



Enactment of the “Virtual Asset User Protection Act” is Imminent: Implications for the Digital Asset Industry

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1. “Act on the Protection of Virtual Asset Users, Etc.” (the “Virtual Asset User Protection Bill”)

On May 11, 2023, the “Virtual Asset User Protection Bill” was passed during the plenary session of the National Assembly’s National Policy Committee. This bill is the result of 19 separately proposed bills on crypto/digital assets being consolidated and reconciled, and it is expected to be enacted into law by a resolution during the regular session of the full National Assembly. In the meantime, as part of its national policy task on digital financial innovation, the Korean government has been promoting the establishment of an overarching legal system for all crypto and digital assets based (built) on blockchain technology.

Based on the Korean financial regulatory authorities’ classification, crypto and digital assets are largely classified into “securities” and “non-securities,” depending on their economic substance. Digital securities are referred to as “security tokens” and are subject to the “Guidelines on Security Tokens,” which was released by the Financial Services Commission (“FSC”) on February 6, 2023. Security tokens that differ from other securities only in the form of issuance are regulated as securities under the “Financial Investment Services and Capital Markets Act” (the “Capital Markets Act”), similar to the traditional forms of financial securities (i.e., represented in paper (physical) or in electronic form). It is expected that a specific legal framework for the issuance and circulation of security tokens will be created along with an amendment to the Capital Markets Act, the “Act on Electronic Registration of Stocks and Bonds” (the “Electronic Securities Act”), and other applicable laws and regulations.

By contrast, “non-securities-type” digital assets will not be regulated as securities under the Capital Markets Act. While the National Assembly has been promoting the enactment of a framework act to regulate all non-securities-type digital assets, with the Virtual Asset User Protection Bill, the focus is to ensure user protection and to regulate unfair trade practices, which are currently emerging as urgent issues of concern, prior to enacting such a framework law.

Several recent digital asset market-related events in Korea and internationally appear to have some relation to the

legislative and regulatory developments in Korea, such as the Terra Luna crypto crash, the FTX bankruptcy in the United States, and the enactment of the uniform legal framework for crypto-assets markets in the EU, the EU’s “Markets in Crypto-Assets Regulation” (the “MiCA”).

2. Key Provisions of the “Virtual Asset User Protection Bill”

In keeping a balance with the Capital Markets Act, which applies to digital securities, the Virtual Asset User Protection Bill focuses on broadly protecting users of crypto and digital assets, and on regulating unfair trade practices.

The key provisions of the bill are:

- The term “virtual asset” means an electronic certificate of economic value that may be traded or transferred electronically. However, the Central Bank Digital Currency (“CBDC”) issued by the Bank of Korea is excluded (Article 2).
- To protect the users’ assets – and in considering the balance to be kept with the Capital Markets Act applicable to securities-type crypto and digital assets – the bill attempts to regulate crypto and digital asset storage and insurance, and the creation and preservation of crypto and digital asset transaction records (Articles 6 through 9).
- Use of undisclosed material information, market manipulation, fraudulent transactions, among others, are defined as unfair trade practices; in case of violation, sanctions may be imposed, such as liability for damages, class action, penalty surcharge, and other penalties (Articles 10, 13, 18, and 20 through 22).
- A “virtual asset service provider” must monitor abnormal transactions in the crypto and digital asset markets at all times and take appropriate measures, including the obligation to notify the financial regulatory authorities (Articles 11 and 12).
- The bill also provides for matters concerning the financial regulatory authorities’ supervision and inspection of “virtual asset service providers,” and their authority to investigate and take actions against unfair trade practices (Articles 14 through 16).
- The bill provides that the law, if passed, will also apply even if the (illegal) action/practice is committed abroad, if such action/practice affects Korea (Article 3).

3. Outlook for Regulation of Crypto & Digital Asset Markets

If and when the “Virtual Asset User Protection Act” is enacted, following the introduction of the “Act on Reporting and Using Specified Financial Transaction Information,” the basic framework for the legal system governing crypto and digital asset markets will be established, along with the “Guidelines on Security Tokens.”

As the focus of the “Virtual Asset User Protection Bill” is to protect users and to regulate unfair trade practices, going forward, it is possible that a framework act covering all non-securities-type digital assets may be enacted through an amendment of the same law or by separate legislation. Even in the case of “securities-type” digital assets, amendments to the Capital Markets Act and the Electronic Securities Act have been announced. As a result, it is expected that a new

trading (platform) market will be created for the issuance and circulation of security tokens. Although the Korean legal system for crypto and digital asset markets is not yet complete, market changes surrounding these new forms of assets are already becoming a reality.

The Korean legal system for crypto and digital asset markets needs to achieve both goals: creating a new market using distributed ledger technology and user protection. So that crypto and digital asset trading can be activated while these two goals are harmonized, going forward, there is an urgent need to promote reasonable and effective policies and to prepare appropriate legislation (law). The reason why foreign laws and regulations are gaining attention in Korea is due to the fact that other countries and regions have already passed relevant laws and regulations on crypto and digital assets and related technologies, such as Singapore, Japan, and the EU (which finally approved the MiCA on May 16, 2023).

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