

## The future of crypto-financing in India

As regulators around the world continue to struggle to formulate an appropriate regulatory framework for cryptocurrencies such as bitcoins and ethereum, a new avatar of blockchain-based financial products—cryptocurrency/crypto-token powered initial coin offerings (ICO)—is gaining popularity as a viable alternative to more traditional means of raising capital. The emergence of a new technology-based means of raising capital will need to be properly regulated in order to streamline investment and ensure adequate investor-protection safeguards. The question that needs to be debated is: Could India look towards a “technological revolution” in raising finance through ICOs?

An ICO is largely similar to an initial public offering, but it differs to the extent that instead of offering shares in a company, cryptocurrencies or crypto-tokens are offered at a predetermined rate. These crypto-tokens are basically digital assets which can be configured in a number of ways to represent a variety of services. They are a method of payment for the service that the company proposes to offer. Examples of such services may include online music/movie- streaming services or cloud storage space. Most notably, *The Wall Street Journal* reported that Protocol Labs Inc., which intends to develop a decentralized cloud data storage system called the Filecoin Network, raised \$52 million.

Companies (especially internet-based) can use an ICO as an alternative means of raising capital. An ICO can be floated by a company by offering its blockchain-based cryptocurrency or crypto-token to the general public in order to raise funding to support its underlying business plan. The success of the company, and by extension, the ICO, is dependent on the strength of the business plan and the quality of the product proposed to be developed, much like the success of an IPO (initial public offering). Further, post an ICO, these crypto-tokens can also be freely traded on independent cryptocurrency exchange platforms (in essence, a secondary market), making it a potential investment tool with the advantage of easy transferability and instant liquidity.

Currently, there isn't much regulatory clarity globally regarding ICOs. China has recently banned all ICOs in order to check the disruption of economic and financial order in the Chinese market. However, whether the ban is temporary (until laws governing ICOs are enacted) or permanent, is unclear.

The US Securities and Exchange Commission and the Canadian Securities Administrators, on the other hand, have released investor bulletins highlighting that some ICOs may need to be categorized as securities in accordance with the nature of the crypto-token offered. They appear to be keen on regulating ICOs with sufficient safeguards.

Similarly, the Monetary Authority of Singapore has observed that the function of digital tokens has extended beyond being just a form of currency. They acknowledged that it can take the form of an offer of shares, units in a collective investment scheme or a debenture. However, when they take the form of a security, they are required to create a prospectus and follow security listing guidelines. Additionally, online exchanges providing a secondary market for the trading of these tokens will also have to be approved or recognized by the Monetary Authority of Singapore as an approved exchange.

However, in order to streamline and regulate ICOs in India, there are legal and regulatory challenges that need to be addressed. First, based on their nature, crypto-tokens/cryptocurrencies could be classified as securities or currency or a payment system or intangible property. This classification shall be crucial in determining the regulatory framework governing their issuance even otherwise and through the ICO route. The nature of classification will also ascertain the

incidence and rate of taxation. Additionally, the hybrid nature of crypto-tokens might require coordination among the Securities and Exchange Board of India (Sebi), the Reserve Bank of India (RBI) and other sectoral regulators for effective regulatory oversight.

Second, compliance requirements will also vary, i.e. if crypto-token is a currency then it will be required to follow “know your customer” norms and anti-money laundering requirements—whereas if they are considered securities, then companies will be required to comply with Sebi listing regulations.

Third, and most important, “crypto-regulations” will have to be enacted inter alia governing issuance through ICOs, transfer and management of crypto-tokens, which shall serve as the Bible for intermediaries such as “crypto-exchanges” and “crypto-brokers”, among others. While it will be a task to regulate a “crypto-token rating agency” primarily due to overlap of jurisdiction, an effective rating agency could potentially aid a retail investor in making an informed investment decision by conducting a reliable due diligence exercise.

In India, there is regulatory opaqueness surrounding the regulation of ICOs (and other similarly placed emerging fintech products). As a crucial first step, it is recommended that a regulatory sandbox approach is followed to develop laws that achieve synergy between new technology, investor protection and effective regulatory oversight. If such an approach is followed, it may lead to greater innovation and investment in India.

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