

May 18, 2023

PROTECTION OF VIRTUAL ASSET INVESTORS IN KOREA AND OBLIGATIONS IMPOSED ON VIRTUAL ASSET SERVICE PROVIDERS

On May 11, 2023, a bill (hereinafter the "**2023 Proposal**") on the Act on the Protection of Virtual Asset Investors ("**Act**") has passed the National Policy Committee of the Korean National Assembly. The 2023 Proposal will be finalized in the plenary session of the National Assembly.

The 2023 Proposal is the first phase of the Act which focuses on enhancing the protection of virtual asset investors by introducing the following key points:

- (i) the definition of "Virtual Asset,"
- (ii) the definition of "Virtual Asset Service Provider" ("**VASP**"),
- (iii) the obligations and prohibitions of VASPs to protect investors, and
- (iv) the Financial Services Commission's ("**FSC**") authority to supervise and inspect VASPs.

It is worth noting that during the process of approving the 2023 Proposal, the National Policy Committee also adopted views relating to the second phase of the Act which will focus on market order regulations such as issuance and disclosure obligations. In addition, the FSC will (i) establish a regulatory framework for stable coins (including security tokens, utility tokens, etc.), and (ii) promote research to assist in establishing a presidential decree.

I. MAIN HIGHLIGHTS OF THE 2023 PROPOSAL

A. Definition of Virtual Asset and Virtual Asset Service Provider under the 2023 Proposal

"Virtual Asset" means electronic certificates (including all rights thereto) that have economic value and that can be traded or transferred electronically. Certificates (i) that cannot be exchanged for money, goods or services; or (ii) products obtained through the use of game products, electronic prepayment means or electronically registered stocks; and (iii) electronic currency issued by the Bank of Korea (commonly known as "**CBDC**") are excluded.

"Virtual Asset Service Provider" means an entity engaging in activities of (i) trading virtual assets; (ii) exchanging virtual assets with other virtual assets; (iii) transferring virtual assets as prescribed by a presidential decree; (iv) keeping custody of or managing virtual assets; or (v) acting as a broker, an intermediary, or an agent for the activities described in (i) and (ii).

B. Obligations of a VASP

The 2023 Proposal includes certain obligations to be imposed on VASPs to enhance protection for the investors.

- (i) VASPs must deposit and manage investors' deposits separately from its own account by depositing the investors' deposits with a custodian by using the methods prescribed by a presidential decree.
- (ii) VASPs must segregate any virtual assets deposited by investors from its own pool of assets. The VASPs must also hold the same type and quantity of the virtual assets deposited by the investors.
- (iii) VASPs must take appropriate measures, such as obtaining insurance, to satisfy their liabilities in the event of hacking, computer failure, etc.
- (iv) VASPs must retain transaction records for not less than 15 years from the termination date of the relevant transaction.
- (v) VASPs must constantly monitor price and trading volume of virtual assets to detect abnormal transactions and take appropriate measures where necessary.

C. Prohibition on Unfair Trading Practices

The 2023 Proposal adopts the prohibitions on Use of Material Nonpublic Information, Market Price Manipulation, and Unfair Trading similarly to the Financial Investment Services and Capital Markets Act ("**FISCMA**"). Accordingly, the FSC has the power to impose penalty surcharge in case of any violation as described below table in Section 2. However, it should be noted that the prohibition on Market Disturbances under the FISCMA is not adopted in the 2023 Proposal.

- (i) Prohibition on Use of Material Nonpublic Information: VASPs and its affiliated persons shall not use any material nonpublic information related to the virtual asset business in trading or any other transaction, or permit another person to use it.
- (ii) Prohibition on Market Price Manipulation: No one shall engage in any act with the intent to mislead anyone into believing that a virtual asset is trading in a bull market, or to mislead any third person into making a judgement error.
- (iii) Prohibition on Unfair Trading: No one shall commit any of the following acts: (a) utilizing an unfair means, scheme, or trick; (b) attempting to obtain money or any interest in property by using a document containing a false description or representation of a material fact, or by omitting of a description or representation of a material fact necessary to prevent others from being misled; and (c) using inaccurate market price.

Additionally, VASPs shall not engage in any of the following acts:

- (i) Trading virtual assets issued by itself or its affiliated persons; and
- (ii) Blocking deposits and withdrawals of investors related to virtual assets without justifiable reasons.

D. FSC's Authority to Supervise and Inspect Virtual Asset Service Providers

Under the 2023 Proposal, the FSC has the authority to supervise and inspect VASPs and power to impose penalties and measures, such as corrective orders, warnings, cautions, or business suspension.

The FSC may delegate part of its authority to the Governor of the Financial Supervisory Service ("FSS") as prescribed by a presidential decree.

E. Establishment of a Virtual Asset Committee

The FSC may establish and operate a virtual asset committee to provide advice on policies and systems for VASPs. Please note that the specifics regarding the composition and operation of the committee will be prescribed by a presidential decree.

F. Data Submission to the Bank of Korea

VASPs in Korea should note that the Bank of Korea may request for data if the Monetary Policy Committee deems it necessary for the implementation of monetary and credit policies, promotion of financial stability and smooth operation of payment and settlement systems in relation to virtual asset transactions.

G. Class Action

Under the 2023 Proposal, one or more of person who suffered damages from trading virtual assets or in the process of trading can become the representative party and file a claim for damages in a class action. The available causes to bring a class action are when damages are incurred due to (i) Use of Material Nonpublic Information, (ii) Market Price Manipulation, (iii) Unfair Trading, and (iv) trading of virtual assets issued by itself or affiliated persons.

II. UPCOMING SCHEDULES AND IMPLICATIONS

Since the 2023 Proposal may be modified or supplemented in the subsequent legislative process, market participants are recommended to continuously monitor this area as well as any progress for the second-phase of the Act.

On an important note, under the current version of the 2023 Proposal, administrative fines, penalty, and fines below will be imposed on VASPs who engage in unfair trading practices or violate various obligations. Therefore, it is recommended for market participants to prepare internal control systems and introduce employee training programs before the legislation comes into effect.

Type of Violation	Fine/Penalty
Obligation to separate investors' deposits by depositing it with a custodian agency	Administrative fine not exceeding 100 million Won
Obligation to segregate investors' virtual assets and hold the same type and quantity of the virtual assets	
Obligation to take measures to fulfill liabilities arising from hacking, computer failure	
Obligation to retain transaction records	

Prohibition on Use of Material Nonpublic Information	Penalty surcharge not exceeding the amount equivalent to 2 times the amount of the profits gained or losses avoided by a violation, or up to 5 billion Won
Prohibition on Market Price Manipulation	
Prohibition on Unfair Trading	
	Imprisonment with labor for at least one year or by a fine equivalent to three to five times the profit accrued or loss avoided by a violation
	Subject to Class Action
Prohibition on trading virtual assets issued by itself or its affiliated persons	Imprisonment with labor for at least one year or by a fine equivalent to three to five times the profit accrued or loss avoided by a violation.
	Subject to Class Action
Prohibition on blocking deposits and withdrawals of investors related to virtual assets without justifiable reasons	Liability for damage caused by the violation
Obligation to monitor abnormal transactions	Administrative fine not exceeding 100 million Won

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For any inquiry or questions regarding the content of this newsletter, please contact us.

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