

Legal Update

ACT ON REPORTING AND USING SPECIFIED FINANCIAL TRANSACTION INFORMATION

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I. INTRODUCTION

On January 11, 2018, Minister of Justice Park announced a ban on cryptocurrency transactions and a closing the exchange through the enactment of a special law on the grounds that the term was inaccurate and that “virtual asset transactions are in fact similar to gambling.” However, despite this announcement, the price of Bitcoin surpassed 20 million South Korean won (“KRW”) on the Korean exchange in November 2020, boasting its ransom. In this regard, people in this industry and cryptocurrency experts predicted that “Bitcoin will be an alternative to gold and stocks,” and “the price of a single Bitcoin can exceed 200 million KRW by 2023.”

“No Daji” is a metaphor for a job that can easily make a lot of profit. One of the etymologies of “No Daji” is that, during the Joseon Dynasty in Korea, the American gold mining supervisor said, “No touch!” when Korean workers touched gold or acted suspiciously. Therefore, for Korean workers who did not speak English, “No Touch!” was understood as a word referring to something that sprouts gold, and “No Daji,” which is pronounced in Korean, became a word for a market where money sprouts easily. As if to ridicule some people’s predictions that the cryptocurrency market will end in 2018, the cryptocurrency market is growing in size around the world, and people in this industry and cryptocurrency experts predict that cryptocurrency based on blockchain technology will become the next economic growth engine and “No Daji.”

In the midst of these people’s continuous interest and increasing market transactions, the Korean government is planning and proceeding with regulations through the enactment of related laws. In this regard, this Article will briefly look at the Amendment to the Act on Reporting and Using Specified Financial Transaction Information (the Amendment to the Act is referred to as the “Amendment”) in order to answer following question: *Would the virtual asset market become “No Daji” or “No Touch!”?*

II. MAIN CONTENT AND RELATED ISSUES OF THE AMENDMENT

As the risk of crime through Virtual Assets (“VA”) increases, the Financial Action Task Force (“FATF”) and G20 have established international standards for preventing money laundering and financing of terrorism. With respect to this, the FATF presented its recommendations in accordance with international standards to each member state and urged them to implement and comply with international standards in accordance with its recommendations. Korea, which has been a member of the FATF since 2009, also needed to enact and enforce related laws to comply with international standards in accordance with the public statement of ‘Guidance for a Risk-based Approach Virtual Assets and Virtual Asset Service Providers’ proposed by the FATF (“FATF Guidance”) on June 21, 2019.

1 Hereinafter, in this Article, cryptocurrencies, virtual currencies, virtual assets, etc. are referred to as ‘Virtual Assets’ (“VA”) according to the unification of terms in the Amendment.

In order to comply with the FATF's international standards that require the establishment of an anti-money laundering system for Virtual Asset Service Providers ("VASP") and VA, on November 21, 2019, the National Assembly Committee of the Republic of Korea held Legislative Review Subcommittee, and the Committee decided to amend the Act. Accordingly, the legislative notice is from November 3, 2020 to December 14, 2020, and the Amendment will come into force from March 25, 2021. Some people in the VA industry may predict that, after the Amendment, the related VA market will be activated as the industry related to blockchain is regulated by law. The industry is divided into a positive response that the legal framework for blockchain and VA has finally been established, and a negative response that the burden caused by the time and economic costs for regulatory compliance will adversely affect the development of the related VA industry.

A. MAIN CONTENT OF THE AMENDMENT

Unlike imposing duties solely on banks and other financial institutions that have given the obligation to prevent money laundering and financing of terrorism, the purpose of this Amendment is to impose such duties and obligations on VASP, thereby preventing such crime and further establishing a sound and transparent financial system in accordance with the FATF Guidance. The main contents of this Amendment include: (i) the scope of VA and VASP; (ii) the obligations of VASP; and (iii) the obligations of financial company doing business with VASP.

1. The Scope of VA and VASP

First, the Amendment defines the scope of VA and VASP. Under the Amendment, the cryptocurrency, virtual currency, virtual assets, etc. were all unified as VA, and VA was defined as "a token that can be electronically traded or transferred as having economic value." However, electronic certificates, results obtained through game products, electronic prepayment means, and electronic money are excluded from the scope of VA under the Amendment. In addition, the scope of VASP is defined as those who engage in the trading, exchange, transfer, brokerage, storage and management of VA, and other activities prescribed by Presidential Decree. However, unlike the FATF Guidance, which is limited to those with the authority to control private keys among wallet operators, the Amendment does not define the wallet operators, so it is expected that wallet operators will also be included in VASP.

