



# Financial RegTech Newsletter

April 2021



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# In this issue

FSI's insights into supervising crypto assets for AML

01

Other regulatory news

03

Regulatory news

02

Global regulatory news

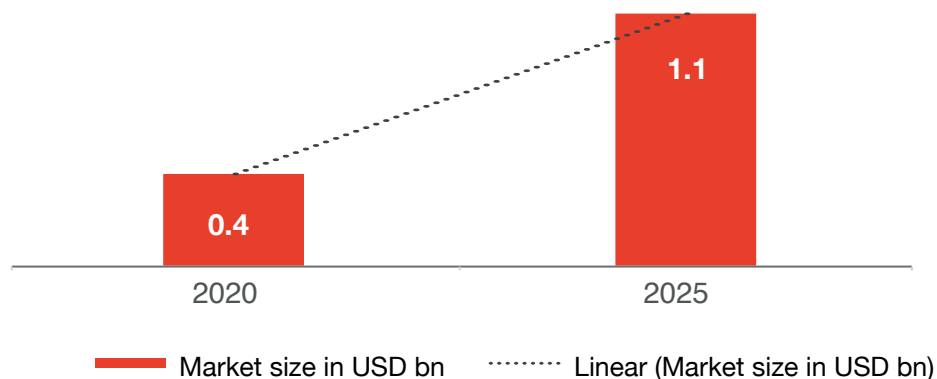
04



The Bank for International Settlements (BIS) and the Basel Committee on Banking Supervision (BCBS) jointly created the Financial Stability Institute (FSI) in 1998. It is tasked with the mandate to assist supervisors in strengthening and improving banking and financial systems. In this capacity, the FSI shared its insights into policy implementation in the area of crypto assets supervision for anti-money laundering in April 2021.

With a projected growth rate<sup>1</sup> of 23.8% and increased acceptance of crypto assets across various geographies and industries, regulating crypto assets remains one of the biggest challenges for every regulatory authority. This edition of PwC's Financial RegTech newsletter provides an overview of the FSI's insights into supervising crypto assets for anti-money laundering.

### Projected CAGR of 23.8% in the crypto asset market



Source: MarketsandMarkets

## Introduction

Crypto assets are nothing but digital assets that depend primarily on distributed ledgers and cryptography or similar technology. Crypto assets have huge proven potential in the area of payments and transfers. However, the same features also make them susceptible to use in money laundering and terrorism financing. There is significant use of crypto assets in illegal activities, and hence, anti-money laundering (AML) regulations and supervision are of utmost importance. According to a study by the FSI<sup>2</sup> around illicit crypto currency transactions worth around USD 11 billion were made in 2019 alone.

The Financial Action Task Force (FATF) swiftly took cognisance of these risks, and proposed frameworks for AML and risks associated with crypto assets. The FATF recommended that all AML/combatting the financing of terrorism (CFT) regulations should be extended to cover crypto currencies. Additionally, the task force also suggested increased monitoring and supervision of all entities dealing with crypto currencies. There has been significant adoption of the FATF standards in the area of AML regulations by various economies. However, the monitoring and supervisory practices are still lagging.

The subsequent sections of the newsletter will cover the adoption of regulatory frameworks for crypto assets at the national level, especially in the area of AML obligations. Additionally, they will touch upon the various supervisory approaches to monitor these risks.

<sup>1</sup> <https://www.marketsandmarkets.com/Market-Reports/crypto-asset-management-market-201925303.html>

<sup>2</sup> <https://www.bis.org/fsi/publ/insights31.pdf>



- The crypto-asset management market size is expected to grow from USD 0.4 billion in 2020 to 1.1 USD billion in 2025, at a CAGR of 23.8%.
- The FATF came up with minimum obligatory requirements for crypto-asset regulation and supervision; and mandated that crypto assets be covered under the ambit of AML and anti-terrorism funding regulations.

