THE FUTURE OF KOREAN REGULATION ON INITIAL COIN OFFERINGS

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I. INTRODUCTION

Market regulators are in limbo given the lack of consensus over how to best regulate cryptocurrencies.\(^1\) There is particular uncertainty regarding initial coin offerings, or ICOs.\(^2\) In the crypto ecosystem, an ICO is the process of raising funds to proceed a project in exchange for tokens (also referred to as coins—a type of cryptocurrency).\(^3\) International regulation of ICOs differs by country. Some regulators exempt ICO firms from regulation in order to promote the blockchain industry. Whereas other governments implement stronger regulations to protect investors from fraud involving cryptocurrency. Because views regarding cryptocurrency vary by country, vastly different methods and degrees of international regulations exist. For example, the United States attempts to protect investors by proactively regulating ICOs as investment contracts subject to securities regulations.\(^4\) By contrast, some countries, such as China, have banned all cryptocurrency transactions and

\(^1\) The term cryptocurrency “refers to an asset that is issued and transferred using distributed ledger or blockchain technology, including, but not limited to, so-called ‘virtual currencies,’ ‘coins,’ and ‘tokens.’ SEC, Framework For “Investment Contract” Analysis of Digital Assets (April 3, 2019), https://www.sec.gov/ico; Cryptocurrency is defined as “decentralized, peer-to-peer digital currency that is used similarly to money.” Julianna Debler, Foreign Initial Coin Offering Issuers Beware: The Securities and Exchange Commission is Watching, 51 CORNELL INT’L L.J. 245, 249 (2018).

\(^2\) The term initial coin offering (“ICO”) is derived from the traditional Initial Public Offering in securities markets. The aim of both IPO and ICO is to raise funds but there are many differences. For examples, shares in IPOs are sold through exchanges regulated by financial regulators, so investor protection is well established. When it comes to ICOs, on the other hand, issuers sell tokens directly to the public at the beginning stage of development. Stephen J. Choi & A.C. Prichard, Securities Regulation, 396-405 (4th ed. 2015); Marco Dell Eraba, Initial Coin Offering: The Response of Regulatory Authorities, 14 N.Y.U. J.L. & BUS. 1107, 1110-14 (2018).

\(^3\) Dell Eraba, supra note 2 at 1110; Maria Fonsea, ICOs and Blockchain Token Funding, INTELLIGENT HQ (May 5, 2017), http://www.intellegenthq.com/finance/icos-and-blockchain-token-funding (last visited July 4, 2020); SEC, supra note 1.

ICOs. Other countries, such as Singapore, have attempted to formulate clear regulations to promote ICOs.

The situation in South Korea is also chaotic. Leading up to 2017, many Korean investors were forced to buy Bitcoin and pay more money on the Korean market, so called ‘Kimchi premium.’ Being concerned about excessive volatility and fraud related to cryptocurrency, the Korean government implemented such drastic measures as banning ICOs. With these regulatory changes, the market quickly plummeted. The Korean government has been deliberating the side effects of regulation and has taken a cautious stance in adopting new regulations. Additionally, the lack of proper regulations has made the situation worse because cryptocurrency industries, including ICO firms, do not clearly know what is illegal, and firms that want to implement ICOs seem to go outside of Korea to other countries that allow ICOs, such as Singapore. Given these situations, it is important to examine how to properly regulate cryptocurrencies.

This paper argues that the South Korean government needs to take advantage of the existing regulations, while also focusing on how to regulate security tokens and utility tokens. Since regulators started to strictly regulate cryptocurrencies, many countries applied securities regulations to tokens, but numerous issues remain regarding how to best regulate tokens with security features.

Considering the South Korean government’s stance that new regulations should follow the global trend, this paper draws conclusions by

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9 Many times, the term ‘token’ and ‘coin’ is used interchangeably. However, coins are the digital currency for payment purpose with Bitcoin as a prominent example. Tokens, on the other hand, represent assets which give holders the right to participate in the network. What is the Difference between Coins and Tokens, BONPAY (Mar. 13, 2018), https://medium.com/@bonpay/what-is-the-difference-between-coins-and-tokens-6ecedff311c31.
10 The authorities in three of the countries featured in this paper—the U.S., Singapore, and Japan—make clear that tokens with securities features are regulated as securities. See Part III infra.
comparing global regulations with Korean regulations. This paper compares the U.S., Singapore, and Japan because of the level of regulation on ICO and concentration of ICOs in each country. In the U.S., regulators have clearly applied securities regulation to cryptocurrencies with features akin to securities. In Singapore, regulators applied securities regulations for ICOs. Finally, in Japan, regulators recently introduced new ICO regulations.

This Article proposes that the Korean government should implement the regulatory mechanism in the Financial Investment Services and Capital Market Act (South Korean Securities Regulation Act, FSCMA). Although IPOs and ICOs are different, the same needs for investor protections, fairness, transparency, and efficiency of the market apply. Moreover, ICOs provide fundraising sources for ICO firms, which must be balanced with the need to protect investors. Finally, such an approach would align with global regulation because most countries use or are considering using securities regulation in ICO regulation. In principle, this paper proposes that ICO firms must comply with the FSMCA. However, considering the regulatory burden for ICO firms and the vulnerability of the general public, the regulator can allow ICO firms to use exemptions such as crowdfunding mechanisms. It should limit market participants to professional investors and allow brokerage firms to screen financial conditions of investors, ICO firms, and the project progress of ICO firms. Regulators should require registration and disclosure to prevent information asymmetry between investors and ICOs firms.

This research will proceed as follows. Part II will introduce the features of cryptocurrency and distributed ledgers. Part III will investigate the current regulation and ICO situation in Korea. Next, Part IV will examine the global response for ICOs regulation—specifically in the U.S., Singapore, and Japan. Subsequently, Part V will propose the regulation mechanism Korea should adopt. Finally, Part VI concludes that for ICO regulation, the existing FSCMA should be used to protect investors and eventually support the development of the blockchain industry.

II. INTRODUCTION TO CRYPTOCURRENCY AND DISTRIBUTED LEDGERS

Cryptocurrency regulations remain unclear and vary between countries. Some countries use ‘currency’ to describe cryptocurrency’s payment function and other countries use ‘asset’ to emphasize its asset features such as crypto asset (Japan) and virtual asset (South Korea, FATF).
Some countries use ‘crypto’ to describe its features made from encryption technology and others use ‘digital’ to express its digital value.\(^\text{14}\)

Cryptocurrency started appearing right after the financial crisis in 2008 to address the problems of a centralized financial system. In September 2008, right after the financial institutions went bankrupt, the pseudonymous Satoshi Nakamoto published the white paper on Bitcoin, the first cryptocurrency, which lamented that entire financial systems reliance on centralized authority.

This Bitcoin white paper proposed a revolutionary system of exchange using blockchain technology in which all transactions are recorded in a distributed and decentralized ledger instead of going through centralized systems managed by third parties, such as banks.\(^\text{15}\) Satoshi intended to prevent double-spending problems through this pure peer-to-peer network in which transactions are time-stamped by hashing and are distributed in the network.\(^\text{16}\) As transaction records are accumulated as blocks, which are accumulations of transaction data, each block is interlinked, establishing the chain. In this distributed ledger system, proof-of-work ensure the reliability of the distributed ledger. Transaction records are verified by participants and without proof-of-work, transaction records cannot be reversed.\(^\text{17}\) This system enhances transparency and provides peer-to-peer accountability, which was for want after the 2008 financial crisis.

Some cryptocurrencies are referred to as coins which operate independently on their own platform, such as Bitcoin. Some cryptocurrencies are referred to as tokens which operate on the other existing coin platform.\(^\text{18}\) These terms are used interchangeably.\(^\text{19}\)

Essentially, there are two types of tokens – a non-security type and a security type. Security type tokens are tokens with securities features and non-security tokens are tokens without such features. Securities features include the right to participate the management of projects such as voting rights and dividends, which will become the asset of investors. Consequently, the Financial Market Supervisory Authority of Switzerland, names security


\(^\text{16}\) Nakamoto, supra note 15.

\(^\text{17}\) Id.


\(^\text{19}\) Difference between Coins and Tokens, supra note 9.
tokens as Asset tokens in the FINMA’s Guideline in 2017.\textsuperscript{20} Tokens without security features are non-security tokens. This non-security type will be categorized into payment tokens and utility tokens.\textsuperscript{21} Payment tokens are used as a means of exchange for values as Bitcoin is exchanged for items in the real world.\textsuperscript{22} Utility tokens are access rights to the specific distributed ledger platform and used to barter for some service.\textsuperscript{23} These three concepts – security tokens, payment tokens and utility tokens – are not mutually exclusive. Most tokens are designed and used as utility tokens but even though they are initially designed as utility tokens, they will be regarded as security given that they have security features for regulatory purpose.\textsuperscript{24} In short, cryptocurrencies have revolutionized transactions replacing centralized governance with blockchain technology.

III. CURRENT KOREAN REGULATION AND PROBLEMS

The South Korean government has taken a very conservative and careful approach toward regulating ICO. Other than the ICO ban, not many regulations have yet been introduced. This section will describe the current regulation of ICOs in South Korea, and the problems associated with the present approach.

