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Striking a balance

Haeng-Gyu Lee, Jung Han Yoo and Seungmin Jasmine Jung
from Jipyong LLC survey the twists and turns in the quest by
Korea's regulators for the optimal cryptocurrency regime

On January 11 2018, the Minister of Justice of Korea announced that a legislative proposal prohibiting cryptocurrency exchanges was in the works. Backlash ensued among the cryptocurrency community resulting in online petitions on the Blue House website and in a significant drop in the price of bitcoin and ethereum in Korea as cryptocurrency investors started to unload their holdings. To counter further mayhem, the Blue House subsequently announced that cryptocurrency policies are yet to be finalised and still under review.

As illustrated above, Korea's cryptocurrency regulations, or the lack thereof, seem to be as volatile as the price of the cryptocurrencies themselves. Nonetheless, Korea is one of the countries with the highest trading volume of cryptocurrencies. For a while, the market even experienced a 'kimchi premium,' a term alluding to the premium in cryptocurrency prices in Korea over those in other countries.

Which regulations apply?

Whilst Korea does not yet have an overarching regulation governing cryptocurrencies, the Korean government has manifested its position on several controversial issues through announcements and press releases.

Regarding the nature of cryptocurrency, the Financial Supervisory Service (FSS) announced on May 31 2017 that 'bitcoins are fundamentally different from legal currency in that it is a so-called virtual currency, a form of digital product with fluctuating prices'. The FSS reinforced this position on June 23 2017 by announcing that cryptocurrencies are not legal currencies. This announcement went one step further by clarifying that cryptocurrencies do not fall under any financial products prescribed by law as follows: first, cryptocurrencies do not qualify as electronic prepayment devices nor electronic money under the Electronic Financial Transactions Act since the issuer neither refunds the balance nor exchanges it into cash or depositary funds;

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Haeng-Gyu has advised numerous Korean entities in their international expansion including the Korea Exchange's joint-ventures with the stock exchanges in Cambodia and Laos and the listing of Korean corporations on the Taiwanese stock exchange, Nasdaq and the Hong Kong Stock Exchange.

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In recent years, Jung Han has expanded his practice to legal issues arising from blockchain, P2P lending, fintech and data privacy of financial institutions. He has been instrumental in building Jipyong's fintech practice, advising various clients in their novel ventures and publishing several articles on the Korean regulatory aspects of cryptocurrencies and ICOs. Jung Han is highly sought after by clients for his in-depth knowledge in this field.

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Seungmin Jasmine Jung is considered one of the foremost experts on cloud computing, cryptocurrency, blockchain and cybersecurity. Jasmine mainly represents clients in the finance, fintech, energy, real estate and technology sector and has extensive experience in acquisition finance, project finance, structured finance, derivatives, data privacy, private equity funds and M&A transactions.

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With her experience at major law firms in New York and Seoul and as in-house counsel, Jasmine has an innate understanding of clients' needs and offers creative yet practical solutions to challenging legal issues. She is highly regarded by her clients for her transactional expertise and strong negotiation skills.

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second, cryptocurrencies are not financial investment products (such as securities or derivatives) under the Financial Investment Services and Capital Markets Act and therefore, transactions cannot be suspended

due to extraordinary price increases or decreases under current laws.

Regarding financial regulatory aspects, the Financial Services Commission (FSC) announced its stance through press releases

issued on September 4 and September 29 2017. The FSC was of the fundamental view that cryptocurrency transactions were not financial transactions and could not be incorporated within the current financial

regime because neither the government nor financial institutions could guarantee the value of cryptocurrencies. However, given that cryptocurrency transactions could negatively impact financial transactions, the FSC considered cryptocurrency transactions as pseudo-financial transactions. Certain cryptocurrency transactions were explicitly prohibited through these announcements, such as cryptocurrency short transactions (where the investor would borrow the purchase money from the cryptocurrency exchanges) and financial institutions' participation in a cryptocurrency business. Also, a negative approach was taken towards initial coin offerings (ICOs), as we will examine in further detail below.

Finally, regarding specific restrictive measures to curb the overheated cryptocurrency market, three emergency briefings have been made by the Joint Commission formed at the end of 2017 by the Office for Government Policy Coordination Secretariat under the Prime Minister, involving various government agencies. As a result, minors and foreigners are prohibited from opening cryptocurrency exchange accounts and engaging in cryptocurrency transactions. Financial institutions are banned from possessing and purchasing cryptocurrencies and accepting cryptocurrencies as collateral. The Joint Commission also announced that financial institutions would be prohibited from providing virtual account services (which do not enable real name verification) to cryptocurrency exchanges and that cryptocurrency exchange users would be required use an account at the same bank in which the cryptocurrency exchange has an account in order to facilitate real name verification (i.e., real name verified account services).

Who are the regulators?