## Regulatory frameworks around crypto assets

### Classification of crypto assets

It is essential to define which instruments are considered as crypto assets. Authorities consider several factors to understand the nature and risks posed by crypto assets. These include:

- nature of cryptocurrency-issuing entity (such as identifiable, non-identifiable, regulated, non-regulated, etc.)
- intended use (e.g. investment, payment, etc.)
- type of ledger (such as open to public, open to specific parties, limited to authorised parties)
- underlying assets
- holder's rights
- transfer of ownership of asset.

### Classification of CSPs

A wide range of activities which can be performed using crypto assets. Many of these, such as payments and money transfer, have been the backbone of traditional financial markets as well. On the other hand, activities like mining of cryptocurrencies are completely new to the financial markets. Based on the lifecycle of the crypto asset, activities can be broadly classified into the following:

- primary market activities – issuance and distribution of crypto asset
- secondary market activities – trading and post-trade activities related to asset
- tangential/other activities – infrastructure and other miscellaneous services which help in proper functioning of primary and secondary market activities.

For all regulatory purposes, the definition and classification of a crypto-asset service provider (CSP) is dependent on the type of activities it performs.

### AML/CFT regulation of CSPs

The FATF standard and guidance mandates that virtual assets be covered under the ambit of various AML and anti-terrorism funding regulations, with a proper risk-based approach, licensing and registration, etc.

Authorities have approached the regularisation of virtual assets in different ways. While some have enlarged the scope, covering service providers who are legally domiciled elsewhere, other authorities have imposed a total ban on all or some activities involving crypto assets. Close to home, the Reserve Bank of India (RBI) had imposed a blanket ban on all crypto activities for a long time.

However, almost all jurisdictions have implemented the bare minimum obligations of the FATF in order to comply with most of the AML/CFT measures. These obligations include:

- due diligence on new and existing customers
- record keeping of transactions
- a risk-based approach
- internal controls for compliance with local and cross-border AML regulations
- enhanced due diligence in special and suspicious cases
- reporting of suspicious activities to the relevant authorities.

However, the 'travel rule' is an exception.

## The travel rule

The travel rule is a colloquial term for the FATF standards related to wire transfers. The travel rule is a binding obligation, as suggested by the FATF, but various authorities have not implemented it.

Some jurisdictions maintain strict compliance with the travel rule. Entities subject to these rules must share the details of originators as well as beneficiaries with relevant authorities.

However, other authorities are still uncertain about how to apply this rule. This is mainly because the robust infrastructure for reporting these details is not available to CSPs, making compliance a technically challenging task. International cooperation in this area is the need of the hour, so that a feasible and standard solution is developed for all jurisdictions.

The private service industry has made some efforts to achieve compliance in this area:

- InterVASP Messaging Standard Overview (IVMS101) – a technical data standard
- Transmission using the Travel Rule Protocol (TRP) developed as a software solution by a Swiss software agency – 21 Analytics
- Sygna Bridge solution.

However, the adoption of these protocols is still at a nascent stage.

## Supervisory practices

Many of the world's leading economies are still in the process of developing their approach to the supervision of crypto assets. Until now, most of the supervision has revolved around monitoring the registration and licensing of CSPs only. The challenges posed by the COVID-19 pandemic have further delayed the implementation of such measures.

The major challenges in implementation of supervisory practices for CSPs are as follows:

- Most of the authorities agree that simply extending the existing regulations to cover crypto assets does not give them the requisite safety cover. Instead, many jurisdictions have created dedicated supervisory teams and national laws to specifically cater to crypto assets and CSPs.
- The crypto asset sector is extremely innovative, and so are the challenges posed by it. As a result, any approach to successfully tackle these challenges must involve supervisory and technological innovation. Machine learning and artificial intelligence have great potential and can help in effectively countering the challenges.

- There is a general lack of knowledge and experience in the private sector regarding AML/CFT regulations.
- P2P transactions, in the current scenario, do not involve any entity within the regulatory perimeter. As a result, with the increase in P2P transactions, the risks and chances of terrorism funding also increases. There is a lack of global coordination to counter this risk.