A. Current Korean Regulation

In 2017, South Korea fell in love with cryptocurrency. The price of Bitcoin on the Korean market was higher than in other markets, a situation referred to as the “Kimchi Premium.”\textsuperscript{25} However, so far, there have been few clear regulations regarding ICOs other than the ICO ban. To respond to the speculative market situation and demands to create the proper regulation, the


\textsuperscript{21} Apolline Blandin et al., Global CryptoAsset Regulatory Landscape Study, 18, CAMBRIDGE CENTRE FOR ALTERNATIVE FINANCE (Jan. 1, 2019) https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/2019-04-ccaf-global-cryptoasset-regulatory-landscape-study.pdf. This classification is similar to those detailed in the guideline of FINMA, the Swiss financial regulator. For regulatory purposes, FINMA’s guideline divides cryptocurrency into payment tokens, utility tokens, and asset tokens (which are similar to security token). If the sale takes place before tokens are issued or exchanged (i.e., pre-financing, pre-sale), the tokens are regarded as securities, meaning the securities regulation will apply. Anti-Money laundering law apply only to payment tokens. FINMA, supra note 20.

\textsuperscript{22} Blandin et al., supra note 21.

\textsuperscript{23} Id.

\textsuperscript{24} If utility tokens are used for payment, then they will be regulated as payment tokens. FINMA’s guideline anti-money laundering (AML) laws will apply only to Payment Tokens.

\textsuperscript{25} Jin Choi et al., supra note 7.
South Korean government organized the Cryptocurrency Task Force.\textsuperscript{26} This task force was led by the Financial Supervisory Committee (“FSC”), which is the governmental agency that regulates financial markets in South Korea. In September 2017, the Cryptocurrency Task Force announced in a press release that it would introduce several strong regulations intended to calm speculation in the cryptocurrency market and protect investors.\textsuperscript{27} Furthermore, worrying about the speculative situation, the South Korean government banned all types of ICOs that same month.\textsuperscript{28}

There have been few clear legislative actions since the September 2017 press release announcements. However, just as the Cryptocurrency Task Force emphasized, existing FSCMA will apply, especially for anyone who conducts securities type ICOs.\textsuperscript{29} There is no specific government guidance for distinguishing between securities type ICOs and non-securities type ICOs. The government has persistently taken the prudent approach to creating new ICO regulation, worrying that it may give the wrong signal to markets and the industry as showing the government’s approval of ICOs.\textsuperscript{30}

In September 2017, the government also announced it would recommend that the cryptocurrency dealers’ association develop rules and guidelines providing for self-regulating the cryptocurrency market, emphasizing investor protection.\textsuperscript{31} In accordance with this announcement, exchanges and blockchain companies established the South Korean Blockchain Association (“KBCA”) and confirmed a self-regulatory framework in April 2018.\textsuperscript{32} This framework benchmarked many features of securities regulation to protect investors and guarantee transparency and stability.\textsuperscript{33}

The framework also established a guideline that strengthened the process and transparency of listing coins. Under this guideline, exchanges will use the listing guideline provided by the KBCA.\textsuperscript{34} The KBCA will provide the information evaluating new coins to exchanges in order for

\begin{itemize}
\item \textsuperscript{26} Cryptocurrency Task Force Meeting to Review the Actions of the Relevant Institutions, supra note 8.
\item \textsuperscript{27} Id.
\item \textsuperscript{28} Id.
\item \textsuperscript{30} Lee et al., supra note 29; Financial Services Commission, ICO Survey Results and Future Countermeasures, at 4 (Jan. 31, 2019), https://www.fsc.go.kr/no010101/73527.
\item \textsuperscript{31} Cryptocurrency Task Force Meeting to Review the Actions of the Relevant Institutions, supra note 8.
\item \textsuperscript{33} Korean BFL 50, 62 (Seoul National University Financial Law Center, 2018).
\item \textsuperscript{34} Id. at 2.
\end{itemize}
exchanges to provide enough information to clients. The KBCA will provide exchange information about problematic coins. Exchanges should use this information as part of the internal review process for listing new coins.

While specific ICO regulation does not currently exist, the Korean government has acted to emulate international cryptocurrency standards. The FSC and the Financial Intelligence Unit, a South Korean governmental agency in charge of anti-money laundering regulation, promulgated guidelines on money laundering in cryptocurrency transactions; the guidelines require account owner identification in all cryptocurrency trades. Six months later, the FSC and the Financial Intelligence Unit amended the guidelines to improve transparency and strengthen monitoring in order to detect money laundering in cryptocurrency transactions. Furthermore, on March 5, 2020, the Korean Congress passed the bill amending the Act on Reporting and Using Specified Financial Transaction Information to mandate cryptocurrency exchanges’ anti-money laundering duties.

35 Id.
36 Id. According to the framework, exchanges should protect investors’ deposits by differentiating between exchange assets and investor deposits. In addition, exchanges should deposit 100 percent of the cryptocurrency to be prepared for clients’ withdrawal requests. Moreover, the framework requires exchanges to run an electronic complaint center to promptly resolve clients’ problems. Exchanges should establish an IT security system, internal processes, and sufficient human resources capacity.

37 The Korea Financial Intelligence Unit, established in 2001, is responsible for the implementation of anti-money laundering laws and regulations as well as collecting, and analyzing suspicious transaction information to supervise and monitor for the compliance of financial companies with its regulations. See KOFIU, MESSAGE FROM THE COMMISSIONER, https://www.kofiu.go.kr/eng/intro/about.do.

38 Before the Financial Information Unit guidelines were promulgated, cryptocurrency traders could have used virtual accounts as their trading accounts. This created a situation where the cryptocurrency traders’ real names could not be easily detected. Some cryptocurrency traders even used one account which could be disguised as the operating capital account for a corporation. Current guidelines require traders to have a bank account with the same bank that the exchanges use to identify the account owner. Exchanges also need to identify traders’ real names. In addition, multiple individual traders are prohibited from jointly using a corporate account. Financial Services Commission, The Government Prepares Special Measures to Eradicate Virtual Currency Speculation (Dec. 28, 2017), https://www.fsc.go.kr/no010101/72961?srchCtgry=&curPage=&srchKey=sj&srchText=&srchBeginDt=2017-12-23&srchEndDt=2017-12-31. The amendments include sharing overseas cryptocurrency dealer information. See Financial Services Commission, Guidelines for Anti-Money Laundering Related to Virtual Currency (June 27, 2018), https://www.fsc.go.kr/no010101/73223?srchCtgry=&curPage=2&srchKey=sj&srchText=&srchBeginDt=2018-06-24&srchEndDt=2018-06-30.

While the Korean government has taken a cautious approach to introduce the governmental framework to regulate cryptocurrencies, including ICOs, as of September 2019, there have been approximately ten legislative proposals submitted to the Korean Congress to regulate cryptocurrency or promote the blockchain industry. Among the bills, Senator Taekyeong Ha’s bill introduced a legislative proposal to amend electronic trading laws. It requires ICO issuers to obtain approval for ICOs from the FSC. The ICO review committee within the FSC will consider approval according to the standards the FSC announced beforehand. This ICO review committee consists of nine members including a chairman who is the FSC vice president. The FSC has discretionary authority to cancel the ICO if: i) the approval is based on fraudulent methods; ii) such ICO is below the FSC standards; or iii) no transaction has occurred for more than one year.

B. Problems

Since the Korean government announced several strong regulations, including banning ICOs in September 2017, it has taken few specific actions to enforce these regulations. The Korean government has kept a cautious stance toward regulating the cryptocurrency market, while it observes and researches regulations in other countries including the G20. Possible reasons for doing so include the desire to not suppress potential market growth by excessive regulation; balanced with the desire to enact regulations strong enough to prevent the Korean market from becoming a playground for perpetrators of fraud.

In the meantime, cryptocurrency industries and investors have experienced chaos in different ways. First, the Korean government’s ICO ban drove all ICO firms to conduct ICOs outside of Korea. In order to develop the Korean government’s position toward ICOs, the Financial Supervisory

41 YOUNGWOOW SHIN, Buleokcheinboebei Mirae [The Future of Blockchain Law], in BULEOKCHEINGWA BEOB [BLOCKCHAIN AND LAW], 471, 482-83 (Kyeonghan Sohn ed., 2019).
43 Id.
44 Id. at 6-7, art. 38.5.
45 Id.
46 Financial Services Commission, The Government Recognizes Some of the Virtual Currency Functions, (May 28, 2018) https://www.fsc.go.kr/no010101/73176?srchCtgy=&curPage=&srchKey=sj&srsrchText=%EB%A8%B8%EB%8B%88%ED%88%AC%EB%8D%B0%EC%9D%B4&srchBeginDt=&srchEndDt= (responding to MONEYTODAY’s article)
Service\textsuperscript{47} investigated the ICO situation from September 2018 to November 2018, targeting twenty-two Korean companies that conducted ICOs.\textsuperscript{48} According to the investigation, Korean ICO companies conducted ICOs outside of Korea by establishing shell companies that actually operated in Korea.\textsuperscript{49} Korean ICO companies in Korea participated in all other aspects of the business such as project development and investor relations. Although it is called an overseas ICO, Korean investors consider the company to be a Korean ICO because the firms advertise to Korea and publish white papers in Korean. For example, BORA Systems launched an ICO in May 2018 at investors in both Hong Kong and Korea.\textsuperscript{50} BORA Systems disclosed information about the project through a white paper both in Korean and in English. This was a typical pre-sale style ICO because it was performed while the company was developing platforms and other contents.\textsuperscript{51}

Second, cryptocurrency fraud is causing vulnerable investors to suffer damages. According to FSA investigations, Korean ICO companies did not provide investors with important information they needed to make critical decisions, including financial information and project contents.\textsuperscript{52} Many white papers, introductions, and profiles of developers failed to disclose or falsified vital information.\textsuperscript{53} Significantly, most Korean ICO companies did not disclose how they used the funds from ICOs, and despite the FSA’s requests, most of them failed to answer.\textsuperscript{54} No company has launched service.\textsuperscript{55} Rather, they are in the development or testing stage, but their progress information has not been disclosed either.\textsuperscript{56} Project contents and Blockchain technology are not easy for the general public to understand. For investors who expected the gain from investing their money in ICOs, it

\textsuperscript{47} The Financial Supervisory Service (FSS) is a quasi-governmental agency created to carry out the financial supervision delegated by the Financial Supervisory Commission (FSC). The FSC is responsible for rulemaking and licensing and the FSS is responsible for prudential regulations, enforcements, etc. \textit{See Financial Supervisory Service, History}, https://english.fss.or.kr/fss/eng/wpge/eng111.jsp.

