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To,
The Cabinet Secretary,
Cabinet Secretariat,
Rashtrapati Bhawan,
New Delhi - 110 004.

September 18, 2020

Dear Sir,

Re: Building a Successful Blockchain Ecosystem for India: Regulatory Approaches to Crypto-Assets

We write on behalf of Nishith Desai Associates, an India-centric global law firm specialising in emerging and futuristic technologies. We write pursuant to various media reports which suggest that the Cabinet of the Government of India is in the process of deciding the regulatory approach to crypto-assets (also referred to as 'cryptocurrencies', 'virtual assets' or 'virtual currencies'), and is considering banning crypto-asset activity outright.[i]

In that connection, based on our experience and legal expertise in the industry, we seek to put forth our independent suggestions, in public interest, for a regulatory framework for crypto-assets rather than an outright ban, as such a framework would preserve the benefits of this new technology while mitigating the risks.

We have been regularly advising Indian and global entities on crypto-asset and blockchain-related legal issues since the early stages of the industry in India (circa. 2013), and have authored multiple research papers in this connection.[ii] Most recently, we represented the Internet and Mobile Association of India in its challenge to the Reserve Bank of India restriction on virtual currencies, which was set aside by the Hon'ble Supreme Court on the ground of being a disproportionate restriction on the fundamental right to trade under Article 19(1)(a) of the Constitution.

A regulatory regime is required for the country to fulfil the 'Digital India' mission and protect the fundamental rights of its citizens. A complete ban will be against the interests of innovation, liberty, and trade. No developed and democratic country has banned crypto-assets despite recognizing the same concerns that the Indian government recognizes e.g., money laundering, volatility, consumer protection etc. There are estimated to be over 50 lakh users of crypto-assets in India[iii] and an outright ban would deprive them of a legitimate trade and property interest.

In December 2018, we had authored and submitted to the Government of India an independent policy paper '*Building a Successful Blockchain Ecosystem for India: Regulatory Approaches to Crypto-Assets*'[iv] ("**Paper**") (enclosed at **Annexure II**) proposing detailed and proportionate regulatory approaches to crypto-assets for India, and suggesting how a regulatory approach could be adopted rather than an outright ban. Various regulatory options were suggested in the Paper, some of which could easily be implemented even by executive notification (e.g., bringing crypto-asset activity within the Prevention of Money-Laundering Act, 2002).

Some of the options we proposed in the Paper are now being adopted by leading jurisdictions globally e.g., the U.K. proposed in a consultation paper published in August 2020 that it would bring crypto-asset activity under the umbrella of its Anti-Money Laundering (AML) law.[v] The Hon'ble Supreme Court's judgment in *Internet and Mobile Association of India* has vindicated the approach that crypto-assets should be dealt with proportionately and not banned outright.

We recognize the concerns of the Government of India on the risks associated with crypto-assets. However, in fact, similar concerns remain true with other financial instruments such as cash and commodities such as gold. A report commissioned by the Society for Worldwide Interbank Financial Telecommunication (SWIFT) which was published just this month found that, "*[i]dentified cases of laundering through cryptocurrencies remain relatively small compared to the volumes of cash laundered through traditional methods*."[vi]

There is also a global consensus to regulate crypto-asset activity in order to ensure that the potential benefits of technology in the financial sector can be realized while risks are mitigated. The G20, which includes India, resolved in June 2019,[vii] based on the Financial Action Task Force's (FATF) recommendations on virtual assets in June 2019, to adopt the FATF recommendations, which are as follows:

> "*To manage and mitigate the risks emerging from virtual assets, countries should ensure that virtual asset service providers are* ***regulated*** *for AML/CFT purposes, and* ***licensed or registered and subject to effective systems for monitoring and ensuring compliance*** *with the relevant measures called for in the FATF Recommendations.*"[viii] (emphasis added)

A recent report by the International Monetary Fund (IMF) is to a similar effect.[ix] Developed jurisdictions like Australia, Canada, the E.U., Japan, Singapore, South Africa, South Korea, the U.K., and the U.S. have favoured a regulatory approach rather than a ban.[x] It is worth noting that South Africa and South Korea, like India, have foreign exchange control regimes.

The blockchain industry is intrinsically linked to crypto-assets. Crypto-assets have specifically received widespread investment and endorsement from reputed establishments and eminent persons, including Tata Consultancy Services (TCS),[xi] Ratan Tata,[xii] Harvard University,[xiii] Massachusetts Institute of Technology,[xiv] Fidelity,[xv] J.P. Morgan,[xvi] Microsoft,[xvii] Samsung,[xviii] Visa and Mastercard,[xix] PayPal,[xx] Facebook,[xxi] Jack Dorsey (CEO, Twitter),[xxii] Andreessen Horowitz,[xxiii] Khosla Ventures,[xxiv] and many others.

