



**07**

# Whether KWT is securitized under the Korean Capital Markets Act

---



## 07. Whether KWT is securitized under the Korean Capital Markets Act

### (1) Securities under the Korean Capital Markets Act

The Capital Markets Act defines financial investment products as "rights acquired by agreeing to pay money or other property value (hereinafter referred to as "money, etc.") at a certain point in the future for the purpose of obtaining a profit or avoiding loss, and there is a risk that the total amount of money paid or due to acquire the right will exceed the total amount of money recovered or recoverable from the right" (the main text of Article 3 (1) of the Capital Markets Act), and its specific types are classified into securities and derivatives (Article 3 (2) 1 of the Capital Markets Act).

The Capital Markets Act defines securities as "financial investment products issued by Koreans or foreigners that do not bear additional payment obligations under any pretext other than money paid by investors at the same time as acquisition" (the main text of Article 4 (1) of the Capital Markets Act), and the specific types are divided into six categories: ① debt securities, ② equity securities, ③ beneficiary securities, ④ investment contract securities, ⑤ derivative-linked securities, and ⑥ securities (Article 4 (2) of the Capital Markets Act).

The Capital Markets Act describes financial investment instruments as securities and derivatives, and securities as "divided" into six categories, including debt securities and equity securities, which are understood as limited enumeration regulations.

Because of the logical structure of the Capital Markets Act's text, in order to say that a hypothetical asset falls under "securities," it would eventually have to fall under one of six types of securities.



## 07. Whether KWT is securitized under the Korean Capital Markets Act

### (2-1) Whether KWT falls under investment contract securities under the Korean Capital Markets Act

The "Investment Contract Securities" is a concept introduced with the enactment of the Capital Markets Act on August 3, 2007 to include securities "determined by the efforts of others" as securities compared to the previous Securities Exchange Act's limited list of securities.

Since the Capital Markets Act was enacted on August 3, 2007 and the concept of investment contract securities was introduced, it is the first time that the financial authorities have reviewed the investment contract securities and presented a certain conclusion in 2022 that it deals with claims related to sculptural investment in Korean beef, art, and music.

In consideration of the specificity of these issues, the financial authorities judged the claim, which Music Cow has been selling to 170,000 customers for about five years, as the first application case for investment contract securities, but also suspended the start of sanctions procedures for violations of recruitment and sales procedures, citing low awareness and intention of illegality.

In particular, in the case of virtual assets, the financial authorities have repeatedly confirmed this position on December 12, 2017 after stating that virtual assets do not correspond to financial investment products, and it seems that they have maintained the same position as they have never shown a separate position contrary to this.

According to this position, it would be natural to conclude that virtual assets are not financial investment products, so they cannot be applicable to securities, which are sub-concepts that presuppose they are financial investment products.

It is true that the definition of investment contract securities introduced under the Capital Markets Act uses Howey standards, but since the two differ sharply, Howey standards cannot be applied in exploring the concept of investment contract securities under the Capital Markets Act, and it should be reviewed based on the text of the Capital Markets Act and the legislative context.

Investment contract securities mean that "a contractual right is indicated in which a specific investor invests money, etc. in a joint business between the investor and another person and mainly attributes profits or losses from the results of the joint business performed by another person" (Article 4, Paragraph 6 of the Capital Markets Act).

In other words, ① a joint project exists, ② an investor must invest money, etc. in the joint project, ③ the joint project must be mainly carried out by others, and ④ a contractual right to receive profits and losses from the results of the joint project must exist.

KWT appears to be a "semi (準) stable coin" issued with the aim of being used for virtual asset payment and settlement services between operators and participating users within a specific blockchain project.

In this case, the KWT issued by your company is designed to keep its value constant and traded with the expectation that it will remain constant, so it is difficult to regard it as a financial investment product because it has no "purpose to gain or avoid losses" as a basic prerequisite for investment contract securities.

In other words, KWT users bought stablecoins to use them as a means of payment, and it is difficult to see them as buying them for the purpose of earning profits.



## 07. Whether KWT is securitized under the Korean Capital Markets Act

### (2-2) Whether KWT falls under investment contract securities under the Korean Capital Markets Act

Furthermore, if we look at whether KWT falls under the investment contract securities under Article 4, Paragraph 6 of the Capital Markets Act,

#### ① Investing money and more

Here, the investor has acquired KWT by spending legal or cryptocurrency, and as previously seen, there is an act of payment such as money.

#### ② Commonality of business

Since KWT is designed and planned as a quasi-stable coin, there is no room for investors to attribute profits and losses to investors through any market fluctuations, and since there are no profits and losses, there is no room for recognition of both horizontal business commonality (co-investment nature among investors) and vertical business commonality (common destiny relationship between business operators and investors), which are conceptualized as sharing profits and losses.

This is in the same way that the people of a country with a fiat currency do not have a horizontal commonality of interest in the monetary value of that currency, nor do the people within the country that issues the currency have a vertical commonality of interest with the central bank.

