

# NEWSLETTER

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Blockchain Team

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## FSC Announces Guidelines on Determining NFTs' Status as Virtual Assets

On June 10, the Financial Services Commission (FSC) released the "Guidelines on Determining NFTs' Status as Virtual Assets" (**Guidelines**). This comes in preparation for the enforcement of the Act on the Protection of Virtual Asset Users (**VAUPA**), which will take effect on July 19, providing specific criteria for the applicability of the Act. Below, we will detail the specific contents of these Guidelines.

### 1. Background

Under the VAUPA, certain NFTs (non-fungible tokens) are excluded from the definition of virtual assets. Since being classified as a virtual asset carries obligations under various regulations, including the VAUPA and the Act on Reporting and Using Specified Financial Transaction Information (**SFIA**), there was a need to establish clear criteria for determining which NFTs are exempt from virtual asset classification.

### 2. Criteria for Determining the Legal Nature of NFTs

The Guidelines establish a two-step process for determining the legal nature of NFTs:

- a. assess whether the NFT qualifies as a security under the Financial Investment Services and Capital Markets Act (**FSCMA**); and
- b. if not a security, evaluate whether it qualifies as a virtual asset under the VAUPA.

The Guidelines emphasize that this determination should be made on a case-by-case basis, considering the substantive nature of the NFT rather than its name or technology. Factors to be considered include the structure of an NFT's issuance and distribution, terms and conditions, advertisements, and the nature of the business and services offered.

#### ■ Criteria for Determining Whether NFT Qualifies as a Security

The Guidelines stipulate that an NFT must first be evaluated against the definition of a security under the FSCMA. If classified as a security, the NFT would be subject to securities regulations, including public disclosure requirements for issuance.

Under the FSCMA, a security is defined as a financial investment product issued by a Korean national or foreigner, where the investor does not incur any additional payment obligations beyond the money or other property paid at the time of acquisition. A financial investment product is further defined as a right acquired by agreeing to pay money or other property at a specific current or future time, with the purpose of generating profit or avoiding loss, and where there is a risk that the total amount paid or payable may exceed the total amount recovered or recoverable.

In essence, to qualify as a security under the FSCMA, a right that is acquired must: (i) be for the purpose of earning a profit or avoiding a loss; (ii) involve a promise to pay money, etc.; (iii) have investment risk (i.e., potential principal loss); and (iv) not have an additional payment obligation for the principal.

This determination is based on the substantive content of the rights, regardless of how they are represented or named.

For a detailed explanation of how securities are classified, please refer to the “Measures to Overhaul Regulations to Permit Issuance and Circulation of Security Tokens” released by financial authorities on February 6, 2023. This document is particularly relevant when assessing whether an NFT qualifies as an investment contract security, a supplementary and comprehensive category of securities regulated under the FSCMA.

#### ■ Criteria for Determining Whether NFT Qualifies as a Virtual Asset

If an NFT does not qualify as a security, it must then be evaluated against the definition of a virtual asset under the VAUPA.

According to the VAUPA, its Enforcement Decree, and supervisory regulations thereunder, “electronic certificates that exist uniquely and cannot be replaced by other electronic certificates, such as those primarily intended for collection or those used solely for transaction confirmation between parties” are excluded from virtual assets. However, “electronic certificates that can be used as a means of payment for specific goods or services” are classified as virtual assets.

Based on these legal definitions, for an NFT to be classified as a virtual asset, it must: (i) be unique, (ii) be non-fungible, (iii) not be usable as a means of payment for specific goods or services. Further, NFTs with minimal economic function, such as those primarily serving as collectibles or receipts, are excluded from virtual asset classification.

The Guidelines provide examples of NFTs highly likely to be classified as virtual assets as follows:

- 1) NFTs issued in large quantities or as part of large-scale series, increasing their fungibility (i.e., traded primarily for price differences among similar NFTs rather than based on individual value) - determined on a case-by-case basis.
- 2) NFTs that can be fractionalized, significantly weakening their uniqueness.
- 3) NFTs that can be used directly or indirectly as a means of payment for specific goods or services.
- 4) NFTs that can be exchanged as virtual assets among unspecified persons or used for payment for goods or services in conjunction with other virtual assets.

On the other hand, NFTs highly likely to be excluded from virtual asset classification include:

- 1) NFTs intended for purposes other than economic value (i.e., identity or qualification verification, or receipts).
- 2) NFTs with minimal economic function in terms of use and purpose (i.e., limited-issue event tickets used solely for exhibition/viewing purposes).
- 3) NFTs that are difficult to classify as tradable or transferable electronic certificates (i.e., those not tradable on the secondary market)

### 3. Considerations if Classified as a Virtual Asset

- **(Compliance with Virtual Asset Regulations)** If an NFT is classified as a virtual asset, business operators concerned must comply with relevant laws such as the VAUPA and the SFIA, as well as regulatory guidelines.

However, certain items explicitly excluded from virtual asset classification (e.g., game money and items under the Game Industry Promotion Act; electronic prepayment means, electronic currency, electronic bond under the Electronic Financial Transactions Act; the electronic bill under the Issuance and Distribution of Electronic Bills Act; and electronic bills of lading under the Commerce Act) are subject to regulations under their respective laws.

- **(VASP Reporting Obligation)** Businesses dealing with NFTs classified as virtual assets may need to report as virtual asset service providers (VASPs) under the SFIA. Failure to report when required can result in criminal penalties (up to 5 years' imprisonment or fines up to KRW 50 million).

### 4. Implications

These Guidelines aim to clarify the classification of NFTs under the VAUPA, potentially improving regulatory predictability. The financial authorities have indicated their intent to actively interpret and apply relevant laws, including the FSCMA and the SFIA, to address attempts to intentionally circumvent existing regulations.

In light of the above, business operators concerned should carefully examine whether NFTs that they distribute or otherwise handle qualify as virtual assets (or securities) and whether their operations constitute virtual asset services under the SFIA (e.g., purchase and sale, exchange, or transfer of virtual assets) to ensure compliance with relevant regulations.

Lee & Ko's Blockchain Team provides in-depth advice on various legal issues related to blockchain and virtual assets to both domestic and international clients. If you need assistance in this area, please do not hesitate to contact Lee & Ko's Blockchain Team.

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