

Crowdfunding in Korea

UC Berkeley International Symposium on Crowdfunding

October 17-18, 2013

Hye-Hwal SEONG

Professor
Inha Univ. Law School

I. Current Situation in Korea

❖ Funding portals, Investors, and the Amount raised

(\$: US dollars. \$1=1,000 Korean Won (Approximation))

- Funding portals emerged since 2007
 - About **30 companies** at present
- Member investors of funding portals : approximately **200,000**
- Around **\$100 million** raised by crowdfunding up to date
 - No exact estimates
 - One estimate is \$80 million, other is nearly \$200 million

❖ Korea Crowdfunding Platforms

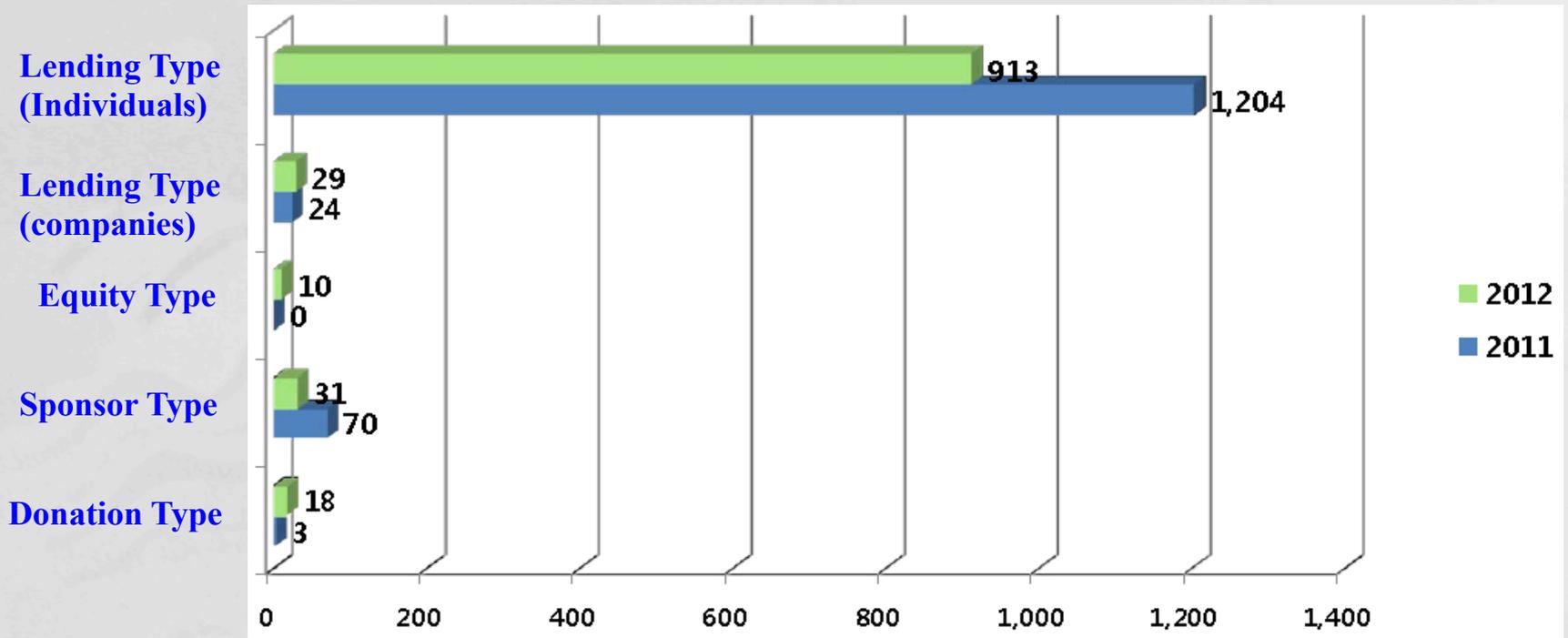
- March 2013, **Korea Crowdfunding Platforms (KCFPS)** established
 - Association of 10 major crowdfunding portals
 - Not official Self-Regulatory organization

