Our Views

Crypto is Cryptic

In my view, in the history of mankind, crypto has been the fastest asset creation – creating almost $2 to $3 trillion in the 10 years since Bitcoin was launched in 2009. Today, world-wide it is one of the most talked about asset-class, or should I say a puzzle! To utilise this asset and to enjoy its benefits as a part of the economic mainstream, regulators and policy makers worldwide are racking their brains on how to set boundaries around it. Across, the globe and in India, there are intense discussions going on about how to regulate this market.

A typical crypto could include crypto currencies, virtual assets, digital currencies etc. However, for the purpose of this discussion I am focussed on crypto coins, tokens and their derivatives which are cryptographically secured. Crypto coins work through a distributed ledger technology which keeps a secured record of individual coin ownership. The ownership can be transferred from one person to the other electronically through a digital platform.

Given the digital nativity of these currencies, lack of transparency about trades and traders, and the global ubiquity of the crypto platforms, an unregulated crypto could be a big systemic challenge. It could lead to situations like a person purchasing crypto coins in foreign currency abroad and selling to someone in India, earning large sums of money avoiding taxation of the country and getting away without any checks of KYC, AML or foreign exchange regulations. Effectively, unregulated crypto could mean unfettered money laundering, unregulated outflows and inflows of forex and a side door to fully convertibility of the currency. As an alternative currency, it could pose threat to monetary policy, and cause issues related to investor protection and fair market practices, security and technological risks.

So, is there an option but to regulate the crypto market? Some may say, ban crypto in India – but is that really an option? Crypto is a digital product which is delivered digitally with no physical traceability – it may well already be existing in the Indian market in some form or the other. Regulating the crypto market with very strong checks and balances could be a solution.

The big question that most regulators across the globe are grappling with is how to regulate this market. The Indian policymakers could also look at the approach followed by some other countries. In the UK, the FCA had provided guidance and regulatory approach in 2019. Further, a conducive environment for innovation was fostered by addressing uncertainty around taxation and KYC/AML. Any sale, use, or exchange of crypto assets attracts capital gains tax and exchange wallet providers are required to be registered. Singapore has also adopted a very supportive approach with a comprehensive regulatory framework including MAS licensed and regulated digital payment tokens and service providers, FATF rules around AML/ CFT, and taxation rules with no capital gains on long term holdings. In Japan, crypto currencies are recognised as crypto assets and are regulated by the securities regulator. AML/ CFT compliance as per FATF have been mandated, and income/ gains from Crypto currency is taxed as miscellaneous income. Brazil has not issued any specific regulations but existing regulations for financial sector cover crypto business. Capital gains tax is applicable, and it is the responsibility of citizens to divulge details to tax authorities.

China, on the other hand, has announced a ban on cryptocurrency transactions. It is conducting a multi-year experiment with its Central Bank Digital Currency or CBDC (termed as e-CNY) which was rolled out in 4 cities to 21 million personal and over 3.5 million corporate wallets resulting in over RMB 34.5bn of transaction value.

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In my view, the regulatory framework would depend on how we define a crypto currency – is it a currency, an asset, or a commodity? The overall regulatory framework/ response could be

1. A detailed KYC framework for any Crypto transaction/ ownership wherein one leg of the transaction is in India or by an Indian

2. A detailed ALM framework based on the trace of money

3. An adequate taxation framework

4. Securities laws depending on whether it is considered a security or a commodity

Of course, given that crypto is a new and evolving technology, the regulatory framework too will have to be dynamic and evolving. Finally, a panel of crypto experts should be created to assist the Government, Regulators and Policy Makers to keep a regular tab on the situation and to facilitate appropriate decision making.

In conclusion, I would say that business as usual is not an option. No action from the Government would mean acceptance of the status quo which has deep risks associated with it. Undoubtedly, it will certainly not be easy to regulate crypto. But its damn if you do, damn if you don't. A swift and evolving regulatory response is a must to decode the Cryptic Crypto.

https://economictimes.indiatimes.com/markets/cryptocurrency/crypto-rules-are-needed-to-avoid-systemic-risks-but-how-we-classify-them-matter/articleshow/87866296.cms

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