

Cryptocurrencies in India: Proposed Regulations and the Future

By

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1.State of Issues

The Lok Sabha (Lower house of the Indian parliament) bulletin dated Jan 29, 2021 listed a bill entitled, Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 under 'E' New Bills, awaiting an introduction, consideration, and passing. As mentioned in this bulletin, the aim of the bill is, "To create a facilitative framework for the creation of the official digital currency to be issued by the Reserve Bank of India. The Bill also seeks to prohibit all private cryptocurrencies in India; however, it allows for certain exceptions to promote the underlying technology of cryptocurrency and its uses". Today, as the bill awaits introduction, the media started buzzing with speculations and concerns from different quarters, specifically crypto exchanges, and investors. Also, the debate on the possible costs and benefits of such a proposed regulation has invited the public's attention. At the same time, some unofficial estimates indicate that the holding in digital currencies in India is around \$1.5 billion (Rs 10,000 crore)¹. About six exchanges are operating in India with reasonably large user bases trading in a variety of cryptocurrencies. In the presence of a vibrant global cryptocurrency market, this move of the Indian government to regulate cryptocurrencies has surprised everyone. The market and the public alike are waiting for the final decision of the Government. Given the above backdrop, this article attempts to trace the chronology of events, analyse the situation, and draw some implications for the future.

¹ [RBI plans and an upcoming Bill: Where are digital currencies headed? | Explained News, The Indian Express](https://indianexpress.com/article/explained/cryptocurrency-bitcoin-rbi-7285249/) <https://indianexpress.com/article/explained/cryptocurrency-bitcoin-rbi-7285249/>

2. Situation Analysis: India's Standpoint on Cryptocurrencies

The Reserve Bank of India Bulletin 2020 identifies Cryptocurrencies as one of the business models of the Indian Fintechs and as one of the forces of creative disruption. This business model deals with bitcoin and other digital currency products and services with 342 firms engaged in this business.

If we look at the global environment at the end of Q1 2021, the crypto market capitalisation was \$1.9 trillion. Compared to the Q1 of 2020, the market witnessed humungous growth in market capitalization (+146% vs -8%) and trading volume (+155% vs +48%), as presented in Coingecko's Q1 report for the year 2021. A survey of the respective websites of five popular exchanges currently functioning in the Indian crypto market reveals the following.

Table 1: Popular Crypto exchanges in India

Name of the Exchange	Launched in the Year	Approximate no. of users as on date	Unique feature claimed by the exchange
Wazirx	2018	400,000	--
Coinswitch KUBER	2020	1,000,000+	Making simple for the common man- invest as low as INR 100/-
Coindex	2018	200,000	Buy as low as INR100/-
Unocoin	2013	1,320,000	--
Zebpay	2015	200,000+	Invest starting INR100

The user base has seen a significant increase during 2013-2020 with the entry of new exchanges over time and a few surviving the 2018 ban by the RBI and relaunching in the Indian market after the Supreme court verdict allowing crypto trade. For instance, the exchanges like Coinswitch KUBER have made retail investors realize that Cryptocurrencies are fungible. One could begin investing with as low as INR100 with near ZERO fees and no lock-in period. Further, from the data available in *Coinmarketcap*, it is evident that four exchanges from India have marked their presence in the global market of some 300 plus exchanges trading in more than 9000 cryptos.

Table 2: *CoinMarketCap* ranking of exchanges in India for spot trading.

Exchange	Rank/Exchange score	Volume(24h) in US\$	Average liquidity	No. of Coins
Wazirx	5.8	199,544,169	148	147
CoinDCX	5.7	49,481,946	545	215
Bitbns	4.7	170,421,457	210	98
Goittus	3.4	1,920,994	32	62

Note: Data as on May 18, 2021, <https://coinmarketcap.com/rankings/exchanges/>. *CoinMarketCap*'s ranking of exchanges considers the Liquidity Scores of exchanges, which reflect the average of the top 25 Trading Pairs listed on the exchange. The ranks and overall scores of exchanges are based on traffic, liquidity, trading volumes, and confidence in the legitimacy of trading volumes reported. The Indian exchanges have scored between 3.4 to 5.8 in this table on a 10-point scale.