< Major Funding Portals in Korea >

Type	Company	Note
Donation	Tumblbug	170 complete or ongoing culture/art projects
	Fundu	Contents in culture, art, IT, venture businesses
	Good Funding	Fund-raising for the film "26 Years"
	Upstart	Small-sized creative projects
Sponsor/Donation	Concrete	Mostly in art/welfare areas
Sponsor/Share Investment/Lending	Opportune	Business sponsor, share investment, lending
Lending	Money Auction	For individuals and small-sized businesses
	Pop Funding	For individuals and small-sized businesses

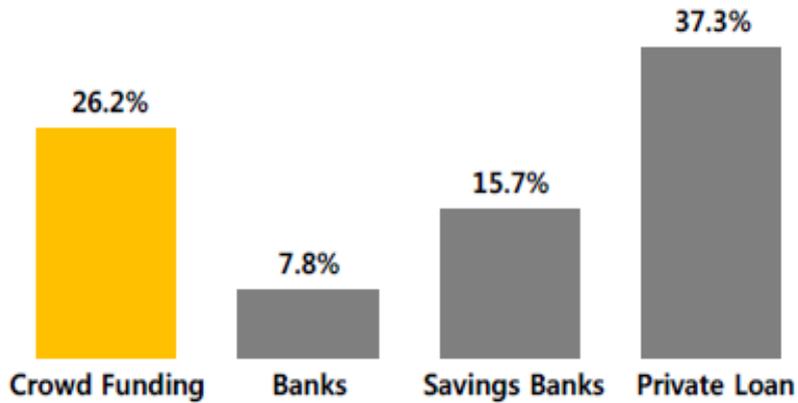
Source: Korea Institute of Finance

< Numbers of Crowdfunding Cases in Korea >



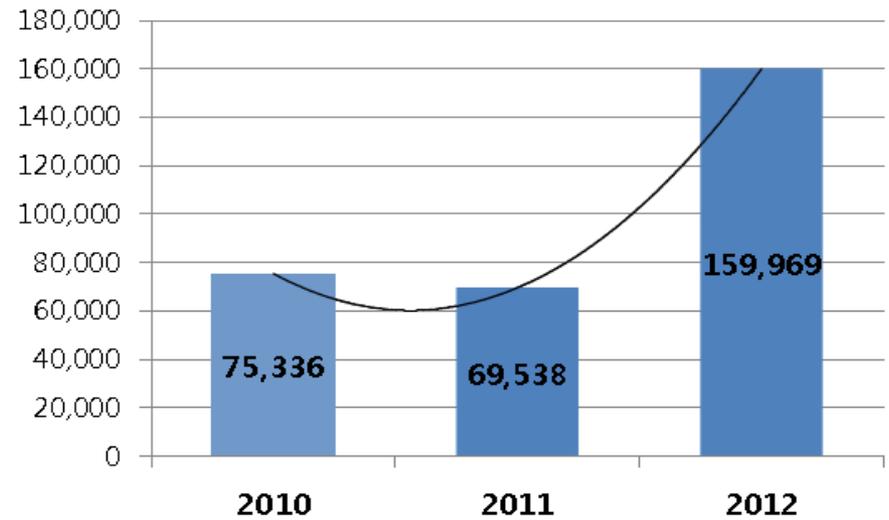
Source: Korea Capital Market Institute
(Counted from seven major funding portals only)

