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Technology news dose*

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## Bitcoins

Bitcoins is a form of decentralized digital currency and mode of payment. They are also known as cryptocurrencies as it relies on advanced cryptographic techniques to ensure authenticated transactions. Bitcoin operates independent of any government or central bank and people can exchange Bitcoins on a peer-to-peer basis, without passing through any financial intermediary. In this article, we shall cover Bitcoins from regulatory angle and cover prevailing regulatory challenges and scopes.

### Technology used in Bitcoins

Before we deep dive into the regulatory landscape for Bitcoins, let us get familiar with the underlying technology and challenges around Bitcoins.

Bitcoin was invented by Satoshi Nakamoto and released as open-source software in 2009. There are no central administrator for Bitcoins and it depends on peer to peer network for maintaining General Ledger and Book-keeping. Bitcoins relies on Blockchain Technology wherein each transaction is broken into blocks of transactions, each connected through links or chains. Thus, not only does this present a unique scenario wherein any central governing body is completely redundant and absent, but also an opening for drastic misusages as participants can be anonymous and difficult to identify.

Blockchain Technology also makes Bitcoins a low cost proposition. As Financial Intermediaries are not present, there are no transaction costs. This has contributed in Bitcoins gaining rapid popularity.

The unique design of Bitcoins and its tight coupling with modern and advance technology has posed serious challenges to the regulators world-wide. Some of the important ones are

- Terror Financing
- Anti-Money Laundering
- Lack of Transparency
- No consumer protection
- Volatility in Prices

Hence, at present, all regulatory bodies are apprehensive to legalize Bitcoins and other virtual currencies. We will now see the different positions taken by the Regulators bodies.

### Global Regulatory Regime around Bitcoins

Regulators around the globe have expressed mixed reactions on the rapid development in cryptocurrencies such as Bitcoins. While on one hand some regulators have shown extreme caution and declared use and trade of Bitcoins as illegal, certain regulators have embraced the advancement and allowed the usage. Following are the view point taken by two prominent global bodies:

#### European Union

The European Central Bank has classified bitcoin as a convertible decentralized virtual currency. Traditional financial sector regulation does not apply to bitcoin because it does not involve traditional financial

#### G7

G7 has classified transmitting of Bitcoins as a source of potential risk and has concluded that such transaction may pose challenges such as anti-money laundering and terror financing

*Source: Wikipedia*

At the same time, a lot of countries are considering over the options to regulate the usage of Bitcoins. A common thought process prevailing across the world is the difficulty to control and regulate block chain technology that in effect, can give rise to risks and threats.

### Bitcoins and India

RBI and SEBI had taken a passive-aggressive stance on usage of Bitcoins. Bitcoins are not yet taken under regulatory supervision. At the same time, regulators have continuously highlighted the associated risk and discouraged Bitcoins transactions. The adopted strategy was more of a 'wait-and-watch' policy that allowed the technology to grow in the market while the stakes were still lower.

However, of late, India and world has witnessed an increased enthusiasm in the space of virtual currencies. Indian regulators have been quick to de-recognize such platforms that propagates Bitcoins and are mulling over tighter directives to control this market.

## Some news bytes around Bitcoins

- US regulators have sounded a positive note and stated that Bitcoins are not a threat to financial systems
- South Korea planning strict regulation around Bitcoin exchanges
- France sounded alerts around the risks concerning Bitcoins
- Russia is considering to legalize Bitcoins
- Indian Income Tax department sent notices to individuals involved in trading Bitcoins

## Major Regulatory Challenges

| Classification  | Accounting and Book-keeping   | Audit and Reporting  |
|---|---|--|
| <ul style="list-style-type: none"><li>• Method of Payment</li><li>• Investment Property</li></ul> | <ul style="list-style-type: none"><li>• Taxation</li><li>• Fair Value Measurement</li></ul> | <ul style="list-style-type: none"><li>• Misstatement in Financials</li></ul> |

Bitcoins are considered to be both a method of payment and an investment property. If considered solely as a mode of payment, Bitcoins should be valued at Fair Market Price and if considered an investment property, Bitcoins should be taxed for any capital gain. This dichotomy is further complicated as General Accounting and Book-keeping also becomes a difficult task. Transactions in Bitcoins raises reporting issues as well. Furthermore, the auditors are challenged by the technological complexities involved as it always poses a risk of misstatement on the financials. Also, the very nature of the product makes Bitcoins susceptible to large swings in price and somewhat easy to fraud. Therefore, most regulatory bodies have not deemed these virtual currencies as legal tender. However, the situation also presents an opportunity as early regulations will be far easy to implement than later on and also give better chance to address the shortcomings and inherent risks.