The flux in regulations partly originates from the lack of central authority. While most of the initial government announcements were made by the FSC and the FSS, the complex nature of cryptocurrencies made it necessary for various government agencies to collectively monitor the developments surrounding cryptocurrency. Accordingly, under the leadership of the Office for Government Policy Coordination Secretariat under the Prime Minister, a Joint Commission was formed at the end of 2017, which included

the following government agencies: the FSS, FSC, Ministry of Strategy and Finance, Ministry of Justice, Korea Communications Commission, Ministry of Science and ICT, Korea Fair Trade Commission, National Tax Service, Ministry of Trade, Industry and Energy and the Korean National Police Agency.

cryptocurrency exchange are unclear, it is clear that once established, cryptocurrency exchanges are subject to data privacy regulations and anti-money laundering regulations.

Data privacy and network security – Given their online presence and nature of business, cryptocurrency exchanges are subject

Under the [AML] Guidelines, banks can only provide real name verified account services to cryptocurrency exchanges

As noted above, the Joint Commission has since made three emergency briefings announcing specific restrictions on the cryptocurrency market.

Are cryptocurrency exchanges regulated?

Cryptocurrency exchanges in Korea are one of the most active exchanges around the world, with Upbit and Bithumb often ranking within the top five cryptocurrency exchanges. Despite the lack of explicit regulations, cryptocurrency exchanges fall under the purview of the government through indirect measures, as detailed below.

Due to the lack of cryptocurrency exchange licensing regimes, cryptocurrency exchanges had been considered a type of online selling business under existing Korean laws. Until recently, cryptocurrency exchanges have been operating pursuant to the Electronic Commerce Act by filing an online selling business report with the relevant municipality. Whether or not such filings should be accepted has proved controversial, as there is fear that acceptance would grant legitimacy to cryptocurrency exchanges. Further, there have been arguments as to whether it is appropriate to view a cryptocurrency exchange as an online selling business. According to several newspaper articles, in February 2018 the Fair Trade Commission has interpreted cryptocurrency exchanges as not being captured by the definition of an 'online selling business,' although official commentary was not available. Hence, as of now, there are no explicit permits or filings required for operating a cryptocurrency exchange.

While the requirements for establishing a

to the Act on Promotion of Information and Communications Network Utilisation and Information Protection, Etc. (Network Act) and deemed a 'network service provider' under the Network Act. Accordingly, the processing and protection of personal information by the cryptocurrency exchange, the security of the information communication network and corresponding systems of the cryptocurrency exchange must all comply with the stringent requirements under the Network Act. For example, the following technical and organisational measures prescribed under the Network Act would apply to cryptocurrency exchanges: maintenance of access control systems, systems preventing falsification and alteration of access records, encryption methods to ensure safe storage and transmission of personal information etc.

In January 2018, eight cryptocurrency exchanges were subject to sanctions levied by the Korea Communications Commission due to the violation of technical and organisational measures under the Network Act and the storage of personal information beyond the statutory limit. The sanctions for the eight cryptocurrency exchanges included fines in the aggregate amount of KRW104.1 million (approximately \$97,000), immediate suspension of the activities in question and submission of plans to prevent such violations.

Anti-money laundering – In January 2018, the FSC's Korea Financial Intelligence Unit issued Anti-money Laundering Guidelines regarding Cryptocurrencies. Technically, the Guidelines apply to the financial institutions whose customers are cryptocurrency exchanges rather than to the cryptocurrency exchanges themselves. Under the Guidelines, banks can only provide real

name verified account services to cryptocurrency exchanges (i.e., cryptocurrency users can only transfer funds through an account at the same bank used by the cryptocurrency exchange). Financial institutions must exercise a higher level of care when transacting with cryptocurrency related businesses and strengthen its cryptocurrency monitoring practice. Further, when a business has been identified as a cryptocurrency exchange, the financial institution must conduct enhanced due diligence. Financial institutions are also required to report suspicious activities and provide examples of typical money laundering activities.

address such concerns. As of May 2018, 23 cryptocurrency exchanges are members of the Korea Blockchain Association. Currently, it is discussing specific regulations in relation to the establishment of a self-regulating committee, dispute resolution procedures, cryptocurrency investor protection, deposits and administration of fiat monies and cryptocurrencies, know your customer procedures, security of IT systems and data privacy.

Such discussions are based on the self-regulatory proposals announced in December 2017 which included, inter alia, the following provisions:

- a cryptocurrency exchange must be a company under the Korean Commercial Code with capital of no less than KRW200 million and the information security system, internal procedures and information protection personnel and organisation commensurate with a financial institution;
- the proprietary assets of the exchange and the reserve funds for the customer must be segregated;
- 100% of the monies deposited by the exchanges users must be deposited in a financial institution and 70% the cryptocurrency deposited by the exchange users must be deposited in a cold wallet; and
- a cryptocurrency customer must use a single account for the purpose of transferring funds to the account of the cryptocurrency exchange.

According to recent articles, the Korean Blockchain Association is also considering self-monitoring regulations regarding suspicious activities, investor protection for new listing of coins on the cryptocurrency exchange and anti-money laundering.

Are ICOs prohibited in Korea?

As noted above, the FSC announced its negative approach towards ICOs in September 2017. In its press release dated

September 29 2017, the FSC went as far as to state that all ICOs, regardless of technology and terminology, will be prohibited. However, this statement requires further analysis in light of the different types of ICOs that currently exist and the prior announcements made by the FSC.