\textsuperscript{48} ICO Survey Results and Future Countermeasures, supra note 30 (The targeting companies were selected based on newspaper articles, rumors, etc. Originally it was twenty-four companies but two of them gave up ICO).

\textsuperscript{49} \textit{Id.} at 3, 7. Those overseas shell companies were usually made up of less than three employees. Overseas shell companies usually do not hire new employees, and instead rely on employees from Korean ICO companies who also work for them. The capital was minimal, generally less than ten thousand dollars, and the shell companies only participated in fundraising activities. Those shell companies contracted with Korean ICO Companies, to which they then transferred the funds they raised.


\textsuperscript{51} \textit{Id.}

\textsuperscript{52} ICO Survey Results and Future Countermeasures, supra note 30.

\textsuperscript{53} \textit{Id.} at 2.

\textsuperscript{54} \textit{Id.}

\textsuperscript{55} \textit{Id.} at 3.

\textsuperscript{56} \textit{Id.}
was not a good choice because the prices of all newly issued coins dropped an average of 68% compared to the price of the first day of trading.\textsuperscript{57} Third, during the course of ICOs, ICO firms have violated current laws such as fundraising without registration under the FSCMA. In 2017, according to the dispute case analysis by FSA, more than 60% of illegal fundraising was related to ICOs.\textsuperscript{58} The lack of clear guidelines made this situation worse. Therefore, it is important to examine how to regulate cryptocurrency under the FSCMA and eliminate the chaos.

Despite this turmoil, the clear regulation for ICO has not been introduced yet. The government keeps the static ban on ICOs. In a press release announcing the FSA Investigation, the Korean government showed worries that investors may misunderstand that the government authorizes illegal ICOs.\textsuperscript{59} Ironically, although cryptocurrency technology and development through ICOs are key to developing the blockchain industry, the Korean government supports the development of the blockchain industry whilst banning ICOs.\textsuperscript{60} Despite this government policy, according to FSA investigation, it seems that Korean ICO firms continue to conduct ICOs overseas,\textsuperscript{61} causing the related frauds to continue occurring. Without creating the necessary regulatory regime on ICOs, merely banning ICOs cannot solve the problem.

If the Korean government wants to promote the blockchain industry, it should also promote ICOs. Instead of worrying about the side effects of the new regulation, it should suggest a method to distinguish between the good and the bad ICOs, and it should consider flexible regulation easily adaptable to the changing situations.

IV. GLOBAL RESPONSE

Attempts to develop proper ICO regulation is not unique to South Korea. This section will explore how other countries and other regional hubs have reacted to ICOs. It will specifically focus on the United States, Singapore, and Japan. These countries have all taken differing levels of scrutiny for regulating ICOs. This section will conclude by reflecting on these global approaches to ICO regulation and will draw lessons for potential South Korean ICO regulation.

\textsuperscript{57} Id. at 8. Average 68% down, compared the price of the first trading day with the price at the end of 2018. Profit Ratios are all negative, between negative 15% to 96.
\textsuperscript{59} ICO Survey Results and Future Countermeasures, supra note 30.
\textsuperscript{60} Id.
\textsuperscript{61} Id. at 3, 7; see also Yogita Khatri, South Korea Will Maintain ICO Ban After Finding Token Projects Broke Rule, COINDESK (Jan. 31, 2019), https://www.coindesk.com/south-korea-will-maintain-ico-ban-after-finding-token-projects-broke-rules.
A. United States

In the case of U.S. regulations, many utility tokens could be classified as security tokens if they have an investment function. The Securities & Exchange Commission ("SEC") in the U.S. started applying the Howey standard to cryptocurrency. Still, the criteria to distinguish between security tokens and utility tokens are not clear.62

i. The Howey Test

The U.S. Securities and Exchange Commission ("SEC") regulates ICOs by applying existing securities laws to cryptocurrencies, without creating new crypto-specific regulations.63 In July 2017, in the DAO64 No

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64 The DAO, or Decentralized Autonomous Organizations, was developed by a German startup, Slock.it, which attempted to create business organizations or corporations by utilizing blockchain technology, Etherium and in April 2016, it created an “automated investment fund” for ICOs. If investors send Ether, the second-generation cryptocurrency, to DAO’s account, then investors will receive DAO tokens. The DAO management runs the DAO project and gave token holders limited voting rights and dividend rights like stocks. SEC found the DAO meet the Howey test because the DAO runs projects and toke holders are promised a return on their investment. See SEC, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (July 25, 2017),
Action Letter, the SEC declared that tokens were investment contracts under Section 2 of the Securities Act, and an issuer should comply with U.S. securities regulations, including the registration requirement.\textsuperscript{65}

The Howey test, developed from SEC v. W.J. Howey Co., defines an investment contract.\textsuperscript{66} It consists of four prongs: (i) is there an investment of money; (ii) is there a common enterprise; (iii) is there a reasonable expectation of profits from the investment; and (iv) does the investment income solely from efforts of others.\textsuperscript{67} First, there should be an investment of money. Recently a U.S. court held that payment with Bitcoin satisfies this prong, so there would be little dispute that ICOs would meet this requirement.\textsuperscript{68} Second, there should be a common enterprise. Most courts adopt horizontal commonality.\textsuperscript{69} Horizontal commonality exists when pooling assets and profit sharing exist.\textsuperscript{70} In some ICOs, firms pooled funds and shared profits.\textsuperscript{71} Third, there should be a reasonable expectation of profits.\textsuperscript{72} According to the U.S. Supreme Court, there would be no expectation of profits if personal consumption is the purchaser’s main motivation.\textsuperscript{73} Thus, if the projects from ICOs are to buy some items for consumption, then there is no expectation of profits.\textsuperscript{74} Fourth, investment should be solely from the efforts of others.\textsuperscript{75} This depends on “whether efforts made by those other than the investor are the undeniably significant ones.”\textsuperscript{76}

The SEC determined that a token of the DAO project is a security based on the facts and circumstances. Under the Howey test analysis, investors reasonably expected the profits from the DAO project because the DAO was created as a for-profit entity that devotes investor funds raised for the DAO project; thus, investors expected to receive returns.\textsuperscript{77} Also, this

\textsuperscript{65} Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934; The DAO, supra note 64.
\textsuperscript{66} SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).
\textsuperscript{67} Id.
\textsuperscript{70} Baltz-Ben et, et. al., supra note 69 at 7; SEC v. SG Ltd., 265 F.3d 42, 49-50 (1st Cir. 2001).
\textsuperscript{71} SEC v. SG Ltd., 265 F.3d 52.
\textsuperscript{72} Choi & Pritchard, supra note 2, at 129-30.
\textsuperscript{73} United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975).
\textsuperscript{75} Choi & Pritchard, supra note 2 at 129-30.
\textsuperscript{76} SEC v. Glenn W. Turner, 474 F.2d 476, 482 (9th Cir. 1973).
\textsuperscript{77} See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934; The DAO, supra note 64.
investment was *solely from the efforts of others* because managers of the DAO control the management of the project.\(^78\) Thus, the SEC decided that the issuer of the DAO token should comply with securities regulations, which includes registration requirements of issuers and exchanges.\(^79\)

The *Howey* test protects investors widely and is flexible enough to cover every case. However, these flexibilities incur huge compliance costs to deciding whether the *Howey* test applies case by case. Many people from the industry would not understand implications of the *Howey* test clearly. More importantly, according to the *Howey* test, most utility tokens can possibly fall into the investment contract category, unless those utility tokens are clearly designed to purchase items for personal consumption. Even investment features can exist in those tokens issued for consumption of items if there is a secondary market for resale of those tokens.\(^80\) The application of the *Howey* test may suppress ICOs, making them more difficult because people have to decide whether each ICO falls into the investment contract category. The SEC’s approach of relying on the *Howey* test to analyze ICOs seems to be aligned with the philosophy of market regulation to strengthen investor protection. However, the *Howey* test’s case by case application creates additional ambiguity in regulation.