### Cooperation and information sharing

Crypto assets are by and large cross-border in nature. These assets offer great advantages in cross-border transactions, such as efficient and instant trade finance activities. At the same time, there are significant disadvantages, such as cross-border terrorism financing. As a result, collaboration in the following areas is the need of the hour:

- international cooperation and consistent and standardised regulations and implementation of international standards worldwide
- evolution of bilateral/multilateral treaties to cover broader financial crime-related issues
- information sharing via international working groups
- collaborative approach between financial authorities and industry to raise awareness about and mitigate AML risks.

- The FATF mandates due diligence, record keeping of transactions, applying a risk-based approach and suspicious activity reporting as minimum obligations.
- Robust reporting infrastructure and implementation of the travel rule is required.
- Technically innovative solutions and cooperation and information sharing at the international level are required to counter the challenges and risks posed by crypto assets.



## The Indian scenario

- The RBI had banned all banks from processing transactions related to cryptocurrencies back in 2018, effectively banning transactions in cryptocurrencies as well. It was only in March 2020 that the Supreme Court of India quashed the RBI's order. Although the RBI has issued strict AML and anti-terrorism financing regulations, it is only recently that there have been some talks about developing and implementing regulations for supervising crypto asset service providers and their activities.
- The Central Government has announced a new bill on cryptocurrencies, the Cryptocurrency and Regulation of Official Digital Currency Bill, 2021. This bill is expected to be tabled for discussion in the Parliament soon. Additionally, a high-level inter-ministerial committee has been formed to study the issues and propose specific actions, including the introduction of an official digital currency.



## Conclusion

While financial authorities have made significant progress in monitoring CSPs, there is still a lot to be done. The following should be our priorities in tackling the challenges and ensuring a safe financial environment:

- implementing the FATF standards, which are the bare minimum required for effective supervision
- defining the regulatory parameter in line with the global standards under the FATF
- implementing the travel rule to cover all crypto-asset transactions and CSPs
- mitigating risks posed by P2P transactions
- increased cooperation and information sharing at the national as well as international levels.

In India, the RBI's initiatives have been in the right direction and have effectively countered the AML and terrorism-funding risks posed by cryptocurrencies. However, there is still a lot to be done in the area of market supervision. The forthcoming bill a big step in this direction and should go a long way in regularising this highly unregularised industry.

# 02 Regulatory news



## Guidelines issued by the RBI for appointment of Statutory Central Auditors (SCAs)/Statutory Auditors (SAs) of commercial banks (excluding RRBs), UCBs and NBFCs (including HFCs)

The guidelines talk about applicability, prior approval of the RBI, number of SCAs/SAs and branch coverage, eligibility criteria of auditors, independence of auditors, professional standards of SCAs/SAs, tenure and rotation, audit fees and expenses, statutory audit policy and appointment procedure.

These guidelines supersede all previous guidelines on this topic.

The detailed notification can be accessed [here](#).

## Priority sector lending (PSL) – lending by banks to NBFCs for on-lending

With reference to the circular, it was decided that bank loans to registered NBFCs (other than MFIs) for on-lending would be eligible for classification as priority sector under respective categories up to 31 March 2020 and will be reviewed thereafter.

Post review, it has been decided to extend this decision to FY20-21.

Bank credit to registered NBFCs (other than MFIs) and HFCs for on-lending will be permissible up to an overall limit of 5% of an individual bank's total priority sector lending. Moreover, banks shall compute the eligible portfolio under an on-lending mechanism by averaging across four quarters, to determine adherence to the prescribed cap.

The detailed notification can be accessed [here](#).

## External Commercial Borrowings (ECB) Policy – relaxation in the period of parking of unutilised ECB proceeds in term deposits

According to the circular (refer to para 12, attention of Authorized Dealer Category-I (AD Category-I) banks and master direction para 4.2 on “External Commercial Borrowings, Trade Credits and Structured Obligations”), ECB borrowers are allowed to park ECB proceeds in term deposits with AD Category-I banks in India for a maximum period of 12 months cumulatively.

Based on requests from stakeholders, including industry associations, these relaxations have been provided as a one-time measure with the purpose of providing relief to ECB borrowers affected by the COVID-19 pandemic. Accordingly, unutilised ECB proceeds drawn down on or before 1 March 2020 can be parked in term deposits with AD Category-I banks in India prospectively for an additional period up to 1 March 2022.

