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Submission to MyGov.in on Virtual Currencies Framework

Background

The Government of India has invited comments from the public on specific questions with respect to regulation of virtual currencies.

CUTS International (www.cuts-international.org) is an independent non-profit economic policy research and outreach organisation. It leads evidence based initiatives to promote improvement in regulation, competition and governance across sectors, with goal of enhancing consumer welfare.

Comments from CUTS International on specific questions are set out below:

a. Whether Virtual Currencies (VCs) should be banned, regulated or observed?

Virtual Currencies, also known as cryptocurrencies, are an outcome of deep innovation and technology advancement, no person or organisation claiming the ownership or control over it. VCs are transacted using blockchain technology that is secure and functions in a self-governed environment. The quantum of VC trade in India is at very nascent stage, when compared with regularised financial transactions, yet path-breaking.

VC transactions are decentralised and interoperable in the blockchain environment. As India is embracing digital payments and exploring multiple solutions to ensure that consumers transact online, VC is an option worth exploring as it has the potential to benefit the financial inclusion initiatives of the Government of India in the long run. With no transaction cost or time involved, VCs would significantly reduce operational pressures on other transaction modes currently prevalent.

Banning or directly regulating VCs will act as a major deterrent to innovations in the financial technology start-up sector of India. The situation is similar to the torrent network ban, which has prima facie reduced privacy but with less impact. Further, banning any activity without necessary resources to implement such ban might not result in desirable outcomes.

At the same time, we understand that the key bitcoin start-ups in India have come together to form Digital Asset and Blockchain Foundation of India[1] for orderly and transparent growth of virtual currency market.[2] It would be prudent for government to engage with such forums to better understand the functioning of virtual currency, its benefits, associated risks and challenges. It has previously adopted similar approach when it worked closely with iSpirit for creating necessary policy and regulatory infrastructure for digital payments and creation of IndiaStack. It will be crucial to ensure that such forum has representation from all stakeholder groups, including consumers, in form of credible consumer organisations. The government should promote such self-regulatory initiatives over direct or indirect regulatory interventions.

Further, regulation should be allowed only on existence of market failure and costs of non-regulatory options (including self-regulation and co-regulation) outweigh respective benefits to the economy. Any restriction without understanding the implications may prove to be an impediment to the future digital aspirations of India.

Hence, at present, instead of banning or regulating, the government should be more inclined towards observing the trend/trading of VCs, while promoting the self-regulatory approach.

b) In case VCs are suggested to be regulated:

i). What measures should be taken to ensure consumer protection?

In order to better understand the use cases of virtual currency and risks to consumers, the government could adopt a regulatory sandbox approach, i.e. permitting use of virtual currency in controlled environment (within specified consumer base – with informed consent, for specific time and specific purposes).[3] This will help understand consumer protection

[1] http://dabfoundation.in/

[2] See, Choudhry, *Will self regulation by bitcoin players spur RBI to authorise use of virtual currencies,* 07 April 2017, Yourstory, https://yourstory.com/2017/04/bitcoin-dabfi/. Also, http://techcircle.vccircle.com/2017/02/27/bitcoin-startups-come-together-to-regulate-indias-cryptocurrency-market/

[3] The Reserve Bank of India's research arm Institute of Development and Research in Banking Technology had issued a whitepaper on applications of blockchain technology for banking and financial sector in India (see, http://www.idrbt.ac.in/assets/publications/Best%20Practices/BCT.pdf). Similar approach could be adopted in case of virtual currencies.

concerns relating to virtual currencies and facilitate the self-regulatory forums to design appropriate disclosure and grievance redress standards.

Based on the findings of the regulatory sandbox, the government can work with self-regulatory forums to ensure market based solutions in form of adequate transparency, disclosures and insurances are available for consumers to deal with losses.

In addition, the regulator must ensure a balanced risked based approach wherein sophisticated informed consumers are not eligible for extra protections available for uninformed and retail consumers.

The regulator may also keep track of the data with respect to consumer concerns and must intervene through regulation and other means only when such concerns cross a pre-determined threshold. It does not make sense for regulator to intervene sans existence of market failure.

ii). What measures should be taken to promote orderly development of VCs.

As an observer, government and regulator must ensure that VCs are facilitated by deploying pilot projects. In the present scenario, VCs development cannot be controlled or moderated. It may just be facilitated or resisted, that too with limited impact.

It be important for the government to take note of international developments with respect to regulation and orderly promotion of virtual currencies. A recent IMF staff paper lists out following principles which national authorities could consider while developing responses to virtual currencies:[4]

1. Regulatory responses should be commensurate to the risks without stifling innovation
2. Regulatory responses should adapt to the changes in the VC landscape

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[4] IMF Staff Discussion Note, Virtual Currencies and Beyond: Initial Considerations, January 2016, at https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf. It makes important point for regulating VC intermediaries which is also a practice in jurisdictions like New York and Singapore. Also, http://www.nfcidea.pl/wp-content/uploads/2015/02/Regulation-if-Virtual-Currancies-by-Jumio.pdf and http://www.international-adviser.com/print_article/international_adviser/news/1006222/singapore-virtual-currency-regulation?print=true and https://www.economie.gouv.fr/files/regulatingvirtualcurrencies.pdf

3. Regulators should design approaches that take into account the novel business models inherent in VC schemes
4. Regulation may need to address not only market conduct issues (for example, anti money laundering /combating financing of terror, fraud), but also the financial soundness of VC intermediaries.
5. Due consideration should be given to the degree of integration between the conventional financial system and the VC market.

The Financial Action Task Force also provides some guidance in this regard. Among other things, it recommends countries to apply risk based approach to ensure measures to mitigate money laundering/ terrorist financing are commensurate with the risks identified.[5] Consequently, the regulator should be highly vigilante of VC transactions, to understand the transactions and source of earning and also the application of necessary taxes, since VCs are prone to illicit activities such as money laundering, drug procurement, etc.

iii). Which appropriate institution(s) should monitor/ regulate the VCs?

For now, the best possible option can only be the financial regulator, the Reserve Bank of India (RBI). However, it is recommended that RBI should have an exclusive cell on VCs that must include civil society and consumer organisations.

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[5] Financial Action Task Force, *Guidance for risk based approach on virtual currencies,* June 2015, at http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf