

Navigating the Future of Virtual Digital Assets (VDAs): Implementing Effective Operating Procedures and Regulations

written by King Stubb & Kasiva | July 11, 2023



Introduction

The crypto assets sector holds significant potential for the economy and employment. However, the existing legal framework falls short in addressing policy concerns and issues surrounding crypto assets. Therefore, it is imperative for governments worldwide to develop comprehensive standard operating procedures for regulating crypto assets. These procedures should primarily focus on consumer protection, regulatory arbitrage, and financial stability, which are pressing concerns for regulators and governments globally. Additionally, it is crucial to recognize that the crypto sphere could potentially be exploited as a haven for funding terrorist regimes or facilitating white-collar crimes.

In India, regulations on Virtual Digital Assets (VDAs) are still in the process of being finalised. Encouragingly, ongoing discussions within the G20 have provided hope for progress in this area. One positive step taken by the Indian government is the inclusion of VDAs under existing anti-money laundering legislation, specifically bringing VDA Service Providers under the

purview of the Prevention of [Money Laundering Act](#) (PMLA) [1].

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Challenges Surrounding Virtual Digital Assets (VDAs)

Blockchain technology has gained acclaim for its ability to authenticate transactions among blockchain users. However, it has not diminished the enduring value of cash as a medium of exchange and store of value.

The issue with cryptocurrencies lies in the traceability of transaction sources. While transactions themselves are transparent and verified, the origin of these transactions often remains obscure. This lack of traceability hampers the identification of funding sources. Moreover, the presence of cryptocurrency mixers further complicates the obfuscation of [cryptocurrency](#) funds, making VDAs vulnerable to exploitation by malicious actors.

Converting fiat currency held in traditional bank accounts into Virtual Digital Assets involves a complex cleansing process. However, it is crucial to establish effective means of tracking VDA transactions and recognize VDA exchanges as regulated entities. Fortunately, software tools are available for untangling VDAs back into fiat currency, which regulators can employ. Developing programs for monitoring VDA movements and maintaining a comprehensive database of transactions are equally important. Utilizing machine learning algorithms can aid in detecting patterns of money laundering, allowing for timely updates to counter innovative laundering methods.

International organizations like the Financial Action Task Force (FATF) have recommended allocating sufficient budget and personnel resources from governments to tackle these challenges effectively.

Regulatory Timeline for Virtual Digital Assets (VDAs)

- I. In 2017, the Reserve Bank of India (RBI) clarified its stance by stating that it had not granted any licenses or authorizations to entities or companies for operating crypto-related schemes or dealing in Bitcoins.

It emphasized that investors were assuming risks at their own discretion.

- II. On March 24th, 2021, the Ministry of Corporate Affairs introduced an amendment to Schedule III of the Companies Act 2013[2]. As per this amendment, companies are now required to disclose their profits/losses and the number of currencies held in their financial statements starting from April 4, 2021.
- III. In 2022, the Advertising Standards Council of India issued comprehensive guidelines titled "Guidelines for the advertising of Virtual Digital Assets and linked services." These guidelines, the first of their kind in India, establish standards for advertising VDAs. They outline the necessary disclaimers, information to be advertised/relied upon, and details that must be shared.
- IV. The Indian Parliament is currently reviewing the Cryptocurrency and Regulating the Official Digital Currency Act 2021 (2021 Bill)[3]. This bill holds significance for the future regulation of cryptocurrencies in India and is currently undergoing the legislative process.

PMLA and the Expansion of VDA Regulations

Section 2(1)(s) of the Prevention of Money Laundering Act (PMLA)[4] has broadened the definition of "person carrying out business and professions" to encompass individuals engaged in activities designated by the Central Government. Reporting Entities adhere to KYC regulations as mandated by the Act, which serve to prevent crimes such as money laundering, terrorism financing, and fraudulent activities. On March 7th, 2023, the Ministry of Finance issued a notification that further expanded the definition of "person carrying on designated business or profession" to include specific activities and transactions related to VDAs.

To effectively harness the benefits of VDAs and ensure their success, a model of regulatory agility and robust enforcement tools is recommended. The expansion of PMLA's scope represents an initial milestone in this regard. The groundwork has been laid at the G20, and it is highly likely that comprehensive laws will be enacted in the coming years to regulate the crypto sector.