The involvement of TCS demonstrably shows that the Indian software ecosystem stands to benefit with crypto-asset technology. NITI Aayog too has recently recognized that blockchain tokens i.e., crypto-assets, are integral to the blockchain ecosystem:

> "*The nature of how public blockchains scale require them to have a* ***token economy*** *– since it is highly likely that the most promising use cases will come from public blockchains due to a variety of factors,* ***regulatory clarity will be required*** *to enable this important type of blockchain in India.*"[xxv] (emphasis added)

A ban on crypto-assets would therefore negatively affect the Indian blockchain software development ecosystem, and not just crypto-asset investors and traders. More and more blockchain players are quietly moving to foreign locations such as Singapore, which is resulting in a loss of skilled workforce.

Having acquired a deep knowledge of this industry, we are convinced that crypto-assets and blockchain technology should not be considered a mere conduit for illegal activities, but have genuine benefits to bring to the nation. These include financial inclusion and the growth of the Indian software ecosystem. We are joined by several well-known organisations in the view that crypto-assets should not be banned in India but should be regulated, namely,

- NASSCOM,[xxvi] the leading information technology industry body in India; and,
- The National Institute of Public Finance and Policy (NIPFP),[xxvii] Vidhi Centre for Legal Policy,[xxviii] Centre for Internet and Society,[xxix] and Software Freedom Law Center,[xxx] which are leading non-profit policy organisations in the country.

In fact, even the inter-ministerial Report of the Steering Committee on Fintech Related Issues, published in September 2019, recognized that crypto-assets form part of the fintech landscape, stating:

> "*Mobile payments, cryptocurrency, investment advisory, insurance aggregators, peer-to-peer lending and some more services which traditionally required human capital, now form the fintech landscape. … The mechanisms surrounding cryptocurrencies, particularly the Blockchain and Initial Coin Offerings (ICOs), are* ***revolutionising the global fintech landscape.*** *The issue of initial coin offerings has emerged as an innovative way of capital raising by fintech businesses. … ICOs generally operate as blockchain-based funding process that enables the issuance of virtual coins or tokens in exchange for fiat currency or cryptocurrency payment*."[xxxi] (emphasis added)

Various other Government reports have recognized that while there are risks associated with crypto-assets, they also bring advantages such as cost-efficiency, faster transaction times, and transparency.[xxxii] Some Members of Parliament have also recognized that crypto-assets are a technology here to stay which should ideally be regulated and not banned.

We would hence like to reiterate the recommendations made in our Paper of 2018. Drawing from international approaches and the authors' own experience advising on the application of Indian law to crypto-assets, the enclosed Paper proceeds as follows:

I. Reasons why regulation should be considered rather than a ban, and

II. Detailed regulatory measures that the Government of India can consider. The regulatory measures proposed include:

    (a) The notification of crypto-asset business activity under the Prevention of Money Laundering Act;

    (b) A new licensing regime for crypto-asset business activity. This regime may be introduced either by:

        (i) New legislative provisions, such as under the proposed regimes on commodity spot trading and payment systems;

        (ii) Administrative regulations under existing laws including the Payment and Settlement Systems Act, the Non-Banking Financial Company regime, the Foreign Exchange Management Act, the Consumer Protection Act, and/or the Securities Contracts (Regulation) Act; and/or,

        (iii) Statute-backed self-regulation;

    and,

    (c) The active enforcement and clarification of existing laws with respect to crypto-assets.

Several of these suggested approaches (e.g., notification under the Prevention of Money Laundering Act) can be done with a minimum expenditure of time and resources. If new legislative provisions are introduced, they would help to clearly assign any regulatory vacuum with regard to crypto-assets to a given regulator, which would avoid jurisdictional ambiguity. Since SEBI has competence as regards investor protection, it is one option that can be considered in this connection. Another option is a multi-stakeholder body with expertise in technology, finance, and economics, which can be a nodal body for crypto-assets.

Like all new and disruptive technologies and business models, crypto-assets bring both advantages and disadvantages. We believe that the primary focus of the regulations should be how to contain the 'bad actors' in the digital ecosystem and make 'Digital India' an active participant in Industrial Revolution 4 (IR4). Balanced regulation would help India achieve this goal, whereas a prohibition would be an unfortunate step backward for the nation.

