

NEWSLETTER

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Korea - Passage of the Act on the Protection of the Virtual Asset Users at the Plenary Session of the National Assembly

The Act on the Protection of the Virtual Asset Users (the **Virtual Asset Act**) which is designed to facilitate and strengthen the protection of the virtual asset users and set in place certain restrictions on unfair trade practices in the virtual asset market, passed the National Assembly on June 30, 2023 and was promulgated on July 18, 2023. The Virtual Asset Act will take effect on July 19, 2024, one (1) year after the promulgation.

1. Background of the Enactment of the Virtual Asset Act

The application of regulations on virtual assets in Korea has been limited to the virtual asset service providers and anti-money laundering obligations as stipulated thereunder have been binding on such virtual asset service providers through the amendment of the Act on Reporting and Using Specified Financial Transaction Information as of March 2021. It has been pointed out that the current anti-money laundering-centered regulatory system standalone is insufficient to pre-empt damage to the virtual asset users, supervise and penalize the virtual asset service providers, and/or redress those users afflicted, with a limit on generating or facilitating proactive response to various unfair trade practices.

As a result, the government has designated the 'Establishment of Digital Asset Infrastructure and Regulatory Framework' as a national agenda to tackle, and further established and operated the 'Digital Asset Private and Public Joint Task Force' on a basis of practical consultations with relevant departments, civilian experts, and industry stakeholders, all of which has led to formulation of a regulatory framework on virtual assets in the direction of 'the gradual and phased promotion of legislation, principles of equal functionality, equal risk, and equal regulation, and global compatibility.'

Following further deliberations and discussions upon a consensus being reached as of April 25, 2023 to first establish a minimum level of necessary regulatory framework as a criterion for consideration at the Subcommittee on Legislative Review of the

National Assembly's National Policy Committee and in turn to push for gradual and phased promotion of legislation that complements such preliminary framework, an alternative bill was put in place which consolidates and adopts from the 19 virtual asset-related legislative bills pending at the National Assembly. Such legislative bill on the Virtual Asset Act, after multiple rounds of discussions and revisions on additional contentious issues, eventually passed the National Assembly's Legislation and Judiciary Committee on June 29, 2023 and the plenary session of the National Assembly on June 30, 2023.

2. Key Contents of the Virtual Asset Act

The focus of the Virtual Asset Act is largely divided into ① protection of assets of the virtual asset users, ② regulation of unfair trade practices in the virtual asset market, and ③ rights of supervision and sanctions by financial authorities on and over the virtual asset market and service providers. The key takeaways are as follows:

Firstly, with regard to the protection of assets of the virtual asset users, institutional framework has been established which entails regulations and obligations binding on the virtual asset service providers to ensure the protection of assets of the virtual asset users - for instance, the virtual asset service providers must ① manage the deposits received from the virtual asset users in the course of virtual asset trading and/or brokerage by depositing or entrusting the same separately from their own assets; ② safekeep virtual assets of users separately from their own virtual assets; ③ possess, in substance, the same type and quantity of virtual assets as entrusted by such users and safekeep the same exceeding the ratio prescribed by presidential decree physically in an offline storage (i.e., cold wallet) separated from the internet; ④ subscribe for and maintain appropriate insurance coverage or mutual aid, or accumulate reserves, to fulfill their responsibilities arising as a result of hacking, system failures, and other unforeseen incidents; and ⑤ preserve trading records for fifteen (15) years to enable tracking and verification of virtual asset transactions and contents thereof.

Secondly, with respect to the regulation of unfair trade practices, ① the Virtual Asset Act, as similar to the Financial Investment Services and Capital Markets Act, prohibits activities such as use of material nonpublic information, market price manipulation, and fraudulent unfair trading practices, and restricts trading of self-issued virtual assets which poses a high risk of falling under or leading to unfair trading; ② the Virtual Asset Act prohibits the virtual asset service providers from arbitrarily blocking deposits and withdrawals without justifiable grounds; ③ the virtual asset service providers must continuously monitor and surveil abnormal trading including an abnormal fluctuation of prices or volumes and take appropriate measures to protect the virtual asset users involved therein; and ④ the virtual asset service providers, when it comes to their knowledge or gives rise to their reasonable suspicion that unfair trade practices have occurred, must promptly report to financial authorities and competent investigation agencies.

Lastly, with respect to the supervision and sanctions on the virtual asset market and service providers by financial authorities, the effectiveness of law enforcement was enhanced by way of establishing clear-cut lines of the authority of financial authorities to supervise, inspect and impose sanctions on or against the virtual asset service providers. In particular, it has clarified that unfair trade practices may be subject to penalties, ranging from imprisonment for one (1) year or more (but up to ten (10) years in case of violation of restrictive provisions on self-issued virtual asset transactions) or fines three (3) times or more of the unjust gains but not exceeding

five (5) times thereof. The property acquired through unfair trade practices shall be confiscated (if confiscation is unfeasible, the value thereof shall be collected punitively).

3. Implications

The Financial Services Commission stated that “the introduction of a regulatory framework for virtual assets through the legislation of the Virtual Asset Act is expected to contribute to the protection of the virtual asset market users and the establishment of a sound and transparent transaction order in the virtual asset market.” They further announced a plan to make necessary preparations (e.g., preparing subordinate regulations) for the following smooth enforcement process and take a pragmatic and multilateral action to establish a market regulatory system by proactively consulting with related organizations such as the Ministry of Economy and Finance, the Ministry of Science and ICT, the Ministry of Justice, the Ministry of the Interior and Safety, the prosecution and the police, the Bank of Korea, and the Financial Supervisory Service, even before the law comes into effect.

With the passage of the Phase-1 Virtual Asset Act which sets forth regulatory provisions to protect the virtual asset users and restrict unfair trade practices, it is necessary to remain on full alert in monitoring the legislative progress of the Phase-2 bill, which will mainly center around regulating the virtual asset market in general including regulating market entry to virtual asset business and/or issuance of virtual assets and public disclosure thereof. Although the legal framework of the Virtual Asset Act is not yet near the completion, the passage of the Virtual Asset Act at the plenary session of the National Assembly entails significant implications from the angle of the full-scale inclusion of virtual assets within the formal regulatory framework. To promote consumer protection and vitalize the virtual asset market, it is crucial to keep an eye on the legislative direction of the Phase-2 bill, especially given a plan of financial authorities to formulate regulatory measures reflecting the discussions and international standards of major countries and international organizations as they become crystalized.

We, the Blockchain Team at Lee & Ko, have been providing in-depth advice to domestic and foreign clients in relation to blockchain, NFTs and virtual asset businesses. If you require any assistance in this regard, please contact the Blockchain Team at Lee & Ko.

For more information pertaining to this newsletter, please contact the attorneys identified on the left.

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