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Uncharted path: Experts seek light-touch norms to regulate cryptocurrency

Experts say what will also play on the minds of policymakers is the potential upside of taxing the cryptocurrency trade.

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*The Supreme Court's order has made it clear that virtual currencies do come under the mandate of the RBI.
(Illustration: Ajay Mohanty)*

In the aftermath of the apex court's landmark judgment on the use and regulation of cryptocurrencies, the fate of the draft Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019, hangs fire. The draft Bill, in stark contrast to the court's order, stipulates that the use of cryptocurrency is punishable with a fine or imprisonment of up to 10 years. Both government and banking sector regulator — the Reserve Bank of India — have to go back to the drawing board once more to firm up their views on the nascent cryptocurrency ecosystem.

“The judgment will free up entities to innovate in, and further develop, technologies based on blockchain or distributed ledger technology,” says Arun Prabhu, partner, Cyril Amarchand Mangaldas. It becomes all the more important in such a scenario for the government and the regulator to revisit and shape regulations surrounding cryptocurrencies, and help foster growth of the evolving ecosystem.

“Infrastructure and talent in the country provide an unprecedented economic opportunity,” says Dinkar Kalra, advocate-on-record, and author of the book *Crypto Currencies in India: Not Illegal, But Not Quite Legal*.

Experts say several scenarios could now pan out. The Supreme Court’s order has made it clear that virtual currencies do come under the mandate of the RBI. So, the central bank could seek a review of the judgment. If the RBI does so, it may leave room for further deliberation. The RBI, with the backing of the government, may stress on its authority to protect consumers from possible frauds.

The other scenario is where the legislature may still think about going ahead with a blanket ban, but experts say, the chances of that may be low. The Supreme Court has noted that the RBI did not have enough material on record to show that the ban, which it imposed, qualified the test of proportionality. However, if the legislature were to pass a law in this regard, and if that law were to be challenged in the court, it would have to pass this test by backing its arguments up with solid evidence. “It is for the government to establish that the risk of damage warrants measures, such as a ban”, says Anirudh Rastogi, founder, Ikigai Law, which represented crypto exchanges in the case.

Another option for the government is to reconsider its stance in light of the judgment.

It could take into account several factors, such as the Financial Action Task Force’s Guidance for a Risk-Based Approach to Virtual Currencies, published in June 2015, which recommended that countries proposing a ban on cryptocurrencies should consider if such a prohibition would drive the industry underground, bypassing controls. The government could also revisit the Inter-Ministerial Committee’s initial report in 2018, along with a draft Bill — the Crypto Token and Crypto Asset (Banning, Control and Regulation) Bill, 2018. The Bill had provisions to allow the sale and purchase of cryptocurrencies at recognised and regulated exchanges. The Committee initially was of the view that the banning option was difficult to implement and, that could also drive some operators underground, encouraging the use of such currencies for illegitimate purposes.

In case the government revisits the Bill, it would be a wait-and-watch game for the industry. “Given the legal complexities, multiple authorities (including the RBI, Sebi, ministry of finance, etc) will need to weigh in,” noted Sanjay Khan Nagra, partner, Khaitan & Co.

Jaideep Reddy and Vaibhav Parikh, lawyers at Nishith Desai Associates, who represented the petitioner in this case, suggest the government consider a new licensing regime for virtual currency intermediaries, supervised by an expert body with capability in technology, economics and finance. The licensing requirements could include capital adequacy requirements, fit and proper criteria, and disclosure requirements.

Experts stress the need for light-touch regulations for the evolving cryptocurrency ecosystem. “If the regulator wears the hat which works for the currency and security interest world, the regulations may easily end up practically as a ban,” says Srinivas Katta, partner, Induslaw

Experts say what will also play on the minds of policymakers is the potential upside of taxing the cryptocurrency trade. “Cryptocurrencies are here to stay, and the sooner the world’s legal systems adapt to it, the less painful the transition will be,” says Dinkar.

Regulatory Sandbox Idea Last August, the RBI had come out with an enabling framework for regulatory sandbox. Some experts feel the regulator could explore putting in place a regulatory sandbox for fintech companies using cryptocurrency technologies.

“Allowing fintech firms to test fintech innovations relating to cryptocurrency/assets will enable the RBI to develop an evidence-based regulatory response for cryptocurrencies in India,” says Shehnaz Ahmed, senior resident fellow, Vidhi Centre for Legal Policy.

Regulatory sandboxes provide an avenue for regulators and innovators to test their innovations within a regulated environment. It helps them collect evidence on the benefits and risks of new financial innovations while monitoring and containing their risks.

Vidhi Centre for Legal Policy’s in a report, *Blueprint of a Fintech Regulatory Sandbox Law*, argues for a standalone law that will bring sandbox testing of fintech innovations under a common framework. The proposed framework would provide a formal mechanism for all relevant financial sector regulators — in this case the RBI and Sebi — to participate in sandbox testing.

Outlining the broad contours of the proposed law, the report suggests creating an inter-regulatory co-ordination committee, consisting of financial sector regulators. While each regulator could continue operating its own sandbox, the proposed law should lay down minimum standards for fintech sandbox testing in the country, it says.

India would not be the first country to have a separate law for sandbox testing. Separate laws for sandbox testing are in Taiwan and South Korea. The UK, Singapore, and Australia already have a common financial sector regulator following a unified framework.