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Crypto assets brought under PMLA: First step towards legitimizing Crypto Industry

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The Indian government's recent move to bring crypto assets under the anti-money laundering laws has significant implications for the crypto industry. Enacted in 2002, the PMLA aims to prevent money laundering and seize property derived from the laundered money. Banks, financial institutions, intermediaries, and other specified persons - collectively referred to as 'Reporting Entities' - are required to comply with obligations such as identity verification, record maintenance, and transaction reporting under the PMLA. The service providers under the virtual digital asset ecosystem ("VASPs") have been notified as a Reporting Entity ("PMLA Amendment") and accordingly, they will be required to undertake the compliance obligations specified under the PMLA.

A wide range of VASPs such as cryptocurrency exchanges, NFT platforms, cryptocurrency custody solutions and wallet providers, crypto borrowing and lending platforms, crypto bridges, gaming crypto companies, crypto launchpads, crypto payment gateways, crypto staking platforms and service providers facilitating initial coin/token offerings and executing SAFTs, are likely to be designated as a Reporting Entity and would be subject to the compliance obligations under the PMLA.

This move by the government marks the first step towards the regulation of the Indian crypto industry. While KYC and anti-money laundering ("AML") policies were generally put in place by the established players as an industry practice, now VASPs have a statutory obligation to carry out these compliances. The PMLA Amendment will also bring standardisation to the industry with respect to compliance obligations. A view that PMLA's operation is restricted to Indian geography only and does not have any extra-territorial operation may be difficult. Hence, even the non-resident service providers, especially the ones targeting Indian users should also assess their position with respect to compliance with the PMLA.

The decentralization, pseudonymity, and global nature of cryptocurrencies have made it challenging for regulators to develop a clear policy approach. While industry players see anonymity as an inherent feature of crypto assets, regulators have stressed the importance of identity verification for AML and counter-financing of terrorism ("CFT") purposes. A key approach for regulating crypto assets from an AML perspective is to impose compliance obligations on the intermediaries involved in crypto-asset transactions. Given that these obligations are imposed on intermediaries, implementation and enforcement action against decentralized organisations (which are common in the ecosystem) could be challenging. However, the FATF's report on "Targeted Update on Implementation of FATF's Standards on Virtual Assets and Virtual Asset Service Providers" (June 2022) also notes that 'decentralized' is used more from a marketing standpoint rather than from a technical perspective, hence even the so-called decentralized arrangements may be subject to AML/CFT standards.

The recent changes in tax and company law coupled with the PMLA Amendment have definitely shifted the narrative for crypto assets from 'ban' to 'regulate'. Further, with the PMLA Amendment crypto industry has been put on the same pedestal as banking and financial institutions. While the crypto sector has always received a skeptical view, the PMLA Amendment will act as a deterrence for the unwanted players, increase trust in the ecosystem, provide legitimacy to operations of VASPs, attract institutional capital and may also help in the removal of the shadow ban imposed on the crypto industry by the banking and payment solution providers. The PMLA compliances may now provide a shield to VASPs and assist authorities with the identification of bad actors, hence, attention may shift from VASPs to the actual suspects.

The PMLA Amendment will also bring the Indian crypto industry closer to FATF's standard on virtual assets and virtual asset service providers, which will also help in alleviating India's position in the FATF's global review to be held in June 2023.

In conclusion, while the PMLA Amendment is a positive step for the development of the Indian crypto industry, ambiguity still exists regarding the overall regulatory direction of crypto assets in India. This would weed out bits & pieces and spurious players. It will lead to consolidation of the market and reduce the swindling of common people. The introduction of separate legislation for crypto assets, possibly including having a licensing regime, would bolster the industry with requisite supervision from the regulators.

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