<Comparison of Lending Rates>



Source: Korea Institute of Finance

< Member investors of Funding Portals >



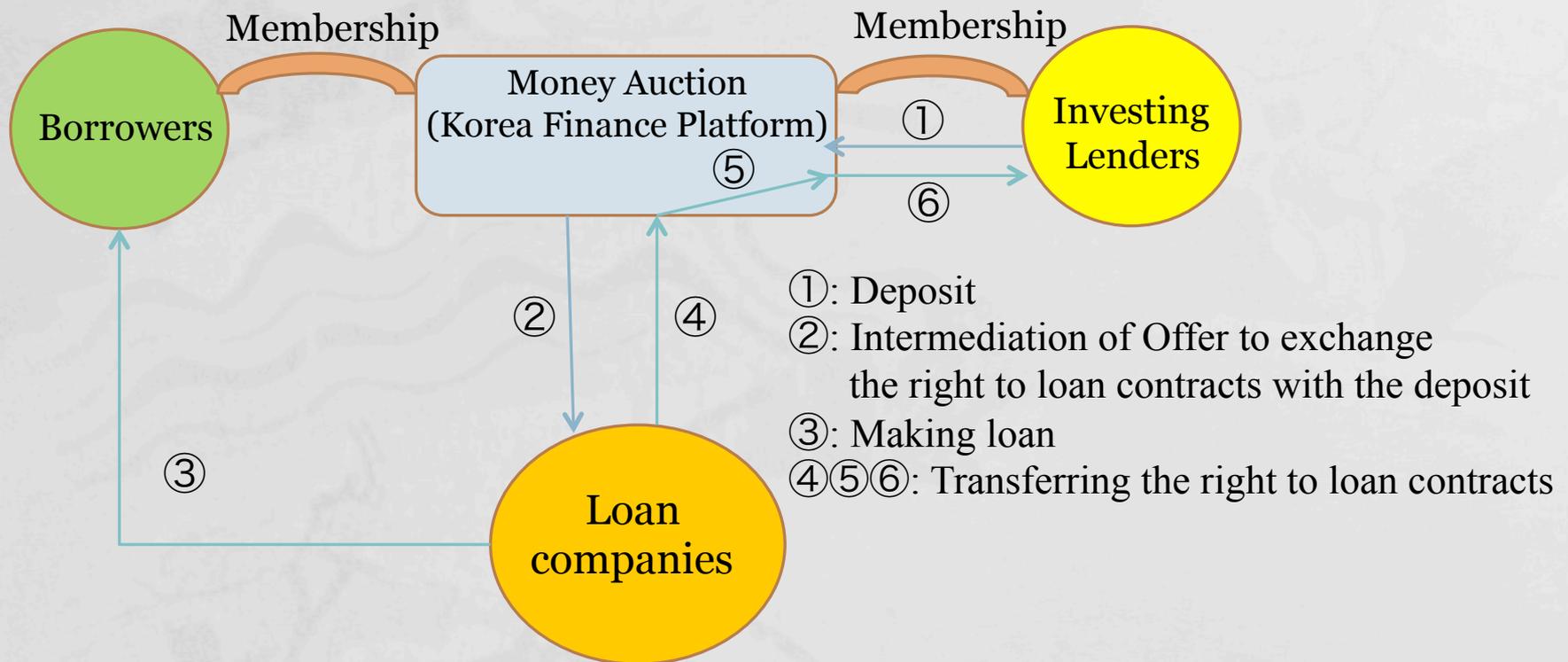
Source: Korea Capital Market Institute
(Counted from seven major funding portals only)

II. Legal Problems with Crowdfunding

Type	Regulatory Issues
Donation type	<ul style="list-style-type: none"> ✓ If \$10,000 or more, regulated by 『Act for Collection of Donations』 ✓ Regulation for pre-registration, audit review, and inspection by municipal governments applied
Sponsor , Pre-purchase , Non-monetary return type	<ul style="list-style-type: none"> ✓ Popular type in culture and art (film, concert, CD, book, product, etc) ✓ Required to register as online sellers or telemarketers pursuant to 『Act for Consumer Protection in Electronic Commerce』 as far as there is no monetary return ✓ If any monetary return combined, it can be an ‘investment contract’ and regulated by 『Capital Market Act』