On April 3, 2019, the SEC announced guidelines on ICOs intended to address these issues and help the public better understand the application of the *Howey* test to ICOs.\(^81\) Although this guideline is not a legally binding opinion, it provides an analytical tool for ICO regulation.\(^82\) The guideline states that in applying the *Howey* test on ICO, the investment of money and common enterprise requirements are typically met.\(^83\) The more difficult hurdle is to maintain a reasonable expectation of profits derived from efforts of others. The guideline identifies features of ICOs that most likely and least likely satisfy this reasonable expectation of profits derived from the efforts of others requirement.\(^84\) The guidelines elaborate on features that fail the expectation test, such as stating that “distributed ledger network and digital asset are fully developed and operational” or “prospects for appreciation in the value of the digital asset are limited.”\(^85\) Although it is not legally binding,

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\(^78\) *Id.* at 11-17, The DAO token holders have the voting rights, but they are limited to the proposal made by the manager, so basically investors did not control the DAO.

\(^79\) *Id.* at 17-18.


\(^84\) *Id.*

\(^85\) *Id.*
the guideline clarifies investment contract requirements and guides compliance.\textsuperscript{86}

In the meantime, the SEC issued a No Action Letter to an ICO firm where the ICO does not satisfy the \textit{Howey} test. On April 10, 2019, the SEC issued a No Action Letter to TurnKey Jet, Inc. where TurnKey Jet plans to tokenize gift cards only for its members.\textsuperscript{87} According to SEC’s analysis, the first prong, investment of money, exists because investors paid funds to buy tokens.\textsuperscript{88} However, the second prong, common enterprise, does not exist because investors use the tokens for their intended purpose like prepaid services but did not expect returns.\textsuperscript{89} Also, the third prong, expectation of profit, also does not exist because investors do not have the rights for returns, dividends, etc., even though they buy the service more efficiently by purchasing tokens.\textsuperscript{90} There are few features of investment because the issuer already fully developed the platform before ICO and the issuer did not emphasize the investment features.\textsuperscript{91} In these regards, the \textit{Howey} test is not met. Applying the \textit{Howey} test to ICOs is still challenging, but the SEC has proceeded to clarify regulation with these efforts.

\textbf{ii. Simple Agreement for Future Tokens}

The \textit{Howey} test is flexible, but its requirements make it harder for ICO firms to raise funds, and ambiguity still exists despite SEC guidelines. To avoid the ambiguity of the \textit{Howey} test, many U.S. ICO teams use a Simple Agreement for Future Tokens (“SAFT”) to ensure that registration requirements are waived relying on exemption mechanisms under securities regulations. In the SAFT, ICO firms direct offers only to accredited investors who qualify for private sale.\textsuperscript{92} They acknowledge that the SAFT is “very likely” to be regarded as an investment contract under the Securities Act, thus ICO firms will rely on an exemption from regulation requirement based on Regulation D.\textsuperscript{93} They usually rely on Rule 506(c) of the Regulation D under the Securities Act, where companies can raise funds without limitation.\textsuperscript{94}

\begin{itemize}
\item \textsuperscript{87} Commissioner Hester M. Pierce, Sec. & Exch. Comm’n, How We Howey (May 9, 2019), https://www.sec.gov/news/speech/peirce-how-we-howey-050919.
\item \textsuperscript{89} \textit{Id.} at 10.
\item \textsuperscript{90} \textit{Id.}
\item \textsuperscript{91} \textit{Id.} at 12.
\item \textsuperscript{92} Juan Baltz-Benet et al., \textit{supra} note 69, at 16 n.69.
\item \textsuperscript{93} \textit{Id.} at 15.
\item \textsuperscript{94} \textit{Id.} at 16. Issuers can sell securities to accredited investors without limitation and to thirty-five other investors. Purchasers of these securities have resale restrictions for six months. 17 CFR §230.506; Rule 506 of Regulation D, SECLAW.COM, https://www.seclaw.com/sec-rule-506/.
\end{itemize}
Usually after ICO firms raise funds, they develop the platform and deliver the tokens to investors. The investors then resell tokens to the public. A benefit of the SAFT model is that the general public can avoid the risk of the project defaulting in addition to enjoying the investor protection of securities regulation.

However, because the SAFT is designed for resale purposes, not the consumption of items, this mechanism can be used to avoid regulation. Reflecting this concern, the U.S. courts made a decision that if the initial purpose of ICO was to distribute tokens, then such sales cannot enjoy exemption from securities regulation. In SEC v. Telegram Group Inc., the court said that the economic reality is important regardless of the fact that sales were made to sophisticated investors. Thus, ICO firms cannot enjoy safe harbor relying on SAFT.

Overall, the U.S. government has put a heavy burden on ICO firms, intended to protect investors. Despite this strong regulatory stance, ICO firms are adjusting to the regulatory status of ICOs. They have navigated to find legitimate ways to do ICOs such as through the SAFT. The U.S. courts also responded to prevent abuse of such measures by its ruling in Telegram Group. The next section will explore how Singapore, where many Korean ICO firms are housed, set up its regulatory framework for ICOs.

B. Singapore

Because the Chinese government and Korean government banned ICOs, the demand for ICOs is moving towards Singapore – making it the hub of ICOs in Asia. In August 2017, the Monetary Authority of Singapore (“MAS”) clarified that it would apply the Securities Futures Act, a securities regulation in Singapore, to cryptocurrency if the offer or issue of cryptocurrency constitutes a security or futures contract under the Securities Futures Act. So if the cryptocurrency is offered or sold for economic

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95 Juan Baltz-Benet et al., supra note 69 at 18.
96 Id.
97 Authors also point out this as one of limitation of SAFT. Id. at 20.
99 Id. at 42.
101 Monetary Authority of Singapore, MAS Clarifies Regulatory Position On The Offer of Digital Tokens in Singapore, (August 1, 2017), https://www.mas.gov.sg/news/media-releases/2017/mas-clarifies-regulatory-position-on-the-offer-of-digital-tokens-in-singapore; Before this action, in March 2014, MAS announced that cryptocurrency would be regulated, focusing on potential money laundering and terrorist finance risks. MAS reasoned that due to the anonymous nature of the transactions, cryptocurrency is more vulnerable to money
benefits such as dividends, that cryptocurrency will be regulated as a security, a collective investment scheme, or sometimes a debenture under the Securities Futures Act.\textsuperscript{102} MAS emphasized that in that case, issuers of those tokens should comply with the disclosure requirement, unless exempt.\textsuperscript{103} Also, unless exempt, issuers or intermediaries of tokens should obtain license under the Securities Futures Act and Financial Advisers Act.\textsuperscript{104} Exchanges also should be approved or recognized by MAS under the Securities Futures Act.\textsuperscript{105}

To elaborate on this ICO regulation, in November 2017, MAS issued “a Guide to Digital Token Offering” (“Singapore Guideline”) and explained ICO regulations in a detailed manner, including exemptions and exemplifying cases.\textsuperscript{106} Case studies in the Singapore Guideline exemplify the cases where tokens issued in ICOs can be regarded as shares, a Collective Investment Scheme, or a debenture.\textsuperscript{107} Also, it elaborated cases where regulation does not apply, such as a payment token offering to foreigners.\textsuperscript{108}

ICO status does not seem to be affected by these strengthened regulations. According to ICO Rating’s quarterly report of 2018, the second quarter’s ICO performance in Singapore increased 23\% in terms of capital size, 68\% in terms of number of cases compared to first quarter.\textsuperscript{109} Also the 2018 semi-annual performance in Singapore increased 263\% in terms of capital size, 219\% in terms of number of cases compared to the 2017 semi-annual performance.\textsuperscript{110} This growth is similar to the growth of the other four laundering and terrorist finance risks. Monetary Authority of Singapore, \textit{MAS to Regulate Virtual Currency Intermediaries for Money Laundering and Terrorist Financing Risks}, (Mar. 14, 2014) \url{https://www.mas.gov.sg/news/media-releases/2014/mas-to-regulate-virtual-currency-intermediaries-for-money-laundering-and-terrorist-financing-risks}.

\textsuperscript{102} \textit{Securities and Futures Act}, Ch. 289, (April 1, 2006) \url{https://sso.agc.gov.sg/Act/SFA2001}.

\textsuperscript{103} \textit{MAS Clarifies Regulatory Position On The Offer of Digital Tokens in Singapore}, \textit{supra} note 101.

\textsuperscript{104} \textit{Id}.

\textsuperscript{105} \textit{Id}.

\textsuperscript{106} Monetary Authority of Singapore, \textit{A Guide to Digital Token Offerings}, 2 (May 26, 2020), \url{https://www.mas.gov.sg/regulation/explainers/a-guide-to-digital-token-offerings}. The offer to sell tokens in ICOs should comply with the requirements of Part XIII of Securities Futures Act including prospectus registered with MAS and accompanied with the offer. Some cases such as the offer made to institutional investors enjoy the exemption from these requirements as elaborated in 2.6 of the guideline.

\textsuperscript{107} \textit{Id}.

\textsuperscript{108} Under this policy, in May 2018, MAS warned eight cryptocurrency exchanges to seek MAS approval in order to facilitate trading of cryptocurrency which falls into the securities or futures contract under the Securities Futures Act. Also, MAS directed one ICO issuer to stop its ICO in Singapore. The issuer argued that its token represents the equity ownership of the company, so it falls into the category of securities and futures product, but it was not registered MAS and distributed without prospectus.