2.1. Regulatory response: Chronology and Rationale

If cryptos are so user friendly, what is the worry of India's central bank, the RBI? Why has the Govt. of India gone back and forth on regulating these currencies? Let me attempt to answer these questions by tracing the chronology of regulatory responses to the use of cryptocurrencies in India, presented in Table 3.

Table 3: India's regulatory response to cryptocurrencies

Date	Response
November 2015	Committee on Payments and Market Infrastructures, RBI defines Digital currencies (DCs)
November 2017	Working Group on FinTech and Digital Banking, RBI, takes cognizance of development in digital currencies in general and Cryptocurrencies in particular as a more conservative market.
2018-19	Union budget, Govt. of India says, "The Government does not consider cryptocurrencies as legal tender or coin and will take all measures to eliminate use of these crypto-assets in financing illegitimate activities or as part of the payment system".
2018-19	First Bi-monthly Monetary Policy Statement, 2018-19, raises concerns being sceptical of usage of Cryptocurrencies on grounds of consumer protection, market integrity, and money laundering.
April 6, 2018	RBI prohibits all Commercial and Co-operative Banks / Payments Banks/Small Finance Banks / NBFCs / Payment System Providers from dealing in Virtual Currencies
Dec 05, 2019	Fifth Bi-Monthly Monetary Policy Press Conference, RBI, says currency issuance is a sovereign function And A private currency cannot overwrite what is in the sovereign domain.
2019	Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019, Govt. of India proposed but not introduced
March 04, 2020	Honorable Supreme Court of India set aside the RBI Circular on Prohibition on Dealing in Virtual Currencies on the ground of proportionality.
December 16, 2020	Enabling framework for Regulatory sandbox, RBI excluded Cryptocurrencies/Crypto assets from sandbox testing
Jan 25, 2021	Booklet on payment systems entitled Payments and settlement systems in India, 2010-20 was apprehensive about risks associated with Cryptocurrency and talked about the possibility of introducing a digital version of the fiat currency, the Central Bank Digital Currency (CBDC).

Jan 29, 2021	Loksabha(Lower house of the Indian parliament) Bulletin, Part II (No.1989-2025) lists a bill To create a facilitative framework for creation of the official digital currency to be issued by the RBI and . also seeks to prohibit all private cryptocurrencies in India
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It is evident from the table above, during 2015-2019, RBI took cognizance of the limited presence of cryptocurrencies in two of its reports. The crypto market was said to be conservative in the presence of dominant use of cash. The Govt. of India, in its union budget statement 2018-19, declared to take all measures against cryptocurrencies since they were not *legal tender*. Given the associated risks of such currencies and its interference with the sovereign function of currency issuance, RBI in April 2018 invoked its payments and settlement systems act, 2007 and banned all Commercial and Co-operative Banks /Payments Banks/Small Finance Banks / NBFCs / Payment System Providers from dealing with virtual currencies. The prime concern of RBI has been to protect the consumers at large and not to allow private currencies to take over sovereign functions. In response to the RBI's ban, "the Internet and Mobile Association of India" moved the apex court, the Supreme court of India. The cryptocurrencies were alive again after the Honorable Supreme Court of India set aside RBI's circular banning cryptos on the grounds of proportionality in its 180-page judgement. Since then, the exchanges have reported substantial trade volumes trying to lure the Indian investors to trade in these currencies. What has attracted the Indian investors to cryptos is its incredibly high return compared to other assets, despite volatility in returns, fungibility claimed and advertised by the exchanges and the absence of any taxation clause in Indian income tax rules, unlike other investments. In the financial year 2020-21, an Indian investor could reap returns of 59.75% in the capital market (Sensex), 5.7% in fixed deposits, (-)1.63% in gold,² whereas cryptos like bitcoin yielded approximately 800% return³.