Type	Regulatory Issues
<p>Lending type</p>	<ul style="list-style-type: none"> ✓ Most common type in Korea ✓ No financial regulation as far as direct lending between lenders and borrowers <ul style="list-style-type: none"> - However, banking regulation can be applied when intermediaries pool the money of lenders and be the counterparty of loan contracts to borrowers ✓ Most lending type crowdfunding in Korea are neither direct lending nor banking types, quite tricky mechanism <ul style="list-style-type: none"> - There are loan companies who are actual lenders - Funding portals are mere agent for the exchange of investing lenders' deposit and the right to the loan contracts - Gray area in regulation

Typical Mechanism of Lending Type Crowdfundings - 'Money Auction' case -



Source: <http://www.moneyauction.co.kr/lender/about/business.run>

Type	Regulatory Issues
<p>Equity investment type</p>	<ul style="list-style-type: none"> ✓ Every invitation to offer for securities (equity or debt) to 50 or more persons is public offering <ul style="list-style-type: none"> - Strictly regulated by 『Capital Market Act』 ♪ - Too much regulatory costs for start-ups ✓ Public offering of \$1 million or less becomes an exempted transaction, and no registration statements and severe civil liabilities <p>However still the regulatory burdens can be costly for startups</p> <ul style="list-style-type: none"> - Duty to submit disclosure documents similar to registration statements (lighter liability for false or misleading statements) - Audit report with certification of CPA - Intermediation of the exempted public offering should be done by registered securities brokers

III. Policy of Government

❖ Innovation for “Creative Economy”

- The new government’s catchphrase for economy is “Creative Economy”
- The main concern of “Creative Economy” is to invigorate start-ups and SMEs
- **Crowdfunding, especially Equity crowdfunding, is highly focused on and praised as an innovative method toward “Creative Economy”**
 - Far less burdensome alternative to usual public offering of securities
- In fact, the problem is not indifference but too much passion for crowdfunding among the departments of the government in Korea
- **Equity crowdfunding is being pushed forward by two parts**
 - **SMEs Department vs Financial regulator (Financial Service Commission)**
- Each made legislative proposals to the National Assembly via Congresspersons
- Still those two are in the negotiation

IV. Details of Legislative Proposals for Introduction of Equity Crowdfunding

IV-1. Issuers

(\$: US dollars. \$1=1,000 Korean Won (Approximation))

	Start-up Companies Support Act (Administered by Department of SMEs)	Capital Market Act (Administered by Financial Services Commission)
Types of Entities	No limitation. Corporation, LLC, LP, LLP, Individual Proprietorship	No limitation. Corporation, LLC, LP, LLP. Individual Proprietorship is unclear
Types of Securities	Equity securities & investment contracts	Equity securities, debt securities (bond, note...), investment contracts
History of Issuers	TBD by Presidential Decree - Maybe less than 7 year companies	
Excluded Businesses	Banking and insurance, real estate, gambling, and some other unhealthy businesses are prohibited from using crowdfunding	
Offering Limit	TBD - Maybe around \$500,000 per year Permitted is selective capital raising (not both) between crowdfunding by this Act and small amount exempted transactions by Capital Market Act for one year	TBD - Maybe around \$700,000 per year

IV-1. Issuers

	Start-up Companies Support Act	Capital Market Act
Duty to Disclose	Duty to disclose via funding portals	Duty to disclose on their websites
Office Work		Required to entrust the 'Korea Securities Depository(KSD)' the management of investors' list
Liability	<p>Subject to administrative sanctions for false or misleading statements</p> <p>No direct liability to investors</p> <ul style="list-style-type: none"> - Funding portals for the issuer primarily take the liability 	<p>Liability for damages caused by false or misleading statements</p> <ul style="list-style-type: none"> - Joint & several liability - Issuer, CEO and/or directors of the issuer, Officers of the issuer directing to make or making the documents for the crowdfunding <p>Damage is legally presumed as the difference between the original invested amount and the remaining amount</p> <p>Statute of limitations</p> <ul style="list-style-type: none"> - 1 year from knowing, 3 years from offering <p>Subject to various criminal and administrative sanctions against the violations of the law and regulations</p>