The detailed notification can be accessed [here](#).





### Priority sector lending (PSL) – increase in limits for bank lending against negotiable warehouse receipts (NWRs)/ electronic negotiable warehouse receipts (eNWRs)

According to the **circular**, the RBI has announced an increase in loan limits for bank lending against NWRs/eNWRs.

According to paragraphs 8.1 (vii) and 8.2 (b) of the **Master circular**, bank loans against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months are qualified for classification under PSL, subject to a limit of INR 50 lakh per borrower.

In order to increase the flow of credit to farmers against pledge/hypothecation of agricultural produce and to encourage use of NWRs/eNWRs issued by regulated warehouses as a preferred instrument for availing such finance by farmers, it has been decided to enhance the PSL limit for loans against NWRs/eNWRs from INR 50 lakh to INR 75 lakh per borrower. The PSL limit backed by warehouse receipts other than NWRs/eNWRs will continue to be INR 50 lakh per borrower.

The detailed notification can be accessed [here](#).



# 03 Other regulatory news



## **Relaxation from compliance with certain provisions of the SEBI (Listing Obligations Disclosure Requirements [LODR]) Regulations, 2015/other applicable circulars due to the COVID-19 pandemic**

SEBI has been receiving appeals from listed entities, professional bodies, industry associations, market participants, etc., requesting extension of timelines for various filings and relaxation from certain compliance obligations under the LODR Regulations, inter alia, due to the ongoing second wave of the COVID-19 pandemic and restrictions imposed by various state governments.

For entities that are listed under SEBI, the deadline for the quarter/half year/year ending 31 March 2021 has been extended to 30 June 2021.

Listed entities are permitted to use digital signature certifications for authentication/ certification of filings/submissions made to the stock exchanges until 31 December 2021.

The official circular can be accessed [here](#).

## **Insurance companies to grant cashless facility for treatment of COVID-19**

A few instances were reported where some hospitals were not granting cashless facility for treatment of COVID-19 despite policyholders being entitled for cashless treatment under their policy.

The Insurance Regulatory and Development Authority (IRDA) has clarified that all network providers (hospitals) who have signed service-level agreements (SLAs) with general and health insurers must mandatorily provide cashless facility for any treatment to policyholders, including COVID-19 treatment, in accordance with the agreed provisions of the SLAs and the terms and conditions of policy contracts.

In the event of denial of cashless facility at any such enlisted network provider (hospital), the aggrieved policyholders may send a complaint to the concerned insurance company.

The detailed notification can be accessed [here](#).

## **Setting up of limited purpose clearing corporation (LPCC) by asset management companies (AMCs) of mutual funds**

In a circular dated 2 February 2021, the modalities for contribution of AMCs towards share capital of LPCC is mentioned. It was prescribed, inter alia, that the contribution from AMCs shall be in proportion to the average AUM of open-ended debt-oriented mutual fund schemes (excluding overnight funds, gilt funds and gilt funds with a 10-year constant duration, but including conservative hybrid schemes) managed by them for FY 2019–20.

The circular has been modified to the effect that the contribution of AMCs shall be based on the average AUM of debt-oriented schemes, as detailed above, for FY 2020–21.

The official circular can be accessed [here](#).

## IRDA's communication on health insurance claims

Instances have been reported where some hospitals were charging differential rates and insisting on cash deposits from policyholders for providing treatment for COVID-19 despite having a cashless arrangement with insurers.

All hospitals have been requested not to differentiate between patients in terms of admission or treatment irrespective of whether or not they are insured or whether they pay cash or avail of cashless facility. In these difficult times, a gesture of this nature on the part of hospitals will raise the confidence of the public in the healthcare system, including health insurance, and build trust.

The details can be accessed [here](#).



