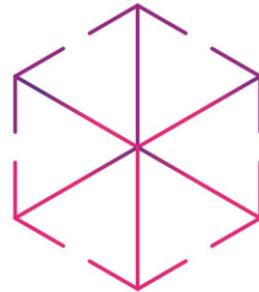


RECOMMENDATIONS FOR THE REGULATION OF VIRTUAL CURRENCY IN INDIA



TRA

Lawyers for Innovation



About the Commentator:

TRA is a law firm specialising in representing new-technology companies and represents a number of companies in the financial – technology sector, including entities involved in virtual currencies’ businesses.

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Executive Summary

With the rapid surge in the usage of Virtual Currency it is important to regulate Virtual Currencies to address security concerns and mitigating systemic financial risk. While the industry across the globe has been advocating for self-regulation, the success of self-regulatory bodies depends on the industry's organization and leadership. It is thus important for the State to regulate, but without over-regulating. Over-regulation would drive VC activity underground, making it significantly more difficult to regulate.

Intermediaries that enable Virtual Currency transactions should be regulated, rather than end-users. The decentralized nature of Virtual Currency makes it difficult to regulate it through one single centralised point for all transactions or to regulate each and every user. Therefore, the pragmatic approach would be to regulate the entities/platforms which facilitates the entry of the fiat currency or valuable goods into the Virtual Currency system, i.e. Virtual Currency exchanges/intermediaries where people buy and sell Virtual Currency for real money, or websites which offer Virtual Currency as a means of payment. This would reduce number of points of supervision, improving enforcement with minimal hindrance to business. These intermediaries should be subject to AML, KYC, anti-fraud and cyber-security regulation.

It is clarified that the term Virtual Currency is used in this paper to refer to any type of digital unit of exchange (not including any type of units of fiat currency, for instance fiat currency stored on electronic wallets will not constitute virtual currency) and excludes a. digital units that cannot be converted into, or redeemed for fiat currency or other Virtual Currency; and b. may not be redeemable for real-world goods, services, discounts or purchases.

No.	ISSUE	TRA RECOMMENDATION
1.	REGULATING AUTHORITY	The Reserve Bank of India (the “ Regulator ”) should be designated as the regulating authority to regulate activities and intermediaries dealing with Virtual Currencies. RBI already has the mandate to assess and regulate systemic financial risk, and regulate payments and settlement systems, which puts it in the right position to regulate Virtual Currencies.
2.	LICENSE REQUIREMENT	<p>I. It is recommended that the intermediaries enabling Virtual Currency transactions are licensed (“Licensed Entities”) so that the Regulator can track the transacting entities and transactions, and subject them to KYC guidelines and Prevention of Money Laundering Act, 2002 (“PMLA”).</p> <p>II. Accordingly, Intermediaries engaged in following activities (“Virtual Currency Business Activity”) <u>as a business</u> should be licensed:</p> <ul style="list-style-type: none"> (a) receiving Virtual Currencies for transfer from one person to another; (b) storing, holding, or maintaining custody or control of Virtual Currencies on behalf of others;

		<p>(c) buying and selling Virtual Currency;</p> <p>(d) performing the exchange services, i.e. the exchange of or conversion of fiat currency or other value into Virtual Currency, or vice versa, or of Virtual Currency into another form of Virtual Currency; or</p> <p>(e) controlling, administering, or issuing Virtual Currency.</p> <p>Exception: <i>Those who are utilizing the Virtual Currency solely for the purpose of sale or purchase of goods and services, and for investment purposes, such as merchants and customers, provided that such seller or purchaser does not mine, earn, pay, purchase or sell Virtual Currency greater than US\$ 1 million in value in any financial year.</i></p> <p>III. Software business: It is clarified that the development and dissemination of software for the Virtual Currency infrastructure by itself may not constitute Virtual Currency Business Activity</p> <p>IV. Agents of Licensed Entities: Any agent or agency arrangement through which any licensed entity conducts Virtual Currency Business Activity should follow self-regulation under such licensed entity.</p>
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3.	GRANT OF LICENSE	Factors such as Financial Conditions and responsibility, technical competency and capabilities, financial and business experience, and character and general fitness of the applicant, may be taken into account during the grant of License.