In its press release on September 4 2017, the FSC distinguished between so-called security-type ICOs and coin-type ICOs. According to the press release, security-type ICOs are defined as the issuance of tokens that share in the profit of the project or are entitled to certain rights in, and distributions from, the company and coin-type ICOs are defined as the issuance of new cryptocurrencies on a platform. (As a side note, the definition of a coin-type ICO provided in the press release may be misleading when read literally because all ICOs, regardless of type, involve the issuance of cryptocurrencies on a platform. Accordingly, it is generally understood that coin-type ICOs refer to utility token ICOs.)

In the September 4 2017 press release, the FSC announced that any ICOs that do not comply with the securities filing requirements would be in violation of the Financial Investment Services and Capital Markets Act and be penalised accordingly.

Based on the above press releases, it seems clear that an ICO of security tokens would be subject to the requirements of filing a prospectus and securities report since the very nature of security tokens fall under one of the definitions of securities under the Financial Investment Services and Capital Markets Act (ie 'investment contract securities,' a security where an investor and a third party invest funds in a joint enterprise and receive profits and losses as a result of the joint enterprise which is mostly conducted by the third party). In the case of utility tokens, however, there are no explicit regulations that apply.

Due to the government's negative and restrictive approach towards ICOs, the ICO market has been stifled in Korea with investors and issuers turning towards jurisdictions with less onerous policies.

Are cryptocurrencies subject to tax?

In 2014, the National Tax Service of Korea stated that when bitcoins are traded as assets, value added tax (VAT) would apply whereas when bitcoins are being used as currency, VAT would not apply. Notwithstanding the

The FSC went as far as to state that all ICOs, regardless of technology and terminology, will be prohibited

The following are typical activities that could give rise to money laundering suspicions: a customer withdrawing funds from a cryptocurrency exchange although there are no records of the customer remitting funds to the account of the cryptocurrency exchange; multiple customers, without prior remittance or import records, remitting funds to a certain foreign company's account purporting to import IT facilities; a customer's daily financial transaction is KRW10 million or more, or the aggregate amount of financial transactions during seven days is KRW20 million or more; a customer conducting five or more financial transactions per day or seven or more financial transactions during a seven-day period; a corporate customer conducting cryptocurrency related financial transactions with a cryptocurrency exchange.

When a financial transaction is deemed highly suspicious for reasons such as non-compliance with the real name verification explained above, a financial institution is entitled decline the financial transaction.

Self-regulatory efforts – The overheated cryptocurrency market in the midst of regulatory vacuum gave rise to several incidents involving personal data leakage and delay in transactions due to IT failure. Accordingly, the need for consumer protection became apparent. The Korea Blockchain Association was established in January 2018 as a self-regulating body to

National Tax Service's stance, taxation of cryptocurrencies is not clearly established as a practical matter. There have been governmental efforts, mainly by the Ministry of Strategy and Finance, to procure evidentiary material for tax and also compiling information on foreign cryptocurrency tax practices in order to create a cryptocurrency tax regime encompassing different types of taxes such as transaction tax, capital tax and VAT. However, as of yet, there have not been any specific announcements or guidelines regarding taxation of cryptocurrencies.

Expected developments

The current legislative vacuum is not expected to continue for long. Since 2017, there are several legislative proposals pending in the National Assembly with regards to the regulation of cryptocurrency and cryptocurrency exchanges. The first of these legislative proposals to be introduced was the amendment to the Electronic Finance Transaction Act. The amendment proposes that cryptocurrency businesses be governed within the framework of the existing Electronic Finance Transactions Act by regulating the sales, exchange market, brokerage, issuance, custody and management

of cryptocurrencies. Specifically, the amendment requires cryptocurrency exchanges to obtain approval from the FSC and maintain a capital requirement of KRW500 million, adequate physical facilities and sufficient human resources.

In 2018, two separate pieces of legislation have been proposed, both by national

requirements, suggesting a KRW100 million capital requirement for cryptocurrency exchanges, in addition to adequate physical facilities and sufficient human resources. It also requires that cryptocurrency-related business can be established by merely filing a report with the FSC.

Although these legislations provide

The current legislative vacuum is not expected to continue for long

assemblymen who belong to parties opposing the current ruling party. The Special Act on Cryptocurrency Business which was proposed on February 2 2018 suggests a KRW3 billion capital requirement for cryptocurrency-related business, in addition to adequate physical facilities and sufficient human resources. It also requires that cryptocurrency-related business obtain a permit from the FSC, effectively making cryptocurrency-related business subject to an approval process. On the other hand, the Act on Cryptocurrency Transactions proposed on February 6 2018 sets forth more relaxed

detailed measures for cryptocurrency exchanges and cryptocurrency-related business, they have been criticised for not dealing in detail with ICOs or other aspects of cryptocurrencies. Accordingly, it is difficult at this stage to determine which legislation will be adopted, if at all, and when such adoption will take place. As Korea's involvement in the ever-changing cryptocurrency landscape increases, it will be interesting to see how the government and legislature strike a balance between technology advancement and consumer protection.