#### ③ A business primarily conducted by others

It's hard to see the success of the blockchain ecosystem surrounding KWT and others as being influenced by a "specific third party" putting in significant effort.

The success of KWT hinges on whether or not the price and value of KWT can remain constant in line with its development, as the quasi-stable coin was designed and operated to be stable through the establishment of reserve funds in line with the Financial Supervisory Service's 'Guidelines for the Protection of User Funds of Electronic Financial Institutions'.

This makes it difficult to recognize the existence of certain third parties that have a significant impact on the success of the business.

#### ④ The right to share in profits and losses resulting from a joint venture

As KWT is a quasi-stable coin, there is no room for profit or loss to be attributed to the success or failure of the business, so it is difficult to recognize the commonality of the business, so this requirement, which presupposes profit or loss as a result of a joint business, will naturally not be met.

Even if there is a profit or loss as a result of the joint venture, it is difficult to see how the KWT holder has any contractual rights as a result of its holding.

This is because KWT users do not have any claim against the issuer that would allow them to attribute profits or losses from the business performance to themselves.

While KWT users may sell KWT to others on secondary markets, such as exchanges, this is an indirect and circumventive form of resale, and cannot be treated as the same as if there were an agreement between the issuer and the user regarding the attribution of profits and losses.

In conclusion, it is reasonable to assume that KWT is not a financial investment product in the first place, as it is difficult for users to view it as acquiring KWT, a stable coin for the purpose of earning profits.

Even if KWT is a financial investment product, it will be difficult to evaluate KWT as an investment contract securities because ① there is no horizontal co-prosperity between KWT holders and business operators, ② there is no other person mainly conducting the business, and ③ the holder does not have the contractual right to receive profits or losses from the results of the joint project.



## 07. Whether KWT is securitized under the Korean Capital Markets Act

### (3) Whether KWT belongs to debt securities under the Korean Capital Markets Act

Debt securities refer to government bond securities, local bond securities, special bonds, private bonds, corporate paper securities, and other similar ones (Article 4, Paragraph 3 of the Capital Markets Act).

However, the semi-stable coin KWT is difficult to see as a debt securities in that it does not grant the holder any payment claim to the issuer.

As previously seen, the Capital Markets Act defines financial investment products as "rights acquired by agreeing to pay money or other property values (hereinafter referred to as "money lights") at a certain time in the present or future for the purpose of obtaining profits or avoiding losses, and there is a risk that the total amount of money, etc. paid or due to acquire the right will exceed the total amount of money, etc. recovered or recoverable from the right (the main text of Article 3-1 of the Capital Markets Act).

However, KWT users bought it to use the stablecoin function as a payment method within a particular community, as it is hard to see it as a purchase for the purpose of making a profit.

### (4) Whether KWT belongs to equity securities under the Korean Capital Markets Act

Equity securities refer to stock certificates, new stock acquisition rights, investment securities issued by a corporation directly established by law, equity shares of joint ventures, limited liability companies, limited partnerships, anonymous associations, and other similar ones, indicating the right to acquire equity shares or equity shares (Article 4-4 of the Capital Markets Act).

However, it is difficult to see KWT as equity securities because it does not indicate its stake in the issuing corporation.

### (5) Whether KWT belongs to beneficiary securities under the Korean Capital Markets Act

Beneficiary securities are beneficiary securities issued by trust companies, collective investment companies, and other similar ones, indicating the beneficiary rights of the trust (Article 4, Paragraph 5 of the Capital Markets Act), and KWT holders and issuers are not in a trust relationship and cannot view KWT as a certificate of the beneficiary rights of the trust, so it will be difficult to see it as a beneficiary securities.



## 07. Whether KWT is securitized under the Korean Capital Markets Act

### **(6) Whether KWT belongs to derivative-linked securities under the Korean Capital Markets Act**

Derivative-linked securities mean that the right to pay or recover money according to a predetermined method is indicated in connection with changes in the price, interest rate, indicator, unit, or index of the underlying asset (Article 4, Paragraph 6 of the Capital Markets Act).

In KWT, there are no separate underlying assets, and even if the payment reserve is regarded as an underlying asset, the payment reserve does not directly affect the price of KWT, and the price impact is limited to indirect and realistic levels, and other money that KWT users receive or recover in connection with changes in the payment reserve price is not predetermined, so it is difficult to see it as a derivative-linked securities.

### **(7) Whether KWT belongs to securities deposit securities under the Korean Capital Markets Act**

Securities deposit securities are issued by a person who has received debt securities, equity securities, beneficiary securities, etc. in a country other than the country in which the securities are issued, and the rights related to the deposited securities are indicated (Article 4, Paragraph 8 of the Capital Markets Act).

KWT does not indicate the rights related to the deposited securities, so it is hard to see them as securities deposit securities.