Regulation of Virtual Digital Asset by FIU-IND

Why in News?

Recently, the Financial Intelligence Unit India (FIU IND) issued show-cause notices to 9 offshore virtual digital asset service providers (VDA SPs) like Bitfinex and MEXC Global, among others.

What is FIU-IND?

- **Established in** – 2004 under the Finance Ministry.
- **Aim** – To act as a nodal agency for receiving, analysing and disseminating information relating to suspected financial transactions
- **Function** – It receives reports from private and public sector banks every month which are
    - Cash transaction reports (CTRs)
    - Suspicious transaction reports (STRs)
    - Cross border wire transfer reports
- It is based on the mandate of *Prevention of Money Laundering Act, 2002 (PMLA)*.
- **Cash transaction reports** – It is ***mandatory*** for banks in India to furnish a monthly CTR to the FIU on
    - All transactions over Rs. 10 lakh or its equivalent in foreign currency or
    - A series of integrally connected transactions that add up to more than Rs. 10 lakh or its equivalent in foreign currency

What are Virtual Digital Assets (VDA)?

> *According to the Financial Action Task Force (FATF), a virtual asset service provider (VASp) can be any natural or legal person who conducts activities like carrying out transfer of virtual assets, administer them, or oversee their sale by an issuer's office.*

- India's Union Budget for 2022-23 for the 1st time defined VDA in the newly-inserted clause (47A) under Section 2 of the Income Tax Act, 1961.
- **VDA** – It refers to
    - any information or code or number or token
    - generated through cryptographic means
    - providing a digital representation of value exchanged with the promise of having inherent value
    - or functions as a store of value or a unit of account
    - can be transferred, stored or traded electronically
- Thus it includes *cryptocurrencies, DeFi (decentralised finance) and non-fungible*

tokens (NFTs).

- ***Indian currency and foreign currency*** as defined under the Foreign Exchange Management Act, 1999, have been excluded from the ambit of VDAs.
- **Tax in India** – ***30% income tax on gains*** made from cryptocurrencies and also rules regarding ***1% tax deducted at source*** on cryptocurrency came into effect.
- **Compliance** – Entities dealing in VDAs, crypto exchanges and intermediaries are considered as '*reporting entity*' under PMLA and thus brought under anti-money laundering/counter financing of terrorism regulations.
- **Obligations** – To verify the identities of on boarded clients, and maintain records of their financial positions and potentially suspicious transactions.
- **Applicability** – To all VDA SPs operating in India irrespective of physical presence.
- The entities though catering to a substantial part of Indian users were not getting registered and coming under the Anti Money Laundering (AML) and Counter Financing of Terrorism Network (CFT) framework'.

Currently, ***31 VDA SPs have registered*** *with FIU IND.*

- **Significance** – It would ensure lack of anonymity and businesses not encountering multiple hurdles.

Some global regulations of VDA SPs are Dubai Virtual Assets Regulatory Authority (VARA) in Dubai and Markets in Crypto-Assets Regulation (MiCA) in European Union.

What approaches emerge when looking to regulate VDAs?

- The Bureau for International Settlements (BIS), has considered provisions to regulate VDA in its report about financial stability from crypto assets in emerging economies.
- Policy options under consideration are outright ban, containment and regulation.
    - **An outright ban** – It *may not prove enforceable* because of the pseudo-anonymous nature of crypto markets and there could be a possibility that regulators become non transparent.
    - **Containment** – It would imply controlling the flows between crypto markets and traditional financial systems or limiting their connections.
    - But it would *not address the vulnerabilities inherent in the crypto markets* and could result in financial stability risks.
    - **Regulation** –The report holds that it must be ensured that benefits of regulating and supervising are greater than the costs involved.
- **Challenges** – Issues for emerging market economies (EMEs) are
    - Defining the (regulatory) authority or entity
    - Defining their scope of regulation
    - Filling in the data gaps to understand the technology and interconnections

Bank of International Settlements (BIS)

• **Established in** – 1930
• **Owned by** – 63 central banks including RBI that account for 95% of the GDP
• **Office** – Head office is in ***Basel, Switzerland*** and it has 2 representative offices in Hong Kong and Mexico City
• **Mission –** To support central banks' pursuit of *monetary and financial stability* through international cooperation, and to act as a bank for central banks
• ***Basel Committee on Banking Supervision*** of BIS provides the Basel norms

References

1. The Hindu| FIU IND regulates VDA SPs
2. The Hindu| Virtual Digital Assets (VDA)

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