\textsuperscript{109} \textit{ICO RATING, ICO MARKET RESEARCH Q2 2018}, \url{https://icorating.com/report/ico-market-research-q2-2018/}.

major countries (i.e. United States, United Kingdom, Switzerland, Estonia) in ICO offerings. Presumably, many market participants are from neighboring countries such as China and Korea, which adopted the strong regulation such as banning ICOs. The decision to strengthen the regulation was made right after the U.S. SEC announced that it will apply securities regulation to ICOs. The strengthening regulation seems to work as a good sign for the ICO market. Most ICO markets do not have clear regulations, which makes ICO firms and investors unpredictable. Singapore regulators seize the core problem and propose clear regulations, which encourages predictable and stable markets that benefit market participants. Also, ICO demands from companies originated in China and Korea seem to go to Singapore with its strong financial center, making Singapore’s ICO market much stronger.

To guarantee the flexibility of regulations related to the fintech industry, MAS has run the FinTech Sandbox since 2016. Any companies having regulatory concerns regarding cryptocurrency, including ICOs, can apply to MAS for the Fintech Sandbox. Once an application received, MAS determines the eligibility by seven evaluation criteria, such as innovative characteristics of financial service. So far, this research has explored U.S. and Singapore which dominate ICOs in their respective region and their regulations are clear and strong. In the following subsection, the research will examine Japan which has started to introduce new regulations on ICOs.

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111 Singapore was not the dominant country in country of fund origin but it is the leading country in ICO registration. ICO RATING, ICO MARKET RESEARCH Q1 2018, https://icorating.com/ico_market_research_q1_2018_icorating.pdf.

The Singaporean government plans to build the Smart Financial Center in Singapore, and to support the government plan, MAS set up a new financial innovation support group (FinTech & Innovation Group) inside MAS in July, 2015.

113 FinTech Regulatory Sandbox Guidelines, supra note 112. Elaborates on seven evaluation criteria to determine whether an applicant is eligible for the FinTech Sandbox as follows:

- Is the proposed financial service innovative?
- Does the proposed financial service address a problem, bring benefits to customers or industry?
- Does the applicant have the intention and ability to use the proposed financial service in Singapore on a broader scale after exiting the sandbox?
- Are the test scenarios and outcomes of experiments clearly defined?
- Is the appropriate boundary conditions clearly defined?
- Are significant risks arising from the proposed financial services assessed and mitigated?
- Is the acceptable exit and transition strategy clearly defined?


As investor interests have focused on ICOs, regulators’ focus also started to shift to ICOs. In 2018, a private study group was formed; it consisted of representatives from financial companies, IT companies, and the government.\footnote{ICO Business Research Group, \textit{Call for Rule-making on ICO}, \textsc{Center for Rule-making Strategies at Tama University}, 1 (April 5, 2018) https://www.tama.ac.jp/crs/2018icoen.pdf.} It issued a report about principles and guidelines for
legalizing ICO ("the ICO Report"). The ICO Report proposed two principles and two guidelines for issuance and five guidelines for trading.

First, the two principles for issuance recommend that issuers clearly disclose ICO conditions and the progress of the project in a white paper to investors. Issuance Principle #1 requires issuers to clearly disclose ICO conditions to investors, shareholder, and debtholders. Issuance Principles #2 requires issuers to disclose the progress of ICO plans in a white paper. The ICO Report focuses on innovations and flexibility in ICOs as well as investor protections. As guidelines for operations, the ICO Report suggests that the design of ICOs should be “acceptable to existing shareholders and debtholders and should not become a loophole in existing financing methods as equity finance.”

Second, to ensure appropriate investor protection, the ICO Report proposes five principles for purchase and sale of cryptocurrency. It includes “Know Your Customer” rules, listing rules, and unfair practice rules. After the hacking of Coincheck, the FSA recognized that the then-current regulatory regime was inadequately protecting investors in case of an exchange’s bankruptcy. Therefore, to strengthen investor protection the FSA organized a study group on legalizing the ICO in April 2018. This regulatory change would alter the concept of cryptocurrency from a payment method to a financial product.

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122 Call for Rule-making on ICO, supra note 120 at 1.
123 Id. at 4-5.
124 Id. at 5.
125 Id. at 4.
126 Id. at 5.
127 Id. at 5-6. Trading principles as follows:

Trading Principle 1: Token Sellers should confirm the identity (Know Your Customer: KYC) and suitability of customers.

Trading Principle 2: Administrative companies that support the issuance of tokens should confirm the KYCs of issuers.

Trading Principle 3: Cryptocurrency exchanges should define and adopt an industry-wide minimum standard on token listing.

Trading Principle 4: After tokens are listed, unfair trade practices of such tokens such as insider trading should be restricted.

Trading Principle 5: Parties related to the trading of tokens such as issuers, administrative companies, and token exchanges should make efforts to ensure cyber security.

In December 2018, the FSA announced its study report, including the new ICO regulation proposal.\(^{130}\) In this report, the FSA classified the ICOs into three groups: Investment Type, Other Rights Type, and Unprivileged Type.\(^{131}\) Investment Type means the ICOs firms promise the future distribution of profits.\(^{132}\) The Other Rights Type is an ICO in which the firm promises to provide services and material.\(^{133}\) The Unprivileged Type is the ICO type in which the firm do not have any obligations to investors like a donation.\(^{134}\)

In this report, the FSA says that the Japanese securities regulation, the Financial Instrument and Exchange Act (Financial Act), should apply to the Investment Type ICO.\(^{135}\) The Payment Act should apply for the Other Rights Types.\(^{136}\) The FSA describes the following as features of Investment Type ICO: (i) high freedom of token design; (ii) high information asymmetry between ICO firms and investors; and (iii) recruiting investors through the internet, which makes raising funds easier but recognizing frauds harder.\(^{137}\) The FSA argues that these characteristics cause more risks to investors, so regulators should create the measures to control them.\(^{138}\) Because tokens can be distributed easily like securities and be a target of fraud, the FSA proposed the following regulations: (i) more disclosure to reduce information asymmetry; (ii) screening by a third party, such as securities firms to prevent the fraud; (iii) unfair trading regulation such as price manipulation; and (iv) limiting the secondary market, such as limiting sale to only accredited investors.\(^{139}\)

Based on these discussions, the Japanese government proposed to regulate securities type tokens like securities. It amended the Payment Act and Financial Act on May 31, 2019, which became effective on May 31, 2020.\(^{140}\) By these amendments, the Japanese government introduced “electronic transfer right (denshi kiroku iten kenri),” so tokens with securities features will be regulated by the Financial Act and will therefore have

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\(^{130}\) Id. at 1.

\(^{131}\) Id. at 20.

\(^{132}\) Id.

\(^{133}\) Id. at 20, 27. For Other Rights Types where the FSA applies settlement regulation, the FSA emphasizes the role of exchanges and collaboration of the government and the self-regulators. Exchanges should require ICOs firms to provide investors the financial status of ICOs firms, the foundation of the price of tokens, and the feasibility and progress of the project.

\(^{134}\) Id. at 20.

\(^{135}\) Id.

\(^{136}\) Id. at 21.

\(^{137}\) Id. at 22.

\(^{138}\) Id.

\(^{139}\) Id. at 22.

registration and disclosure duties. However, if the offering meets some conditions such as being limited to Qualified Institutional Investors, then regulation, such as the registration requirement, will be eased. Thus far, this paper has examined the regulatory response of United States, Singapore and Japan. The next subsection will reflect the response and draw insights to Korean ICO regulation.

D. Reflection on Research of Global Regulation

Every country has its own way to regulate cryptocurrency—and nearly every country discussed herein is starting, or preparing to start, applying securities regulation regimes to ICOs. This approach has become a global trend for investor protection. Security tokens and utility tokens under certain circumstance may be regulated as securities. However, as noticed in the U.S., it is not simple to apply securities regulation to utility tokens. The standard to define security features and application of rules vary by country. Many utility tokens with securities features may be treated as securities. But applying securities regulation to utility tokens with no securities features will incur huge social costs including administrative cost of the government and compliance cost of issuers. It also creates additional ambiguity in regulation by applying securities regulation case by case.

To solve these problems, regulators have provided guidelines to distinguish features of securities token and utility tokens. The U.S. SEC Guidelines exemplify features of utility token cases with “distributed ledger network and [where] digital asset are fully developed and operational” or “prospects for appreciation in the value of the digital asset are limited.” The Singapore Guideline elaborates cases of utility tokens where no rights or functions are attached to tokens other than real use right of platform. In the study report, Japanese FSA focuses more on the features of securities token. It describes features for security token and includes cases that i) the information asymmetry for such token is great, ii) ICO was based on internet

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144 FinTech Regulatory Sandbox Guidelines, supra note 112 at 14.
so ICO firms easily approach investors, or iii) high degree of design freedom for ICO firms exist.\(^{145}\) As discussed above, the global regulators examined in this Article already applied, or have started to apply, a securities regulations regime to security tokens. To provide investors and ICO firms with information on how to distinguish between security tokens and utility tokens, each country’s regulators are making efforts to build up guidelines.

Additionally, it is noticeable that the U.S. and Singapore have strong and clear regulatory regimes. Especially, in the case of Singapore, although MAS introduced stronger regulations, it did not influence ICO performance and rather, clearer regulation played as a good sign for ICO demands. Also, flexibility of regulation is important considering features of ICOs and tokens. The cryptocurrency industry is rapidly developing. The U.S. and Singapore, both successful ICO hubs, use flexible regulations.\(^{146}\)

In Singapore, ICO firms can ask for the FinTech Sandbox and MAS in Singapore will decide their eligibility case by case and if approved, they will enjoy exemptions from some of regulations.\(^{147}\) This is flexible regulation that can fit every situation, but it may require high administrative cost and more human capacity for regulation. Regulators utilize disclosure regulation and third-party review to guarantee flexibility of regulation. It is also notable that FSA in Japan launched to regulate ICOs with security features with securities regulation.