2. The Obligations of VASP

Under the enforcement ordinance of this Amendment, VASP has duties and obligations to prevent money laundering and financing of terrorism, including customer identification, suspicious transaction reporting, and storage of related data. If illegal activities are suspected and there is a reasonable basis for this, the fact must be reported to the commissioner of the Korea Financial Intelligence Unit. In the case of remittance of 5 million KRW or more in Korea/US\$ 5,000 or more abroad by the VA telegraphic transfer, VASP is obligated to verify information on the sender and recipient, and to provide the information to the financial company receiving the remittance. In the case of reporting on large cash transactions, if there is a transaction exceeding the amount prescribed by Presidential Decree within the range of 50 million KRW, VASP is obligated to report the fact to the Korea Financial Intelligence Unit ("FIU"). Next, in accordance with the Amendment, VASP is *obligated to report*. Under the Amendment, VASP is obligated to report to the FIU on matters prescribed by Presidential Decree, such as the name of the business, name of the representative, the location of the business place and contact information. With regard to the additional obligations of VASP, they have an obligation to separate and manage transaction details for each customer in order to fulfill the aforementioned reporting obligations related to money laundering risk analysis and evaluation.

3. The Obligations of Financial Company, etc. Doing Business With VASP

Under the Amendment, financial company, etc. must take reasonable care to fulfil their obligations to prevent money laundering and financing of terrorism. When financial company, etc. doing business with VASP, the financial company, etc. is obligated to confirm the basic identity of its customers, VASP, the purpose of the transaction, etc. In addition, the financial company, etc. is obligated to check whether the VASP has fulfilled the reporting obligations mentioned above, and whether the VASP's proprietary assets and deposits are kept separately. Accordingly, the financial company, etc. doing business with VASP is obligated to refuse or terminate the transaction in accordance with the Amendment in the event that its customer, VASP, does not fulfill the aforementioned reporting obligations or if it is judged that there is a risk of money laundering and financing of terrorism.

2 For the scope of the amount in this Article, the contents of the amendment to the Act on May 20, 2021 were referenced. VASP
3 Reporting Procedure: (i) filing of the VASP report at the FIU; and (ii) acquisition of the VASP license from the FIU.

B. RELATED ISSUES OF THE AMENDMENT

1. ISMS Certification

In order for VASP to fulfill their reporting obligations under the Amendment, they must obtain information protection management certification called Information Security Management System (“ISMS”). ISMS certification is a system that relevant review authorities such as Korea Internet & Security Agency (“KISA”) judge and certify whether the management system established and operated by companies to protect key information assets meets the certification standards set by law. Basically, it takes approximately 13 to 14 months, including the preparation period, to obtain ISMS certification, and it costs about 100 ~ 200 million KRW excluding consulting costs.

NO.	Procedures for ISMS Certification	Estimated time of Completion
1	Discussion with the ISMS consultants re necessary tasks & preparation for ISMS construction and operation	Preparation (6~7months)
2	Remediation of recommendations and findings identified by the ISMS	
3	Producing documentation and providing them in hardcopy packages to the ISMS consultants; Review and supplementation of the documentation	
4	Filing an application for ISMS examination at the KISA	Preparation for examination
5	Commencement of the preliminary examination for ISMS	(2months)
6	Commencement of the main examination for ISMS	Examination (3months)
7	Commencement of remediation of findings at the ISMS examination	
8	Completion of remediation	
9	Completion of KISA’s re-examination of remediation	Certification
10	Acquisition of the ISMS certification issued by the KISA	(2months)

2. Real Name Verification Virtual Accounts Services

Under the Amendment, when financial company, etc. doing business with VASP, the financial company, etc. is obligated to confirm the basic identity of its customers, VASP. Furthermore, the financial company, etc. is obligated to check whether the VASP’s proprietary assets and deposits are kept separately. Therefore, in order to fulfill the obligations under the Amendment, VASP seems to be inevitable to secure registration for issuance of the Real Name Verification Virtual Accounts (“RNVVA”) by commercial banks. Accordingly, this can be a heavy burden on VASP. This is because this provision, which requires the financial company, etc. to issue the RNVVA after evaluating VASP, will be a double regulation that requires VASP not only to be reviewed by financial authorities but also commercial banks.

