **10.1 General**, it is difficult to find cases of DAOs being organised independently for business such as investment, and it seems that there are some cases where a DAO is adopted as the governance of the token ecosystem or for purposes other than investment or is planned to be adopted in the future. As it is understood that the specific operation methods of these DAOs are different for each token ecosystem, it is difficult to describe the typical governance structure of domestic DAOs as a whole.

10.3 Legal Entity Options

As DAOs are not yet particularly active in Korea, it is difficult to say whether the domestic DAO generally adopts a specific legal entity structure. However, if a DAO is not established as a corporation, it is believed that its form will be the closest to the partnership amongst the organisational concepts planned under the current law. For reference, in the case of “National Treasure DAO”, as mentioned in **10.1 General**, the organiser who was promoting the formation of the DAO prepared and disclosed the articles of partnership and others on the premise that the relevant DAO corresponds to a partnership.

Lee & Ko has a dedicated blockchain team made up of around 20 professionals with extensive litigation and advisory experience and capabilities relating to blockchain and virtual assets. The team actively collaborates with other practices within the firm, such as economic analysis, information security, tax and IP, to effectively deal with any relevant issues such as tax, finance, foreign exchange and data pri-

vacy. The team is fully cognisant of the policy direction and business trends/practices of the Korean financial regulatory authorities. Clients include two of Korea's four major virtual asset exchanges, Dunamu and Korbit, as well as numerous IT companies, including Google and Naver, which the team has advised on their provision of virtual asset-related services.

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Chloe (Jung-Myung) Lee is noted for her expertise in digital finance, fintech, blockchain, NFTs and financial regulatory and compliance. Before joining Lee & Ko, she served as Legal

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Il Shin Lee specialises in fintech, TMT, data privacy and cybersecurity, and e-commerce. He advises cryptocurrency exchanges on the regulatory issues they face, and advises

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