In sum, application of securities regulation is becoming the global trend. Clear and flexible regulations are the key to developing the successful ICOs. To protect investors, disclosure and third-party review are preferable. In the next section, this Article proffers regulatory proposals for Korean ICO regulations.

V. REGULATORY PROPOSAL FOR ICO REGULATION IN KOREA

This section will propose future ICO regulations which could be implemented in Korea. The largest regulatory question today in Korea and globally is how to protect vulnerable investors through ICO regulation. Regulators must consider the economic cost and benefit of the legislation and the features of the industry when creating the new regulatory regimes. In this context, this section proposes using the existing securities regulation regime and strengthening disclosures. Also, this Article proposes limiting ICO participants by relying on crowdfunding laws or SAFT. Lastly, considering


\(^{147}\) *FinTech Regulatory Sandbox Guidelines*, supra note 112 at 10.
that the cryptocurrency ecosystem is quickly growing, regulators should also focus on keeping regulations flexible.

A. Korea Should Regulate ICOs under Existing Securities Law Rather than Creating New Regulations

The Korean government should consider using the current securities regulation regime to regulate ICOs, rather than creating new legislation.148 Although ICOs and IPOs are different, they function similarly to fund companies for projects. Concerns regarding investor protections are present in both ICOs and IPOs. Under the principle of “the same economic function, the same regulation,” regulators can consider using securities regulation to regulate ICOs.149 By regulating ICO with FSCMA, the government can take advantage of the pre-existing regulatory schemes such as disclosure requirements to protect investors.150

Moreover, this can reduce the high cost of administration. Out of approximately ten bills covering cryptocurrency proposed by the Korean Senate as of September 2019, only three bills proposed creating new laws, while the others proposed amending current law.151 However, all bills were repealed and the bills amending the Act on Reporting and Using Specified Financial Transaction Information were approved with the alternative bills proposed by the National Policy Committee in March 2020.152 That failure to legislate contributes to the delay of regulation, causing investors vulnerable to ICO-related frauds. If the government used the current securities regulation regime, it could save this legislative burden and introduce an operative regulatory framework quickly and easily. The Korean government can rely on investor protection mechanism of the FSCMA such as disclosures.153

Moreover, as discussed earlier, using securities regulation is a global trend. At a similar time as the U.S. SEC started to regulate ICOs as securities in the DAO No Action Letter, many other countries started to consider ICO regulation. Because global regulation for cryptocurrency is not yet established, the Korean government has maintained the position that it will examine the regulatory process of other countries and global regulation to

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148 The author has argued that to regulate unfair trading at the cryptocurrency market, regulators should rely on FSCMA. Whayoon Song, Legal Study of Unfair Trading on Virtual Asset Market, 13.1 KOREAN J. BANKING & FIN. L. 346-50 (2020).

149 See Report from Study Group on Virtual Currency Exchange Services, supra note 129, at 17.


151 Youngwoo Shin, supra note 41, at 482-83.

152 This amendment includes the introduction of virtual asset concept, several requirements for cryptocurrency exchanges such as certified information security management system. See Young Kim et al., supra note 40.

adopt regulatory regimes. ICOs are conducted all around the world and investors can easily participate in other countries’ ICOs online so global regulatory cooperation will be important in the future. In that matter, using the securities regulations regime as a model supports the Korean government’s position.

Some people from the blockchain industry may oppose this position because financial regulation is too restrictive for the blockchain industry. However, as illustrated in Singapore, stronger regulation does not affect the promotion of ICOs. The expansion resulted from the influx of interested parties from other countries, attracted by the clear regulation and convenient infrastructure for the financial industry. Applying securities regulations to ICOs may attract foreign ICO firms which operate internationally and would prefer similar regulation everywhere.

B. Investment Contract Provision Will Not Be Feasible to Apply to Security Tokens

Regulators may consider recognizing securities tokens as securities, and therefore relying on investment contract provisions. However, considering the past cases and the Korean government’s policy, it would not be feasible to use investment contract provisions when applying securities regulation to securities tokens in reality.

Investment contracts were introduced to the FSCMA to cover atypical financial products that do not fall into the typical securities definition. This provision is developed from the investment contract

154 Cryptocurrency Task Force Meeting to Review the Actions of the Relevant Institutions, supra note 8; ICO Survey Results and Future Countermeasure, supra note 30.


156 For trading in secondary markets, IOSCO stated that global cooperation is important and IOSCO principles 13, 14, and 15 will apply. However, for ICO, there is no clear statement about global cooperation yet. INT’L ORG. OF SEC. COMM’NS, ISSUES, RISKS AND REGULATORY CONSIDERATIONS RELATING TO CRYPTO-ASSET TRADING PLATFORMS: FINAL REPORT, 26-27 (2020). Changmin Chun also pointed out that considering other countries have set up ICO regulations, it is time for Korean government to introduce a regulatory regime referring to global regulation. See Changmin Chun, Overseas Virtual Asset Financing Regulation Status and Future Assignment, Presentation at 2019 Electronic Financing Seminar, at 14, 50 (Dec. 18, 2019), http://www.bok.or.kr/portal/bbs/B0000232/view.do?ntttId=10055437&menuNo=200725.

157 The FSCMA introduced “Financial Investment Instruments” which means 1) with an intention to gain profits or avoid loss; 2) a right acquired by an agreement to pay money or any other thing with property value at a specific point the present or in the future; 3) where there is a risk that the total amount of such money, etc., paid or payable, to acquire that right may exceed the total amount of money, etc. already recovered or recoverable from such right.
concept, the *Howey* test for U.S. securities regulation of investment contracts. 158 FSCMA Article 4(6) defines “investment contract” as “1) instruments bearing the indication of a contractual right 2) under which a specific investor is entitled to the profits earned, or liable for losses sustained, 3) depending upon the results of a joint venture in which the specific investor invests money, etc. jointly with a third person and which is to be run mainly by the third person.” 159 Issuers or third parties usually conduct ICO for a specific project, and investors expect to profit from their investments in said project. The DAO report concluded that ICOs are securities if they meet the *Howey* standard. 160 The Korean government may benchmark the regulatory mechanism developed by the U.S. SEC because it can rely on the investment contract provision of the FSCMA. However, unlike the U.S. SEC, Korea’s FSC is reluctant to apply investment contract standards to specific cases.

In 2014, there were scams regarding sales of real estate in which third parties and investors agreed to pool real estate, rent units, and distribute the profits. 161 The FSC relied on Section 2 of the Fund Raising Act instead of investment contract securities of the FSCMA. 162 The FSC has not explained its holding, except to say that the investment contract securities can be used where the product does not have features of other preexisting securities types. 163 Jabonn Kim has analyzed why the FSC did not apply the investment contract approach to cryptocurrencies. He concludes that although the investment contract concept originated from U.S. securities regulations, the FSCMA definition of securities is based on “security types theory” unlike U.S. regulations. 164 So it is possible that under this theory the FSCMA would

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158 15 U.S.C. § 77b. The *Howey* test requires: 1) a person invests money, 2) in a common enterprise, 3) is led to expect profits, 4) solely from the efforts of another SEC v. *Howey* Co., 328 U.S. 293, 298 (1946).

159 FSCMA, Act No. 8635, art. 3(1) (S. Kor.). The provisions of the FSCMA are similar to the *Howey* test. The expectation of profit prong is reflected in Section 3(1) of the FSCMA, the definition of Financial Investment Instrument. Unlike the fourth prong of the *Howey* test, the FSCMA clearly includes the cases in which investors participate in management of companies saying “mainly by third person” so clearly includes vertical commonality concept.


162 See id.

163 See id.

not apply because cryptocurrency does not fall into the type of securities such as investment contracts.\textsuperscript{165} Although the creators of the FSCMA intended to create flexible regulation, the FSCMA still keeps a limited definition. Importantly, he also points out the weakness of the FSC’s enforcement power.\textsuperscript{166}

I agree that the FSCMA defines securities as types in a clearer and more limited way than the U.S., resulting in the FSC having limited power. However, even if the FSC regulates cryptocurrency as investment contracts, problems remain because ICO firms must comply with duties of issuers such as filing registration statements, disclosure duties, and other requirements which are designed for listed companies and do not fit ICOs well. Also, each cryptocurrency has different characteristics and ICO firms and regulators should judge whether it is an investment contract. In this context, if regulators follow an investment contract approach, they should promulgate guidelines for judging and amending other rules. It would be very burdensome for the FSC to create guidelines by itself. The FSC may lack jurisdiction to apply the FSCMA to cryptocurrency, since cryptocurrencies have various characteristics and new products develop that can be cooperatively regulated by different departments such as IT related department. Thus, in these reasons, the investment contract approach is difficult to practically use.

