

NEW ENFORCEMENT DECREE ON THE PROTECTION OF VIRTUAL ASSET USERS APPROVED BY THE GOVERNMENT

<Ensuring safe protection of users' deposits and virtual assets>

- User deposits should be kept at banks and invested in risk-free assets.
- User deposits shall be returned to users by banks when VASPs go bankrupt.
- More than 80 percent of users' virtual assets should be kept in cold wallets.

<Prohibiting unfair trading activities>

- Detailed standards provided on the use of material nonpublic information.
 - Method for calculating unfairly gained profits established.
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The Financial Services Commission announced that the government approved a new legislative bill on the Enforcement Decree of the Act on the Protection of Virtual Asset Users at a cabinet meeting held on June 25. The Enforcement Decree will go into effect on the same day as the Act on the Protection of Virtual Asset Users ("the Act" hereinafter) on July 19.

The Act was enacted on July 18, 2023 with aims to protect virtual asset users and establish a sound order in the virtual asset market. The Act provides definitions on virtual assets and those that are excluded from the scope of virtual assets. The Act mandates virtual asset service providers (VASPs) to safely keep and manage users' deposits and virtual assets. The Act also establishes legal grounds to impose penalties and sanctions on unfair trading activities, such as the use of material nonpublic information and price manipulation. In this regard, the Enforcement Decree to the Act approved by the Government today prescribes specific procedures and methods delegated by the Act as follows.

KEY DETAILS

Definition and Formation of an Advisory Committee (Articles 2 to 7)

Virtual assets are defined as electronic tokens with economic value, which can be traded or transferred electronically. Electronic tokens that are regulated by another legislation or are deemed to pose no harm to users, such as game money, electronic money, electronic stocks, and central bank digital currency (CBDC) are excluded from the scope of virtual assets. Electronic bonds, mobile gift certificates, deposit tokens linked to the CBDC network, and non-fungible tokens (NFTs) are also added to the listed of excluded tokens.

The FSC will organize an advisory committee on virtual assets to seek consultation on related policies and regulations. The committee will be made up of representatives of relevant government ministries and experts from the private sector, and will be chaired by Vice Chair of the FSC.

Management of User Deposits (Articles 8 to 10)

VASPs should keep and manage customers' deposits at credible financial institutions. Under the Enforcement Decree, banks are designated as credible financial institutions. VASPs and their custodian institutions are required to keep customers' deposits separate from their own funds. VASPs and banks should enter a custody service agreement whereby banks will manage VASPs' user deposits to invest in risk-free assets, such as national and local government bonds and pay yields to VASPs.

In the case that a VASP goes bankrupt or if its business registration is cancelled, the custodian institution (bank) will return user deposits directly to customers after publishing specific time and place for reimbursement on daily newspapers and websites. This will ensure safe return of deposit for virtual asset users even in the case of their VASPs becoming bankrupt.

Protection of Users' Virtual Assets (Article 11)

VASPs are required to keep more than 80 percent of users' virtual assets in cold wallets (specific level determined by the FSC). Specific cold wallet storage requirements will be regulated by the subordinate regulation on the supervision of VASPs. In special cases where there are concerns for hacking, malfeasance, business closure, or other reasons that may be alarming, the FSC may impose a specific cold wallet ratio on a particular VASP.

Prohibition of Unfair Trading Activities (Articles 15, 16, 18)

VASPs should regularly monitor transactions for suspicious or abnormal trading activities, particularly focusing on instances in which (a) the price of virtual assets or volume of transactions becomes unusually volatile, and (b) there are rumors or reports that may potentially affect the movement of prices. Specific standards on suspicious or abnormal transaction activities will be drawn up through self-regulatory guidelines prepared by the Financial Supervisory Service (FSS) and the virtual asset industry. When finding any suspicious or abnormal transaction activities, VASPs should immediately report to the financial authorities.

The Enforcement Decree also provides specific standards on how to distinguish material nonpublic information from publicly available information. In this regard, the standards adopted are equivalent to those currently applied for investment transactions under the Financial Investment Services and Capital Markets Act (FSCMA). In this regard, a particular piece of information is no longer considered to be nonpublic if (a) two or more of daily newspapers or economic dailies have reported on it (from 06:00 am the following morning), or (b) it has been reported by national broadcasters and Yonhap News (from six hours after reporting). Information made available through virtual asset exchanges will no longer be considered as nonpublic after six hours from the time of publication, or after one day if the information has been published on the issuer's website. In this case, the issuer's website needs to be accessible for the general public, and it should have updated posts of material information in the preceding six months.

With the implementation of the Act, unfair trading activities involving virtual assets

become subject to criminal punishments and penalty surcharges. The severity of prison sentence, administrative fine, or penalty surcharge is determined by the amount of unfairly gained profits. For criminal penalties, a prison sentence of minimum one year or a fine of three to five times the amount of unfairly gained profits can be imposed. When the amount of unfairly gained profits is between KRW500 million and KRW5 billion, a prison sentence of minimum three years can be imposed. When the amount of unfairly gained profits is KRW5 billion or more, a prison sentence of minimum five years to up to life may be imposed. A penalty surcharge of twice the amount of unfairly gained profits can also be imposed. When it is not possible to assess the amount of unfairly gained profits, maximum KRW4 billion in penalty surcharge can be imposed. In this regard, the Enforcement Decree prescribes how to calculate unfairly gained profits depending on the different types of unfair trading activities—use of material nonpublic information, price manipulation, and dishonest transaction—and according to the method for calculating realized gains, unrealized gains, and losses hedged by such wrongdoing.

Prohibition of Arbitrary Deposit and Withdrawal (Article 17)

When there are reasonable grounds, VASPs are able to block users from making deposits or withdrawals. Under the Enforcement Decree, the reasonable grounds constitute unavoidable instances where there is an error in telecommunications network over which virtual asset transactions take place, or when there is system maintenance to address network problems. When demanded or directed by an administrative authority, pursuant to the National Tax Collection Act, or when customers' deposits or virtual assets are deemed to be associated with illegal properties, pursuant to the Act on Regulation and Punishment of Criminal Proceeds Concealment, VASPs are able to suspend customers from making deposits or withdrawals. Suspending deposits or withdrawals can take place for two months each time for maximum six months.

FURTHER PLAN AND EXPECTATION

The Enforcement Decree will be promulgated in early July. The FSC's proposals for subordinate rules and regulations will be introduced after a deliberation by the FSC at a regularly scheduled meeting on July 10. Together with the Act on the Protection of Virtual Asset Users, the subordinate rules and regulations will become effective on July 19.

With the implementation of the Act, the authorities expect that users' deposits and virtual assets will be more safely protected by VASPs, and unfair trading activities will be more effectively regulated, which will ultimately help to create a more safe market environment for virtual asset users.

The FSC and the FSS will seek to ensure thorough preparation for the enforcement of the Act to continue to work on user protections and promote sound market order.

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