Business Standard

Explained: Why there is a need to regulate crypto-assets in India

There is a misunderstanding that crypto-assets like Bitcoins are illegal in India

Business Standard **February 03, 2019** Last Updated at 23:31 IST

A committee headed by Subhash Chandra Garg, economic affairs secretary, is in the process of drafting regulations to govern crypto-assets. Vaibhav Parikh, senior leader, and Jaideep Reddy, leader, at law firm Nishith Desai Associates, explain why there is a need to regulate crypto-assets, not prohibit their use

There is an impression that the RBI has banned Bitcoins. Is this correct?

There is a misunderstanding that crypto-assets like Bitcoins are illegal in India. No doubt, crypto-assets are not 'legal tender', but this does not make them illegal. The fact that they are not 'legal tender' only means they are not recognised as Indian currency. However, they can be classified legally as digital goods. The RBI circular prohibits its regulated entities (i.e. banks, etc.) from facilitating the buying and selling of virtual currencies, including Bitcoins. This makes trading in crypto-assets impractical since it cannot be done through banking channels. On a policy note, no major democratic country has banned crypto-assets. If India chooses to do so, the entire blockchain ecosystem, which has huge benefits to bring to the country, will move out. This exodus has already begun after the RBI circular. Crypto-assets are an integral part of blockchain technology as we have discussed in detail in our submission to the government. Throughout history, regulation has always been found to be a more effective solution than prohibition.

What are the arguments in favour of the government regulating crypto-asset activity rather than prohibiting it?

An outright ban on crypto-asset activity should not be considered for several reasons. Many experts agree that crypto-assets are essential to blockchain technology, which is a new and disruptive technology that presents both benefits and risks. Crypto-assets create an incentive for blockchain participants to verify transactions. Crypto-assets bring benefits such as disintermediation, which in many cases leads to reduced transaction costs and greater transaction integrity. Examples from history (electricity, railways, telecommunications, motor vehicles, aircraft, mobile phones, and the internet) have taught us that, despite initial regulatory scepticism, disruptive and complex technologies should be regulated and not banned. Banning crypto-assets is likely to have counter-productive effects and may also suffer from constitutional infirmities. Rather, in line with the approach of the G20, the Financial Action Task Force, and advanced economies like the EU, the US, Japan, and Singapore, a balanced regulatory approach should be taken to promote the various benefits of the technology and mitigate the risks. A recent study by Incrypt, which surveyed Indian blockchain software developers, found that blockchain has the potential to be one of the next major growth drivers for the software ecosystem in India, and that allowing crypto-asset transactions is integral to this. A prohibition would nip this opportunity in the bud.

Can the current body of laws be used to regulate crypto-assets?

We submitted and presented to the Subhash Garg committee a detailed paper, *Building a Successful Blockchain Ecosystem for India: Regulatory Approaches to Crypto-Assets*, in this respect*. The paper delves into detail on the precise steps under the Indian legal framework that the government could take to regulate crypto-assets. Crypto-asset businesses could be brought within the Prevention of Money Laundering Act by a simple central government notification. This would bring them within a well-established regulatory regime and tackle one of the main concerns expressed about them. Crypto-asset businesses should also be licensed in order to protect consumers and avoid fraud and systemic risks. There are already regimes being considered by the finance ministry to regulate commodity spot exchanges and other unregulated exchanges. Crypto-asset exchanges can be brought within these regimes. Alternatively, a variety of laws, like the Consumer Protection Act, the Foreign Exchange Management Act, the Securities Contracts (Regulation) Act, and NBFC laws enable the government to frame specific regulations for various aspects of crypto-asset business activity. In either case, responsibility for such licensing or oversight should be clearly assigned to a given regulatory body to avoid jurisdictional ambiguity. Since the Securities and Exchange Board of India (Sebi) has proven expertise as regards exchanges and investor protection, it is one option that can be considered.

Meanwhile, existing laws such as those relating to consumer protection, securities, taxes, and white collar crimes should be actively enforced with regard to crypto-asset business activity. Much of this activity is already covered by these laws (eg, the recent prosecution of OneCoin and GainBitcoin). However, the applicability of some of these laws may be further clarified specifically with respect to crypto-assets.

It is also worth noting that all crypto-assets are not alike. There are over 2,000 of them and the implications of each should be assessed on a case-by-case basis. We have suggested three categories of crypto-assets to facilitate analysis.

**As a disclosure, Nishith Desai Associates advises and represents various clients in legal matters relating to crypto-assets*