Instead of relying on catch all provisions in an investment contract, Korean regulator can apply securities regulations reviewing features of tokens like the U.S. and Singaporean regulators do. However, it may make users confused and will be burdensome to regulator too. Therefore, Korean regulators should consider creating a new provision to include cryptocurrency as securities as Japanese regulators did and guidelines to distinguish between security type ICOs and non-security type ICOs.\textsuperscript{167}

C. The Korean Government Should Limit ICO Participants to Protect Investors.

Because securities tokens have features of securities, ICO firms should comply with the FSCMA unless they are qualified for exemptions. However, the requirements of the FSCMA, such as filing registration statements and disclosing required information, are designed for listed companies and do not fit ICOs well. This incurs huge compliance cost for ICO firms and this leads ICO firms to seek exemptions. Also, the contents of the projects and the technology in ICOs are hard for the general public to understand. Therefore, the possibility of fraud is greater than in other transactions. Thus, to protect investors and the economy, it is better to limit market participants and the size of ICOs, especially in the beginning stage of

\textsuperscript{165} Id. at 189-91, 193.
\textsuperscript{166} Id. at 193, 197.
\textsuperscript{167} See Song, supra note 148, at 350.
the market development. As ways to enjoy exemptions from the FSCMA, this research introduces crowdfunding laws and SAFT structure.

i. Crowdfunding Laws

The crowdfunding laws under the FSCMA support fundraising from investors by small to medium size firms. The concept is similar to ICOs in that it is conducted online by startups targeting the general public, so it is possible to apply this law to the ICO regulations. In July 2015, the FSCMA was amended to introduce the crowdfunding brokerage business, and it became effective in January 2016. Considering crowdfunding companies are usually small startups, the FSCMA designs regulations for crowdfunding brokers, not companies. The FSCMA defines a crowdfunding broker as “an investment broker engaging in the online brokerage of public offering or sale of debt securities, equity securities and investment contract securities.” Once registered, an issuer can enjoy waiver from duties or lower duties of the FSCMA: Instead of submitting a registration statement, an issuer can upload information related to the financial status and condition of subject securities, among other possibilities.

The crowdfunding law limited the issuers’ annual issuance premium to around seven hundred million Korean won (around a hundred thousand dollars). In order to strongly protect investors, the crowdfunding takes measures to set different investment amount limitations according to the level of knowledge on the financial market and the assets of investors. The FSCMA classifies investors as either ordinary investors or professional investors. The FSCMA defines professional investors as “investors who ha[ve] ability to take a risk accompanying investment.” Professional investors listed include the government, financial institutions, listed corporation, and others similarly situated and individuals whose assets including bank deposits, total more than 500 million won. The FSCMA defines the ordinary investors as “investors other than professional

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168 FSCMA, Act No. 8635, art. 9(27) (S. Kor.).
169 See Press Release, Financial Service Comm’n, Doib Doel Keulaudeu Peonding [Crowdfunding to be Introduced] (July 23, 2015). The author takes sole responsibility for this source.
171 FSCMA, Act No. 8635, art. 9(27) (S. Kor.).
172 Id.
174 FSCMA, Act No. 8635, art. 117-10(6) (S. Kor.); SEONG, supra note 170, at 236.
175 FSCMA, Act No. 8635, art. 9(5)-(6) (S. Kor.).
176 FSCMA, Act No. 8635, art. 9(5) (S. Kor.).
The crowdfunding law limits the amount of investment allowed according to income. However, for professional investors, there is no limit. Because funding by ICOs is conducted online by startups and many individual investors, its concept is similar to crowdfunding brokerage. So, it is cost effective to use this regulatory mechanism. The regulator can use some concepts of this regulation such as limitations of participants and ICOs amount.

The concept of the current crowdfunding laws could be used or amended for the ICOs regulation. Brokerage firms can play a role as a gatekeeper to protect investors. As licensed third parties, the brokerage firms should be given the responsibility to review the financial conditions, and the project progress of the ICOs. Second, current crowdfunding law classifies investors into three types and allows ordinary investors to participate in ICOs. Considering that the disclosure requirements for ICOs are insufficient to adequately protect investors, it is easy to understand why fraud is prevalent. Therefore, it is better to limit the market to professional investors. Limits on the amount invested in ICOs should be increased to at least twice the current limit. The average ICO amount last year in the Korean ICO firms were 30 billion won, but the limitation on total issuance amount in crowdfunding is only 1.5 billion won. Third, conditions for traditional securities such as one-year resale restrictions, one-year lock-up limitation for issuers, and controlling shareholder are not applicable to ICOs, so it should be repealed for ICO regulations.

In short, crowdfunding laws in the FSCMA can be used for ICOs. ICO firms take advantage of the eased disclosure requirements and the limited investors of ICOs.

ii. Utilizing Simple Agreements for Future Tokens

ICO firms also may limit the scope of ICO to the institutional investors by entering SAFTs between ICO firms and institutional investors, especially in the beginning stage of the market development as U.S. ICOs firms utilize. Although SAFT is designed to sales to institutional investors, this should not be used to avoid disclosure requirements of securities

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178 Enforcement Decree of FSCMA, art. 10(17) (S. Kor.). It sets the requirement following and the designation as professional investors is assigned.
180 FSCMA, Act No. 8635, art. 117-10(6) (S. Kor.); SEONG, supra note 170, at 236.
181 FSCMA, Act No. 8635, art. 117-10 (S. Kor.); see FSCMA, Act No. 8635, Enforcement Decree of FSCMA, art. 117-15(1) (S. Kor.). The limitation on total issuance amount in crowdfunding used to be 0.7 billion, but the government increased to 1.5 billion to support the stable fundraising. Press Release, Financial Service Comm’n, FSC Proposes Capital Market Reform (Nov. 1, 2018), https://www.fsc.go.kr/eng/pr010101/22193.
D. The Korean Government Should Strengthen Disclosures of Utility Tokens

The purpose of utility tokens is to provide tokens for the exchange of services and items for consumption. In this manner, it is not a security, nor is it the object of securities regulation. However, many times the ICO firms rely on the utility token appearance to avoid regulation. Many investors also purchase utility tokens in expectation of profits, not only means of exchange with services and products. This situation makes regulations ambiguous and creates a loophole. It is better to make a two-tiered framework which (i) includes utility tokens with securities features; and (ii) is a system for pure utility tokens.

First, for pure utility tokens, appropriate disclosure is important and regulators should have information about ICOs in case the ICOs are illegal. In this context, the new regulatory regime in France is worth discussing. In 2019, the French government introduced the new regulations for utility tokens which states that ICO firms can ask for the approval of the French Financial Market Authority (“AMF”). Approval by the AMF, known as an AMF visa, is optional and the AMF will disclose the entities to receive AMF visas on the AMF’s website. Because this visa from the AMF will be granted if ICO firms meet with certain requirements such as adequate disclosures, investors may be more relieved about the status of the ICOs. Instead of requesting approval, ICO firms can submit disclosure documents to AMF to help investors make informed decisions.

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184 See William Hinman, supra note 74.
185 In 2018, “The Plan d’Action pour la Croissance et la Transformation des Entreprises (PACTE – Action Plan for Business Growth and Transformation)” was proposed and it was enacted in 2019. The French government said that the purpose is “eliminating barriers to business growth at every stage of business development, from business transfers, including financing” to companies with innovations (Bruno Le Maire, Minister of Economy and Finance, and Delphine Geny-Stephann, Minister of State, attached to the Minister of Economy and Finance). This bill suggests the new regulatory regime to ICOs, enforcement measures about non-compliance with the foreign investments rules. PACTE, the Action Plan for Business Growth and Transformation, GOUVERNEMENT.FR, https://www.gouvernement.fr/en/pacte-the-action-plan-for-business-growth-and-transformation (last visited May 21, 2021).
187 See PARIS EUROPLACE, supra note 186.
188 Id. at 3.
There is an argument for another agency, such as the Consumer Protection Agency, to be responsible for the registration or approval. However, for efficient regulation, it is better to have one regulatory organization govern both ICOs and cryptocurrency trading. That way regulators also can be aware of ICO and cryptocurrency status and take action when it is necessary. Also, issuers’ compliance cost will be lower. Currently, in the U.S. issuers must research and comply with regulations from several organizations including FinCen, the SEC, and the CFTC.\textsuperscript{189} Additionally, different states develop different regulations.\textsuperscript{190} These are heavy compliance burdens for issuers. The Korean government should delegate power to one organization such as the FSC or establish a new organization that cooperates with the relevant entities.

Second, when the regulator finds that a utility token has any features of a security, the regulator should recommend that such issuers follow the regulation for security tokens. Considering compliance cost and vulnerability of investors, regulators may recommend utilization of crowdfunding laws or SAFT in such cases. In short, for the pure utility tokens, adequate disclosure process should be adopted referring to the AMF’s visa. For the utility token with security features, regulators need to recommend following regulation for security tokens to protect investors.