IV-2. Funding Portals

	Start-up Companies Support Act	Capital Market Act
Entry Regulation	<p>Crowdfunding brokerage should be done by Registered funding portals only</p> <p>Registration to Department of SMEs required</p> <p>Registration to be disclosed to public</p> <p>Net Worth (Owner's Equity) - TBD, Presumably less than \$ 1 Million</p> <p>Professional in brokerage required - Requirement is TBD</p> <p>Control System for conflict of interests required</p>	<p>Crowdfunding brokerage should be done by Registered funding portals only</p> <p>Nobody except registered funding portals can use the name of crowdfunding or similar ones</p> <p>Registration to FSC required</p> <p>Registration to be disclosed to public</p> <p>Foreign crowdfunding intermediaries allowed</p> <p>Net Worth (Owner's Equity) - More than \$500,000 (The least net worth requirement for registered brokers)</p> <p>Control System for conflict of interests required</p>

IV-2. Funding Portals

	Start-up Companies Support Act	Capital Market Act
Prudential Regulation & Corporate governance	<p>Very light regulation</p> <p>Directors & officers have no violation of financial acts and regulations</p> <p>Required to submit annual report</p> <p>Subject to the inspection of Department of SMEs</p> <p>Subject to the disciplinary actions by Department of SMEs</p> <ul style="list-style-type: none">- Revocation of registration, suspension of business, etc	<p>Directors & Officers have no violation of financial acts and regulations</p> <p>Prudential regulation hardly applied</p> <p>Internal control system required</p>

IV-2. Funding Portals

	Start-up Companies Support Act	Capital Market Act
Business Conduct Regulation	<p>Duty to separate investors' money from their own accounts and to deposit or trust it in other financial companies</p> <p>Nobody can offset and/or seize the above investors' money</p> <p>Prohibited from transferring and/or providing as collateral the above investors' money</p> <p>Required to deposit investors' securities to Korea Securities Deposit</p> <p>Periodic duty to disclose about the business situation</p>	Same with SUCSA

IV-2. Funding Portals

	Start-up Companies Support Act	Capital Market Act
Business Conduct Regulation	<p>Duty to disclose (explain) about issuers including risk factors</p> <p>Duty to give educational information to investors for informed decision</p> <p>Duty to update the information about issuers</p> <p>Required to submit to department of SMEs the plans and results of crowdfunding</p> <p>Duty to disclose the standard and procedure for charging brokerage fee</p>	<p>Funding portals are prohibited from purchasing securities being handled by themselves with their own accounts</p> <p>Prohibited from giving investment advice to investors regarding to issuers</p> <p>Duty to certify the investment limits by investors and capital raising limits by issuers</p> <p>Prohibition of most invitation to offers except as follows:</p> <ul style="list-style-type: none"> - Advertisement on its own websites - Issuers' disclosure - Management of investors' forum sites <p>Prohibited from general solicitation of investment</p>

IV-2. Funding Portals

	Start-up Companies Support Act	Capital Market Act
Business Conduct Regulation	<p>Prohibited from charging penalty on investors' revocation of offers to purchase securities until the end of offering period</p> <p>Liability for investors' damages caused by false or misleading representations in the crowdfunding plans of issuers</p> <p>Damage is legally presumed as the difference between the original invested amount and the remaining amount</p> <p>Subject to various criminal and administrative sanctions against the violations of the law and regulations</p>	<p>Prohibited from charging penalty on investors' revocation of offers to purchase securities until the end of offering period</p> <p>Duty to ascertain the information disclosed by issuers</p>