Standard Operating Procedure for VDAs

1. **Establishing Minimum Benchmarks and Standards:** A universal standard for VDAs should be adopted by countries worldwide, considering the cross-border nature of these transactions.
2. **Promoting Data Sharing:** Countries should establish channels for information sharing regarding crypto transactions.
3. **Capacity Building:** There is a need for developing expertise in emerging technologies to meet the evolving demands of the industry. Building a talent pipeline will ensure a skilled workforce capable of harnessing the potential of VDAs.

4. **Ensuring Consumer Protection Standards:** Public awareness regarding VDAs should include cautionary notices and advertising standards. Guidelines, such as the ASCI Guidelines, can provide comprehensive rules on endorsements, risk disclosure, safety, and the role of celebrities and prominent personalities. The RBI has also issued circulars emphasizing the risks associated with crypto assets in India. Implementing Standard Operating Procedures (SOPs) can help entities like financial institutions understand the regulatory stance, adopt risk assessment practices, and provide general guidance on broader impacts and risk avoidance.
5. **Granting Access to Law Enforcement Agencies for Dealing with Fraudulent Activities:** Addressing jurisdictional issues at an international level is essential. A standardized operating protocol aligned with international best practices, as guided by FATF, should be established to ensure a risk-based approach toward VDAs and Virtual Asset Service Providers (VASPs). The reporting requirements under the Prevention of Money Laundering Act 2002 now apply to VASPs as well. The CERT-In mandate for record-keeping and KYC ensures transaction reconstruction in the event of cyber incidents involving VDA transactions.
6. **Addressing Regulatory Arbitrage:** The unique nature of crypto assets, which do not fit the definition of traditional securities, along with the presence of crypto exchanges resembling traditional stock exchanges, has created a regulatory gap that arbitrageurs exploit. Establishing a regulatory mechanism is crucial to mitigate this issue.

Conclusion

The Reserve Bank of India (RBI) has expressed valid concerns regarding the risks posed by virtual assets to the traditional banking and finance sector, as well as India's overall financial stability. The Supreme Court, in the case of *Mobile Association of India v. Reserve Bank of India*[\[5\]](#), acknowledged that RBI's notification informing the public that virtual currencies are not valid legal tender was issued in good faith. Accepting cryptocurrencies as legal or acceptable tender would have serious implications for the capital account regime, eroding policy control measures on capital inflows and outflows. Additionally, the majority of cryptocurrencies are controlled by corporate entities, which diminishes sovereign control over the fiscal and monetary landscape.

Therefore, the SOP outlined above is not exhaustive. In addition to the aforementioned steps that require international cooperation and understanding, countries like India need to make significant investments in developing programs and solutions to track and identify suspicious crypto transactions. Internationally agreed-upon regulations are necessary to ensure oversight of corporate-controlled digital currencies. It is through such collaborative efforts that the potential of virtual assets can be harnessed while safeguarding financial systems and maintaining regulatory control.

FAQs

What is a VDA?

VDA stands for Virtual Digital Asset, which encompasses various asset classes such as Cryptocurrency, Non-Fungible Tokens, Smart Contracts, and more.

What is Fiat Currency?

Fiat currency refers to traditional cash currency that is issued by a government and is not backed by a physical commodity like gold or silver.

Who plays a prominent role in converting Fiat currency into VDA currency?

Miners play a significant role in the conversion of Fiat currency into virtual digital assets. Miners are responsible for verifying and validating transactions on blockchain networks, which enables the creation and transfer of VDAs.

[\[1\]](#)The Prevention of Money Laundering Act 2002, No. 15, Acts of Parliament, 2002 (India)

[\[2\]](#)The Companies Act 2013, Schedule III, No. 18, Acts of Parliament, 2013 (India)

[\[3\]](#)The Cryptocurrency and Regulating the Official Digital Currency Act 2021 (2021 Bill)

[\[4\]](#)The Prevention of Money Laundering Act 2002, Sec. 2 (1) (s), No. 15, Acts of Parliament, 2002 (India)

[\[5\]](#)Mobile Association of India v. Reserve Bank of India, MANU/SC/0264/2020

[King Stubb & Kasiva,](#)
Advocates & Attorneys

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Tel: [+91 11 41032969](tel:+911141032969) | Email: info@ksandk.com