\textbf{E. For Investor Protection, ICO Firms Should be Required to Disclose Enough Information Appropriately}

Many investors in Korea, often older adults, do not know much about cryptocurrencies, yet they have invested their money in ICOs or cryptocurrency trading and have suffered losses because of fraud.\textsuperscript{191} Therefore, it is essential to think about protecting cryptocurrency investors. The first problem in the ICO market is information asymmetry between issuers and investors. Compared to issuers required to disclose continuous information about an IPO, cryptocurrency issuers disclose minimal information. They provide information through their website and white papers, where issuers explain the project plan and structure.\textsuperscript{192} Moreover,
white papers usually do not provide specific information about issuers.\textsuperscript{193} Around 55% of white papers did not provide issuer’s contact information accurately.\textsuperscript{194} Also, around 82% of white papers did not provide the regulatory status of ICOs,\textsuperscript{195} around 25% of white papers do not offer information about financial status,\textsuperscript{196} and more than 96% do not provide information about segregation of funds.\textsuperscript{197}

Thus, regulators should provide the framework for the information that issuer should provide in the white paper, such as by way of a standard form, and verify that information. If the information is incorrect, regulators should not approve the ICO. The information should include the issuer’s personal information such as name, address and contact. Also, it should include the financial status of issuer and the project, the plan to use funds from the ICO, and the features of the cryptocurrency.\textsuperscript{198} To make comparisons easier, a regulator should provide a template for disclosure. After the ICO, issuers should also disclose information about what its financial status is, how the project is developing, and how the funds were used. For effective regulation, the government may delegate self-regulatory organization to rate the quality of ICOs. It is similar to the rating funds or evaluating the quality disclosure of listed companies and disclosing each penalty points of the listed companies to the public via the Korea Exchange.\textsuperscript{199}

F. Regulation Should Be Flexible to Reflect Rapid Development of Industry

As the cryptocurrency industry is rapidly developing, regulation should be flexible enough to adapt these changes. Self-regulation and a regulatory sandbox may contribute to flexibility from insights of global regulation research.

\textsuperscript{193} Zetsche et al., supra note 5, at 11.
\textsuperscript{194} Id. at 16.
\textsuperscript{195} Id. at 11.
\textsuperscript{196} Id. at 15.
\textsuperscript{197} Id.
\textsuperscript{198} Id. at 39; see generally Hye Hwal Seong, Gasanghwapaegongmowasangjange daehan jeokjeonggyujaebangan [A Study on the Optimal Regulation on Initial Coin Offering (ICO) and the Listing of Cryptocurrency], 37 SANGSABEOPYEONGU [COM. L. RES.] 63 (2018).
\textsuperscript{199} Korea Exchange levy the penalty score to listed companies not complying disclosure rules and when the penalty scores reach to the certain level, such companies may be delisted. KOSPI Market Disclosure Regulation, Jan. 21, 2005, amended on July 22, 2015, art. 35 (S. Kor.), translated in Korea Exchange homepage, http://global.krx.co.kr/ (last visited May 21, 2021); Enforcement Rules of KOSPI Market Listing Regulation, Jan. 27, 2005, amended on May 13, 2013, art. 13 (S. Kor.), translated in Korea Exchange homepage, http://global.krx.co.kr/ (last visited May 21, 2021).
i. ICO Self-Regulation

While there is no clear regulation by the government, it is worthwhile experimenting with self-regulation.\textsuperscript{200} Self-regulation will play a role as the gap-filler when government regulation does not exist.\textsuperscript{201} Also because the Korean government worries about the effects of new regulation on cryptocurrency, regulators may use the self-regulation for ‘testing the water’ before introducing the governmental regulation.\textsuperscript{202} Currently, KCBA’s self-regulation framework proposes cryptocurrency exchanges use KCBA’s listing guideline but a detailed guideline is not yet available to the public.\textsuperscript{203} Considering that considerable fraud occurs in ICO stage, it is better to structure more detailed regulation on ICOs. In structuring the framework, cooperation with the Korean government would be essential. So, the Korean government should react more actively on cryptocurrency regulation. Moreover, appropriate enforcement of self-regulation is as important as well-structured regulation. As the government regularly audits self-regulatory organization in the securities market and approve the rules of self-regulation under the FSCMA,\textsuperscript{204} the Korean government should involve itself more proactively in the beginning stage of self-regulation.

Among self-regulatory organizations, exchanges can play a gatekeeper role in ICOs regulation because they are the entities that have power of approval of listing/delisting and have custody of the cash. Hye Hwal Seong argues that exchanges should disclose the listing and delisting policy, and the regulator may suggest the standard form of listing standard.\textsuperscript{205} His reasoning is based on comparing exchange regulations containing a clear listing/delisting standard and disclosure policy with exchanges that do not.\textsuperscript{206} In April 2018, a few exchanges disclosed a listing or delisting policy.\textsuperscript{207} Only one exchange had a listing standard and asked issuer for detailed disclosure. Almost three year later, in April 2021, more exchanges disclose their listing or delisting policy compared to the situation in April 2018.\textsuperscript{208} Although there

\textsuperscript{200} The author also proposes self-regulation in secondary markets of cryptocurrency to effectively regulate unfair behaviors such as price manipulation. Song, supra note 148, at 353-354; see also Whayoon Song, Legal Study to activate Self-Regulation for Unfair Behavior of Virtual Asset Market, 22 (1) KOREAN SEC. L.J. 183, (2021).
\textsuperscript{201} See Joon-Young Kim & Hyung-Seok Han, supra note 32.
\textsuperscript{202} See id.
\textsuperscript{203} In October 2018, KBCA proposed ICO and exchange guideline at a discussion session, the Blockchain ABC Korea where senators, governmental officers, etc., participated but this guideline is not in public. Press Release, Korean Blockchain Association, Proposed ICO and Exchange Guideline (October 4, 2018), https://www.kblockchain.org/board/press/read/621?nPage=4.
\textsuperscript{204} FSCMA, Act No. 8635, art. 283 (S. Kor.).
\textsuperscript{205} Seong, supra note 198, at 89-91.
\textsuperscript{206} Id.
\textsuperscript{207} Id. at 73-74.
\textsuperscript{208} Currently, all four exchanges (Bithumb, Coinone, Upbit, Korbit) have listing standard, checklist or guideline. Jeong In-sun, [Opening the Exchange] ④ Coin Listing.
was no regulation, exchanges started to disclose listing or delisting standards, even though those standards seem to be vague and arbitrary.\textsuperscript{209} As mentioned above, exchanges play an important part in regulating ICOs. If exchanges arbitrarily list and delist or otherwise act arbitrarily, transparency and fairness in the market will decline. Thus, regulators need to propose principles for a listing standard which guides exchanges without sacrificing their self-regulatory work.

ii. Application of a Regulatory Sandbox to ICO

As Singapore launched its Regulatory Sandbox benchmarked on the British model,\textsuperscript{210} the Korean government also started its Regulatory Sandbox to encourage companies to test innovative services and products in the real world. On April 1, 2019, the Special Law on Supporting Financial Revolution became effective and introduced the Regulatory Sandbox in financial services.\textsuperscript{211} Under this Regulatory Sandbox in financial services, financial institutions or corporations can test the new products or services when it is not clear whether they are legal.\textsuperscript{212} Once the Innovative Financial products and Services Review Committee of the FSC receives applications, it reviews them using eight criteria including innovation.\textsuperscript{213} Once approved, the applicant is exempt from the thirty four financial laws including the FSCMA.\textsuperscript{214} In 2019, ICO firms have not applied for this review because of the policy banning ICOs.\textsuperscript{215} Moreover, the few ICO firms that have applied have been rejected.\textsuperscript{216}

The Korean government can utilize this Fintech Sandbox for ICO as the Singapore Government does. However, the Korean government has maintained that ICOs are speculative.\textsuperscript{217} To take advantage of the Fintech Sandbox in regulating ICOs, the Korean government’s stance needs to

\textsuperscript{209} SEONG, supra note 170, at 73.
\textsuperscript{210} PARK HYUN-OK, ISSUE REPORT 2019-10: THE ENGINE OF INNOVATION IN MAJOR COUNTRIES, REGULATORY SANDBOX 6 (NIPA, 2019).
\textsuperscript{212} Id.
\textsuperscript{214} Id.
\textsuperscript{216} See also id.
\textsuperscript{217} ICO Survey Results and Future Countermeasures, supra note 30.
change in order to save social cost for legislation, administration and eventually promote blockchain industry.

VI. CONCLUSION

The blockchain is one of the core technical infrastructures of the fourth industrial revolution. ICOs are the fundraising tool that enable the blockchain industry to develop. The Korean government has a policy to support the development of the blockchain industry and to lead technological innovation in the world. However, the policy banning ICOs hinders the development of the blockchain industry. To promote its growth, the government should not ban ICOs because they contain speculative features. Instead, the government should regulate ICOs to protect investors.

The Korean government can rely on the framework for regulating the securities market in the FSCMA because there is the same need to protect investors and promote transparency. Moreover, this would follow the global trend. Since the U.S. SEC has applied the Howey test to ICOs, most countries have started to rely on a securities regulation model. However, the U.S. regulatory regime is not the best fit for every country. The Howey test is very flexible and convenient, but it can suppress ICOs more than necessary. The Korean government should consider the most appropriate method to regulate ICOs in Korea. Specifically, to protect investors, the government can limit the market to sophisticated investors or limit the ICO size. The government could also require that sufficient information be disclosed to potential investors in utility tokens to allow them to make an intelligent investment decision.

People compare the sharp increase and decrease of cryptocurrency’s price to the dot-com bubble in the early 2000s.\(^{218}\) The price of cryptocurrency will probably go up and down for a while. However, just as the dot-com period becomes the inflection point in the creation of a flourishing economy based on the internet, the ICO bubble is also expected to be the foundation of another economic success based on blockchain industry. Considering the current demand for ICOs in Korea and the expected development of the blockchain industry, continuing the policy of banning ICOs cannot be the right solution. It is time to introduce new regulations on ICOs and take an important step toward the future of the blockchain industry.