This Amendment does not define the standards for issuing RNVVA, and it is expected that there will be a lot of confusion, such as many lawsuits. If the banks have the authority to issue RNVVA based on its subjective judgment, under this Amendment, the banks will have the right to decide on the issuance of RNVVA, which is an essential requirement for VASP’s business operation. Accordingly, whether VASP’s business can be operated is determined by the banks’ subjective judgment, and it is expected that there will be disputes over the evaluation standards of these banks. In addition, during the evaluation process of banks, VASP is expected to have the burden of providing its trade secrets to banks.

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Regulation in accordance with the Travel rules can be a huge burden for VASP. This is because it will not be easy to identify and control the personal information of beneficiary and originator due to the nature of a blockchain with a decentralized system structure. Thus, it seems necessary to build a system, accordingly, but the FIU announced that the date of entry into force with respect to the Travel rules under this Amendment will be on March 25, 2022 instead of the effective date of this Amendment, on the grounds that "a sufficient period of time is needed to introduce a common solution autonomously in the industry in order to build an information sharing system." However, VASP may not be on the lookout for building a system to comply with Travel rules under this Amendment. Accordingly, blockchain technology companies are in haste preparing to provide related services. The technology companies are planning to provide a decentralized authentication service that enables them to encrypt customer information and provide it to the relevant authorities only when necessary.

4 The expansion trend of banks' business in the VA market: (i) NH Bank – plans a digital business expansion through the VA custody business; (ii) KB Kookmin Bank – announced a business expansion plan to the VA market through technology cooperation with Hashed, HAECHI LABS, and Korea Digital Asset; (iii) SHINHAN Bank & KEB Hana Bank – plan a business expansion to the VA custody services.

III. THE FUTURE OF VA AND VASP

This Amendment may be good news in that the legal framework of blockchain has finally been established for some VASP, but it will probably not be for startup and small & medium sized VASP. In order to fulfill the reporting obligation under this Amendment, VASP needs to obtain ISMS certification, and considering the time cost of more than 12 months and economic costs of about 200 million KRW to obtain such certification, it is highly likely that it will be an economic, technical and time burden for startup and small & medium sized VASP. Furthermore, it is expected that it will take a considerable amount of time to establish an appropriate system unless there are clear guidelines for the expected Travel rule regulations in the future, and this uncertainty will be a big challenge for startup and small & medium sized VASP.

In the case of large VASP, they have already signed memorandum of understandings with related technology companies to prepare for future Travel rules. However, it is likely that many startup and small & medium sized VASP will close their business if mandatory regulations are enforced without sufficiently considering the size and circumstance of the VA industry. The banks' passive attitude toward RNVVA is expected to continue, and as a result, VASP who have not been issued RNVVA will no longer be able to operate their business. In addition, as banks have a significant authority to decide whether VASP can operate their business, VASP will have to bear the risk of infringement of trade secrets that may occur during the banks' due diligence process. Thus, like the Matthew effect that is summarized by the proverb "the rich get richer and the poor get poorer," large VASP will likely get larger. Accordingly, small & medium sized VASP, excluding a few large VASP, will probably need to close their business.

IV. CONCLUSION

At the same time as the global VA market has grown rapidly, the risk of crimes involved has also increased. Accordingly, the FATF established international standards to prevent money laundering and financing of terrorism, and FATF urged its member states to comply with its Guidance. Korea, which has been a member of the FATF, also needed to enact and enforce related laws to comply with the FATF Guidance, and in this regard, the National Assembly Committee of the Republic of Korea decided to amend the Act. The Amendment, which will come into force from March 2020, stipulates the reporting obligations of VASP, and they must obtain ISMS certification under this Amendment. Also, according to this Amendment, VASP is obligated to prevent money laundering, such as customer identification, suspicious transaction reporting, and storage of related data. Accordingly, it is necessary to establish a system to comply with the Travel rules expected in the future. Lastly, VASP must obtain RNVVA from banks, but banks are expected to remain passive because this Amendment does not define the standards for issuing RNVVA.

This Amendment will be good news for some VASPs who have had difficulties in business planning and operation due to the lack of clear regulation on the VA industry. However, it is highly likely that it will be an economic, technical and time burden for startup and small & medium sized VASP, and accordingly, they will probably close their business due to compulsory regulations under this Amendment. It would be difficult to see that the Korean government will completely regulate VA and VASP through this Amendment. However, it does not mean that VA and VASP will forever be unregulated. While investors and VASP have been continuously pouring their money into this market, clear guidance from Korean judicial and legislation should be inevitable. Therefore, the future market of VA can probably answer to the question of whether the VA business will become: (i) "No Daji" in which gold spurts out for investors and VASP; or (ii) "No Touch!" that blocks the access of investors and VASP after this Amendment comes into force.