Before taking a decision, we would urge the Government of India to conduct public consultations so that the Government can benefit from informed perspectives from around the world, since global organizations are embracing, rather than escaping, the change brought about by crypto-assets and blockchain technology. The consultative approach adopted by the Srikrishna Committee on the proposed data protection framework[xxxiii] may be followed in this connection. The matter may also be referred to the appropriate Cabinet Committee for detailed deliberation. In the event any Bill is introduced in Parliament on the subject, we would submit that it should immediately be referred to the Standing Committee on Information Technology for a detailed examination, owing to the complex nature of the subject.

We would be privileged to have the opportunity to present our suggestions for a feasible regulatory framework to relevant stakeholders in the Government of India *via* videoconference.

Please forward this letter and its Annexures to all concerned.

Thank you for your time and consideration.

Sincerely,

Nishith M. Desai (nishith@nishithdesai.com)
Vaibhav Parikh (vaibhav.parikh@nishithdesai.com)
Jaideep Reddy (jaideep.reddy@nishithdesai.com)
Advocates,
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The authors' brief profiles are provided at **Annexure I.**

Disclosure and Disclaimer: Nishith Desai Associates advised the Internet and Mobile Association of India in its writ petition in the Supreme Court of India challenging the RBI circular on Virtual Currencies dated April 6, 2018, which was set aside by the Supreme Court in its judgment dated March 4, 2020 (W.P. (C) No. 528 / 2018). However, the enclosed suggestions by the authors are made in an independent capacity, keeping in view the best interests of the public, the government, and the industry. They are not made on behalf of any organisation. The suggestions in the Paper are provided to the Government of India in good faith and in public interest. This Paper should not be construed as a legal opinion and the authors accept no liability for the actions or omissions of any third party relying upon the same.

Encl: Annexures I and II

Carbon Copy:

Hon'ble Prime Minister, All Cabinet Ministers and Ministers of State,
Cabinet Secretariat,
Rashtrapati Bhawan,
New Delhi - 110 004.

Hon'ble Minister of Law and Justice, Electronics and Information Technology and Communications,
21, Mother Teresa Crescent,
New Delhi – 110 011.

Hon'ble Chairperson and Members,
Standing Committee on Information Technology,
Lok Sabha Secretariat,
New Delhi - 110 004.

CEO,

NITI Aayog,

Sansad Marg, New Delhi – 110 001.

Endnotes:

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Annexure I

Profiles of the Authors

NISHITH DESAI

Nishith Desai is the founder of the research-based and strategy-driven international law firm, Nishith Desai Associates, with offices in Mumbai, Silicon Valley, Bangalore, Singapore, New Delhi, Munich and New York. Mr. Desai is a renowned International Tax, Corporate, and IP lawyer, researcher, published author, and lecturer in leading academic institutions around the world. He specializes in the Financial Services sector and assisted the Government of Mauritius and the Government of India in launching their individual offshore financial centers. Soon after India opened up its economy to the outside world in 1991, he established the first five India-focused funds. He was instrumental in setting the firm's blockchain practice group in 2013.

VAIBHAV PARIKH

Vaibhav Parikh heads the U.S office of Nishith Desai Associates. He also leads the practice areas of Technology, Mergers and Acquisitions, Private Equity, and Crypto-Assets and Blockchain. Vaibhav often plays the role of key advisor to leading crypto-asset exchanges in India and leading financial dailies often turn to him for his views on the subject. Over the years, Vaibhav has been advising many leading Indian e-commerce companies in their operations from a legal and regulatory standpoint. Tying in his expertise in advising several private equity players and venture capitalists in navigating their way to successful investments, Vaibhav has facilitated some of India's largest e-commerce transactions.

JAIDEEP REDDY

Jaideep Reddy is a senior member of the firm's Technology Law practice and co-heads its Crypto-Assets and Blockchain practice. He specializes in the legal issues relating to crypto-assets and blockchain technology, privacy and cybersecurity, payments, telecom, and other emerging technology law issues. He led the firm's team representing the Internet and Mobile Association of India in its Supreme Court challenge to the Reserve Bank of India circular on virtual currencies. He has authored various articles and research papers on technology law, including blockchain technology, and also led the drafting of a self-regulatory code of conduct for the blockchain industry, based on international best practices. He is admitted to practice law in India and California, U.S.A. He holds a Masters in Law from the University of California, Berkeley, School of Law and a B.A., LL.B. (Hons.) from the W.B. National University of Juridical Sciences, Kolkata, India.

Annexure II

Building a Successful Blockchain Ecosystem for India: Regulatory Approaches to Crypto-Assets

[separately enclosed;

and available at

https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Building-a-Successful-Blockchain-Ecosystem-for-India.pdf]