### The European Securities and Markets Authority (ESMA) publishes final report on SME growth markets (GMs)

ESMA, the EU's securities markets regulator, published its final report on the functioning of the regime for SME GMs under the Markets in Financial Instruments Directive (MiFID)/Markets in Financial Instruments Regulation (MiFIR). It covers recommendations and possible amendments to the MiFID II framework for the SME GM regime which are required to improve the regime's appeal. The SME GM regime has been successful, with 17 multilateral trading facilities (MTFs) registering as SME GMs to date.

The final report includes recommendations to promote concentration of liquidity on SME GMs, improve standardisation and access to information for investors, and suggestions on how to develop homogeneous admission requirements.

The report was submitted to the European Commission and is expected to be taken into consideration for further legislative proposals on the MiFID II SME GM regime.

The official notification can be accessed [here](#).

### FCA consults on strengthening investor protection in special purpose acquisition companies (SPACs)

The Financial Conduct Authority (FCA) has launched a consultation on proposed changes to its listing rules for certain SPACs. Currently, a SPAC listing is suspended at the point it identifies an acquisition target. However, this results in the investor being locked into a structure SPAC till the time the target is announced. The FCA is proposing that SPACs that comply with higher levels of investor protection should not be subject to this requirement.

SPACs are comparatively complex investment vehicles where the capital structure, potential value and return prospects of any acquisition target is to be assessed. Based on evidence from the US market, SPACs have highly varied returns for public investors and can often result in losses, despite a degree of publicity around these vehicles. Therefore, even if the FCA proceeds with the proposed measures, investors should carefully consider all the available information before investing in a SPAC.

The detailed notification can be accessed [here](#).



## The European Securities and Markets Authority (ESMA) published data for the systematic calculation of equity, equity-like instruments, bonds and other non-equity instruments

ESMA has published data for the systematic adoption of quarterly calculations for equity, equity-like instruments, bonds and other non-equity instruments under MiFID II and MiFIR.

The ESMA has published the total number of trades and total volume over the period of October 2020–March 2021 for the purpose of systematic internaliser (SI) calculations under MiFID II as follows:

- 22,409 equity and equity-like instruments
- 105,011 bonds and
- 7,934 sub-classes of derivatives (including equity derivatives, interest rate derivatives, commodity derivatives, C10 derivatives, emission allowance and derivatives thereof and contracts for difference [CFDs]).

The SI test was to be performed by 15 May 2021.

As per the public statement on the use of UK data in ESMA databases and performance of MiFID II calculations following the end of the UK transition period on 31 December 2020, the UK data reported before Brexit is to be used to perform the calculations.

The detailed notification can be accessed [here](#).

## ESMA publishes final report and guidelines on reporting of periodic information and material changes by trade repositories (TRs) supervised under the European Market Infrastructure Regulation (EMIR) and Securities Financing Transaction Regulation (SFTR)

The guidelines aim to increase the transparency of TRs supervised by the ESMA. Their introduction will bring the following benefits:

- Reduce efforts to get this information intermittently and ensure that no information is omitted.
- Reduce the processing time of information received.
- Establish harmonised reporting templates.
- Ensure complete information that is essential for the ESMA's risk-based supervision.
- Improve the internal planning of ESMA's supervision teams regarding information review and facilitate processing.
- Standardise practices that are already implemented by TRs.

The guidelines will also streamline TR processes and ensure the accuracy of information used for the calculation of TR supervisory fees.

The detailed notification can be accessed [here](#).



# Contact us



## Mukesh Deshpande

Partner, Technology Consulting  
PwC India  
mukesh.deshpande@pwc.com  
+91 98450 95391

## Hardik Gandhi

Associate Director, Technology Consulting  
PwC India  
hardik.gandhi@pwc.com  
+91 98193 79703

## Umang Agrawal

Associate Director, Technology Consulting  
PwC India  
agrawal.umang@pwc.com  
+91 97691 95355

## Arvind Raj

Principal Consultant, Technology Consulting  
PwC India  
arvind.raj@pwc.com  
+91 99693 58788

## Anurag Gupta

Principal Consultant, Technology Consulting  
PwC India  
anurag.gupta@pwc.com  
+91 77603 14901

## Acknowledgements

This newsletter has been researched and authored by Samrat Biswas and Prachi Gujare.





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PD/June2021 - 12828