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Legal Update

National Assembly Passes New Law for P2P Lenders, Becoming the First of Its Kind to Provide Legal Basis for Marketplace Lending

On October 31, 2019, during its plenary session, the National Assembly of Korea passed the “Act on the Online Investment-Linked Finance and Protection of Users” (the “**P2P Act**”). The P2P Act is the first law of its kind in the world to have provide a legal basis for P2P lending and marketplace financing. The P2P Act is expected to come into effect 9 months after the promulgation of the P2P Act.

In general, the P2P Act provides the legal basis for the online investment-linked finance business (the “**P2P Business**”), and specifies requirements for engaging in the P2P Business as well as regulations on P2P Business activities and protection of investors and borrowers.

Peer-to-peer lending is a method of debt financing that allows people to borrow and lend money without a financial institution. Investors can be individuals or companies, and can be used by individuals or companies that need a personal loan or a business loan. With peer-to-peer lending, borrowers are matched with investors through a lending platform. Investors can see and select exactly which loans they wish to fund.

Key Aspects

Definition of Online Investment-Linked Financing (“P2P Financing”)

The P2P Act defines P2P financing as: (i) the lending (including bill discounts, securities by means of transfer and other similar methods for the provision of funds, collectively, the “**Linked Lending**”) of investor funds, whereby the lenders invested to fund and designate specific borrowers (such investments, the “**Linked Investments**”); and (ii) the investors’ right to collect the principal and interest for the Linked Lending (Article 2(1)).

Requirements for Engaging in the P2P Business

Under the P2P Act, an entity intending to engage in the P2P Business shall register with the Financial Services Commission of Korea (the “**FSC**”) and must be a joint stock company (*jusik hoesa*), as defined under the Commercial Act. In addition, the P2P Business must meet certain requirements, including a minimum capital of at least KRW 500 million, personnel and systematic facilities, a valid business plan, a system to prevent conflict of interests, eligible executives and major shareholders, and social credibility.

The FSC should make a decision whether to grant registration within two months (may be delayed, subject to any supplements to the registration documents) from submitting the application to register subject to certain exceptions (Articles 5(2) and 5(3)).

Regulations on Activities of P2P Finance Companies

The following are the key aspects of the regulations applicable to the activities of P2P finance companies:

- Requirement to publicly disclose the transaction structure, financial and business status, loan amount, system for evaluating borrowers’ ability to repay loans, default rate, interest rate, fees and other extra expenses, repayment method, and the collection method for the loan principal and interest (Article 10(1) of the P2P Act)
- Interest (including fees collected from the borrowers) limited to the maximum interest rate under the Loan Business Act (24%) (Article 11(2) of the P2P Act).
- Prohibition on: (i) Linked Lending to the lender itself or its shareholders; (ii) Linked Lending prior to soliciting investors; and (iii) providing for different maturity dates and interest rates for Linked Investment and Linked Lending (Articles 12(1), 12(2) and

12(7) of the P2P Act). However, provided that the Enforcement Decree to the P2P Act prescribes a limitation of self investment if the third party investment ratio of the Linked Investments is not more than certain ratio prescribed by the Enforcement Decree of the P2P Act, which ratio shall not exceed 80%. If more than the prescribed ratio is accumulated, then the P2P finance company may make a self investment in the amount less than the prescribed ratio and within the capital limit.

Protection of Investors and Borrowers

- **Confirmation of Information on the Borrower and the Investor:** : P2P finance companies must confirm the borrowers' income, property and liabilities, and they are prohibited from extending Linked Lending in excess of the borrower's objective repayment ability (Article 20 of the P2P Act). Also, P2P finance companies must confirm the identity of the investors of the Linked Investment and the P2P finance companies may, under the use agreement, require investors to provide information about their income, property, investment experience, among others. (Article 21 of the P2P Act).
- **Investor Protection:** The P2P Act includes provisions for reasonable investment judgment by investors and protection of investment funds.

P2P finance companies must provide the following to the investors: (i) information regarding the Linked Lending; (ii) information of the borrowers; (iii) risks concerning the Linked Investment; (iv) the fee rate; (v) the tax rate; (vi) the rate of return and the net rate of return on the Linked Investment; (vii) expected rate of return for the investor; and (viii) debt collection procedures (Article 22 of the P2P Act).

Also, the P2P finance companies must separate the investment funds and loan repayments from the properties and the Linked Investment funds of the investor. The P2P finance companies must also deposit or entrust the investment funds and loan repayments to a bank or to another institution (Article 26 of the P2P Act).

If bankruptcy proceedings or rehabilitation proceedings for a P2P finance company are commenced, the Linked Lending loans will not be deemed to constitute the property of the P2P lender for which the receiver has the authority to manage and dispose, and accordingly, insulating the Linked Lending loans from insolvency (Article 28 of the P2P Act).

- **Credit Line and Investment Limit:** The P2P Act provides for the following limit:

Linked loans to a particular borrower may not exceed a certain percentage of the balance of the P2P finance company's total Linked Investment (may not exceed 10%, as determined by the Presidential Decree). (Article 32(1) of the P2P Act).

Further, investors' Linked Investment will be limited to the investment limit provided by the Enforcement Decree of the P2P Act, considering the investment purpose, financial profile of the borrower (Article 32(2) of the P2P Act).

Other Provisions Regarding the Investment

- **Investment by Financial Institutions:** Specialized credit finance companies – as defined under Article 2(4) of the Loan Business Act or any other entities designated under the P2P Act (excluding P2P lenders) – may engage in Linked Investment up to the limit prescribed by the Enforcement Decree of the P2P Act, which shall not exceed 40% of the Linked Investment (Article 35 of the P2P Act).

Supervision and Inspection

- The P2P Act: (i) grants the FSC and the Financial Supervisory Services to supervise, inspect and regulate P2P finance companies; and (ii) requires P2P lenders to submit business reports and other materials upon the FSC's or Financial Supervisory Services' request (Article 43 and 54 of the P2P Act).

Transitional Provision

- The P2P Act is expected to become effective nine months after promulgation (Article 1 of the Addenda to P2P Act).
- Lenders who have engaged in activities similar to the P2P Business, as defined under the P2P Act (including online linked lender under Article 3(2)6 of the Lending Business Act), may apply for registration as a P2P lender seven months following the promulgation of the P2P Act, and registration must be completed within one year of the promulgation (Articles 3 and 4 of the Addenda to the P2P Act).

Enactment of Subordinate Regulations

- The FSC is planning to promulgate the subordinate regulations by June 2020.
- The subordinate regulations are expected to provide the following: (i) the minimum required capital amount; (ii) requirements for the P2P finance companies' principal investment; (iii) duties of P2P lenders and scope of duties that cannot be delegated; (iv) regulations on advertising; (v) credit line and investment limit; and (vi) scope of financial institutions' participation in Linked Investments

Significance

The P2P Act is the first law to have legally acknowledged a new e-business following the "Act on Registration of Credit Business, Etc. and Protection of Finance Users," and its enactment has significant meaning in that P2P financing, in that it is being acknowledged by a separate legislation. Until now, P2P lending was mainly regulated through guidelines and administrative legislation orders.

With the enactment of the P2P Act, we expect various P2P lending to become more systematized and advanced, contributing to the development of FinTech in Korea and to the adequate protection of users of P2P financing.

Should you have any questions or need further information, please feel free to contact us.

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