² <https://www.livemint.com/money/personal-finance/returns-on-my-investments-11618849104085.html>

³ <https://economictimes.indiatimes.com/markets/stocks/news/cryptocurrency-crowned-top-performing-asset-class-of-2020-21-with-800-return/articleshow/81778033.cms?from=mdr>

However, despite the Supreme court's verdict and high trading volumes, the Govt. of India has been moving towards some regulation of these currencies. The reasons are the following. First, both the Govt. and the RBI do not want crypto-like private virtual currencies to interfere with the sovereign function of currency issuance, thereby confusing the user with crypto's seemingly legal tender characteristic. Secondly, the Indian tax laws do not have any provision to capture the use of cryptocurrencies at present. In the absence of authentic data, it is difficult on the part of the Govt to take an informed decision on possible ways to tax these assets if the Govt intends to do so. The crypto traders have indeed suggested taxing crypto transactions instead of banning them *in toto*. Thirdly, the Govt. seems to be apprehensive of using such currencies in illegal transactions and money laundering. The current regime in the Govt. went for demonetising high denomination currencies in 2016 to curb corruption and illegal transactions. Hence its apprehensions on crypto are understood well. Finally, even when the Govt. is aware of the possible benefits of the blockchain technology underlying cryptocurrencies, with the slogan being "Don't punish the technology", in the public domain, its volatile prices pose a threat to financial stability in the system.

3. Indecisiveness and An Uncertain Future

The most recent development in the debate on allowing cryptocurrencies is a statement by the Honorable Finance Minister of the Govt. of India, Mrs Nirmala Sitharaman on the Government's intent to take a *calibrated* approach towards Cryptocurrencies. In the India Today conclave south held during March 12-13, 2021 she said, "My view on this is that of course the Supreme Court had commented on cryptocurrency and while the RBI may take a call on official cryptocurrency but from our side, we are very clear that we are not shutting off all options...A Cabinet note is being prepared. It's almost nearing completion and then it will be taken to the Cabinet... we will allow a certain amount of window for people to experiment on blockchain and bitcoin. However, the

what formulation of cryptocurrency will be part of the Cabinet note which will get ready soon,”⁴. These words have brought some solace to the crypto exchanges and investors. Thus, the future entails the following possibilities. First, the Indian govt. may not have a blanket ban on Cryptocurrencies so that the underlying technology is not punished. These currencies are expected to be traded as “high risk” assets but not as a medium of exchange for day-to-day transactions and settlement of payments. The survival of cryptos will then depend on the risk appetite of those dealing in them without the state’s obligation to rescue them in times of crisis. Second, the regulation may call for necessary changes in the Income-tax provisions to tax a limited set of transactions as the Govt. may deem fit to maintain orderly condition in financial markets. As reported by Livemint on March 23, 2021, the exchanges such as WazirX and CoinDCX have approached the Govt. of India not to ban trade in Crypto but tax them. Third, the RBI may issue Central Bank Digital Currency (CBDC) as a legal tender. But CBDC cannot substitute Cryptocurrencies since their functions are different. Fourth, with some regulation in place, the RBI and the Govt. of India may launch a crypto literacy programme as part of the general financial literacy programmes. This is essential since the way exchanges communicate to the public to gain popularity and gain business may sometimes be misleading. For instance, a blog in wazirx.com claims, “Very recently, on February 1, 2021, the Parliament passed a crypto bill named “The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021” – which created FUD in the Indian crypto ecosystem”⁵. This is factually incorrect since the bill is yet to be introduced. Finally, India’s commitment to saving energy and reducing carbon emissions may go well with the regulation not supporting and mining bitcoin in a big way. As I conclude this piece, three leading cryptocurrency exchanges of India, namely WazirX, CoinDCX and CoinSwitch Kuber, crashed on the evening of May 19, 2021. This was followed by India’s leading payments bank, Paytm in

⁴ <https://www.indiatoday.in/business/story/not-shutting-all-options-on-cryptocurrency-says-finance-minister-nirmala-sitharaman-at-india-today-conclave-1779328-2021-03-15>

⁵ [How is the cryptocurrency industry expected to be in 2021? - WazirX Blog](#)

stopping its banking support to crypto exchanges on May 22, 2021. As reported in media, this action of Paytm has been at the behest of an informal ruling from the RBI. This makes investors' lives even more difficult since they will have to go through a cumbersome transaction. Moreover, investors will have to face a severe uncertain environment. Further to this on May 31, 2021, RBI cautioned the banks not to use the old order in disallowing transactions in virtual currencies. The RBI advised the banks and other regulated entities to follow customer due diligence in virtual currency transactions. Therefore, the current environment of cryptocurrency in India is certainly not so favourable to the exchanges and the investors. I see a dreary future of crypto in this country in such confused environment.

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