4.	COMPLIANCE S	<p>Licensed Entity shall at all times be required to comply with the following:</p> <ol style="list-style-type: none"> I. Key Policies: maintain and enforce written policies with respect to anti-fraud, anti-money laundering, cyber security and privacy. II. Capital Requirement: maintain minimum capital requirement to assure the financial integrity as may be prescribed by the Regulator taking into account the risk profile of the Licensed Entity. III. Protection of Customers: to protect the interest of customers, the Licensed Entity shall be required to comply with the following: <ol style="list-style-type: none"> (a) maintain a surety bond or trust account in INR, in such form and amount as may be prescribed by the Regulator. (b) To the extent the Licensed Entity, stores, holds, or maintains custody or control of Virtual Currency on behalf of another person, such Licensed entity shall hold Virtual Currency of the same type and amount as that which is owed or obligated to such other person. (c) The Licensed entity should be prohibited from disposing off the assets including Virtual Currencies (whether by sale, transfer, assignment, hypothecation, pledge or otherwise) held by, or under the custody or control
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		<p>of such Licensed Entity on behalf of another Person, except under the direction of such Person.</p> <p>IV. Material changes in business, or Change in control: The Licensed Entity shall be required to obtain prior written approval of the Regulator in the event of following:</p> <ul style="list-style-type: none"> (a) any proposal to introduce a materially new product/service or any material change to the existing product/service/activity, especially if the new product/service may raise a legal or regulatory issue about its permissibility, or which may raise safety, soundness or operational concerns. (b) change of control or merger or acquisition of all or substantial part of the assets of the Licensed Entity. <p>V. Accounts & Information: Licensed Entity should be required to maintain detailed copies of the books and records, including detailed log of each transactions. Detailed procedures are prescribed in the PMLA regulations. All minutes of board meetings, and communication and documentation related to investigations of customer complaints, and error resolution, or concerning facts giving rise to possible violations of laws should be maintained in records.</p>
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		<p>VI. Inspection and Information: The Licensed Entity shall permit and assist in its examination by the Regulator at any time. The Licensed Entity shall be required to notify the Regulator in the event of following:</p> <ul style="list-style-type: none"> (a) any criminal action or insolvency proceeding against the Licensed Entity or its directors, principal stockholders, officers or beneficiaries; (b) discovery of any violation or breach of law, regulation or rule related to the conduct of activity; and (c) any proposed change in the methodology used to calculate the value of Virtual Currencies in fiat currency.
5.	ANTI-MONEY LAUNDERING	<p>I. We recommend that the extant guidelines on Know Your Customer/Anti-Money Laundering/Combating Financing of Terrorism guidelines issued by the Regulator to banks, from time to time, shall apply mutatis mutandis to all the persons dealing in Virtual Currency Business Activity.</p> <p>II. PMLA regulations shall apply to the entity dealing in Virtual Currency Business Activity.</p>

		<p>III. Records of Virtual Currency transactions: Licensed Entity shall maintain the records of all Virtual Currency transactions, involving the payment, receipt, exchange, conversion, purchase, sale, transfer, or transmission of Virtual Currencies, which should be available for scrutiny by the Regulator or any other agency / agencies as may be advised by the Regulator. The log maintained by the Licensed Entity should include:</p> <ul style="list-style-type: none"> (a) the identity and physical addresses of the parties to the transaction; (b) the value and method of the transaction; and (c) the date and precise time of transaction. <p>IV. The Licensed Entity shall be further required to file Suspicious Transaction Report (STR) to Financial Intelligence Unit – India (FIU-IND).</p> <p>V. The Licensed Entity shall not be engaged in, or knowingly allow the transfer of Virtual Currencies when such action will conceal the identity of a customer or counterparty.</p>
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6.	CYBER - SECURITY PROGRAM	<p>I. We recommend that the Licensed Entity should be required to establish and maintain an effective program for ensuring the functionality and security of the Licensed Entity’s electronic system.</p> <p>II. The program referred above shall be implemented by a qualified Chief Information Security Officer, and shall be approved by the Board of Directors.</p> <p>III. The said program shall include audit functions such as penetration testing (annually), vulnerability assessment (quarterly), and audit trails to track the reconstruction of the financial transactions.</p>
7.	BUSINESS CONTINUITY	<p>I. A Licensed Entity shall be required to maintain a written Business Continuity and Disaster Recovery (“BCDR”) plan to ensure the continuity of its services in the event of emergency or disruption of normal business activities. This plan shall undergo an annual testing by an independent internal personnel or qualified third party for revision. The BDCR plan, at minimum, shall:</p> <p>(a) identify the facilities required for the continuous operation of Licensed Entity’s business;</p> <p>(b) include a communication plan for the essential persons during the emergency;</p>

		<p>(c) maintain back-up facilities, for copying of essential data.</p> <p>II. In the event of any emergency which may have significant adverse effect on the Licensed Entity, the Licensed Entity shall promptly notify the Regulator.</p>
8.	CONSUMER PROTECTION	<p>I. The Licensed Entity shall be required to disclose to its customer in a clear, conspicuous and legible writing in the language preferable to the customer about all the material risks involved with the products/services/activities, and the rights of the customer.</p> <p>II. The Licensed Entity shall not be engaged in any fraudulent activities, and should take additional measures to develop a written anti-fraud policy which shall, at a minimum, include:</p> <ul style="list-style-type: none"> (a) identification and assessment of fraud-related risk; (b) procedures for controlling such identified risks; (c) allocation of responsibility for monitoring risks; and (d) procedures for periodic evaluation and revision of the anti-fraud policies.

9.	ADVERTISING	The Licensed Entity shall be prohibited to advertise its products/services/activities in India unless it contains the name of the Licensed Entity and the legend that such Licensed Entity is “Licensed to engage in Virtual Currency Business Activity by the Reserve Bank of India”. The Licensed Entity shall not directly, or by implication, make any false, misleading, or deceptive representations or omissions.
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