IV-3. Investors

	Start-up Companies Support Act	Capital Market Act
Investment limitation	No aggregated limitation for all issuers Limitation per issuer only	Aggregated limitation for all issuers, and individual limitation for a single issuer
Investment Amount limits	<p>Maximum investment amount : TBD</p> <ul style="list-style-type: none"> - Presumably, about \$10,000 per issuer is the maximum annual limit based on annual income and net asset - Without certification of income or net asset, investment limit may be around \$2,000 per issuer 	<p>With certification of income/asset : TBD</p> <ul style="list-style-type: none"> - Individual issuer limitation: not more than \$10,000 (presumption) - Aggregated limitation: not more than \$20,000 (presumption) <p>Without certification of income/asset : TBD</p> <ul style="list-style-type: none"> - Individual issuer limitation: not more than \$5,000 (presumption) - Aggregated limitation: not more than \$10,000 (presumption) <p> The presumed above amount reflects the intention of FSC to converge crowdfunding regulation into Capital Market Act</p>

IV-4. Other Matters

	Start-up Companies Support Act	Capital Market Act
Resale Restriction		Resale restricted for one year, except transferring to professional investors
Central Repository		<p>Funding portals are required to transfer all the relevant information regarding to crowdfunding to 'Central Repository'</p> <ul style="list-style-type: none">- The main task of the Central Repository is to check the capital raising limitations by issuers and investment limitations by investors <p>Central Repository to be newly established</p>

IV-5. General Estimates and Comments about the Two Proposals

	Start-up Companies Support Act	Capital Market Act
Estimates & Comments	<p>Overriding the basic securities regulation of Capital Market Act</p> <p>Relatively issuer support-oriented</p> <p>Relatively effective support program possible for start-ups - Mixing with other support funds</p> <p>Regulatory focus on funding portals rather than issuers, considering the weak ability to take responsibility of issuers</p> <p>Investment and capital raising limitations are checked by funding portals</p>	<p>The same regulatory framework as the basic securities public offering regulation, but many exemptions are provided</p> <p>Relatively investor protection-oriented</p> <p>International convergence - Crowdfunding regulated by securities regulators in US, Italy, and some other countries</p> <p>Central check & supervision for investment and capital raising limitations by Central Repository</p>

V. Prospects

❖ Solutions being considered and discussed to the confrontation of two legislative proposals

(Presumed based on the relevant articles of newspapers)

1. Division of roles by the two departments

- If the annual amount of crowdfunding of an issuer is \$500,000 or more,
 - Regulated by Capital Market Act and Financial Services Commission
- If the annual amount of crowdfunding of an issuer is less than \$500,000,
 - Regulated by Start-up Companies Support Act and SMEs Department

2. Consolidation of the two proposals and Convergence into Capital Market Act

Honoring the basic perspectives and features of Start-up Companies Support Act

- Relaxation of regulation considering the issuer support mind of SUCSA
- Elimination of the aggregated investment limits for all issuers



Thank You !



hhseong@inha.ac.kr

Hye-Hwal SEONG

- Associate Professor of Law, Inha University
Law School, Incheon, Korea
- Doctor of Juridical Science
- Attorney at Law in New York

- ✓ Vice Chairman of Financial Investor Protection Academic Association, 2012 - Present
- ✓ Secretarial Director of Korea Securities Law Association, 2007 – Present
- ✓ Member of Market Efficiency Committee of Financial Services Commission, 2012 - Present
- ✓ Member of Regulation Reform Committee of Korea Coast Guard, 2012 – Present
- ✓ Member of Advisory Committee of Financial Services Commission for the Overall Revision of the Consolidated Capital Market Act, 2011
- ✓ Member of Dispute Resolution Committee at Korea Exchange, 2009 – 2013
- ✓ Member of Delisting Review Committee of KOSDAQ Market at Korea Exchange, 2009 – 2011
- ✓ Head and Senior Vice President of Legal Department at Korea Exchange, 1990 – 2008