## Role of Regulators in Future



- As is the case with any new technology product, advent of Bitcoins has created a known challenge of Information Asymmetry in the Market. This gap can be adequately addressed as more regulations can introduce transparency and focus on consumer protection. The prevailing regulatory regime has stressed a lot to address these problems and we believe that regulatory bodies can play a positive role to enhance transparency and information exchange.
- Through proper classification of Bitcoins and virtual currencies, regulatory bodies can ensure that clear valuation and taxation policies can be applied.
- Finally, any future regulation in this space must address to address the problems of Terror financing and Anti-Money Laundering from the start itself.

To conclude, Regulations and Regulatory bodies need to diligently assess the advancement in virtual currencies space and must ride the technology wave to properly regulate and control this space.

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## **Regulatory News**

### **Introduction of Legal Entity Identifier for Large Corporate Borrowers**

The Central Bank has decided to require banks to make it mandatory for corporate borrowers having fund based and non-fund based exposure of Rs. 5 crore and above from any bank to obtain Legal Entity Identifier registration and capture the same in Central Repository of Information on Large Credits.

Details regarding the notification can be accessed [here](#).

### **Directions on Managing Risks and Code of Conduct in Outsourcing of Financial Services by NBFC's**

The Reserve Bank of India issued a direction on Managing risk for Non-Banking Financial Company with a view to put in place necessary safeguards applicable to outsourcing of activities by NBFC's. The master direction talks about the various risks in outsourcing, activities which cannot be outsourced, material outsourcing arrangement, NBFC's role and Regulatory and supervisory requirements etc. The directions are concerned with managing risks in outsourcing of financial services which are not applicable to technology related issues and activities not related to financial services.

[Here](#) is the link to the official notification.

### **Risk Management and Inter Bank dealings- Simplified Hedging Facility**

The central bank with an objective to hedge exchange rate risk on transactions, contracted or anticipated, permissible under FEMA (1999). This is applicable to any over the counter derivative or exchange traded currency derivative permitted under FEMA (1999). This is an amendment to Master direction- Risk Management and Inter Bank dealings dated July, 2016.

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

### **Over the Counter Government securities Transaction by Foreign portfolio Investors**

The Reserve Bank of India has decided to permit FPIs to settle OTC Secondary market transactions in Government securities

either on T+1 or on T+2 basis. It may be ensured that all trades are reported on the trade date itself.

Details of the portal can be accessed [here](#).

### **Secondary Market transactions in Government Securities- Notional Short Sale**

The Central bank has decided that market participants undertaking 'notional' short sale need not compulsorily borrow securities in the repo market. While the short selling entity may ordinarily borrow securities from the repo market, in exceptional situations of market stress, it may deliver securities from its own HTM/AFS/HFT portfolios.

The official press release can be viewed [here](#).

### **Conversion of debt into equity- Review**

Reserve Bank of India has issued revised guidelines on the limit imposed on shareholding of the post converted equity of the borrower company under reconstruction by Asset Reconstruction Company. ARC's which meet the conditions are exempted from the limit of shareholding at 26% post converted equity of the borrower company.

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

### **Rationalization of Merchant Discount Rate (MDR) for Debit Card Transactions**

With a view of promoting debit card acceptance by a wider set of merchants, the Reserve Bank of India has decided to rationalize the MDR for debit card transactions. As per the revised notification, starting January 1, 2018, small merchants using physical POS infrastructures may have to shell out a maximum of 0.40% of the bill value while other merchants may shell up to 0.90%. In case of QR code based infrastructures, these figures stand at 0.30% and 0.80% respectively. Banks have been directed to ensure that the MDR levied on merchants should not exceed Rs 200 for small merchants per transaction and Rs 1000 for others.

The official notification from RBI can be viewed [here](#).

### **Submission of Financial Information to Information Utilities**

According to the Insolvency and Bankruptcy Code (IBC), all financial creditors have been directed by RBI to submit to Information Utilities (IUs) all financial information and information of assets against which security interest has been credited. National E-Governance Services Limited (NeSL) has been identified as the first IU in this regard. Official notification from RBI can be viewed [here](#).

### **Customer Protection - Limiting Liability of Customers of Co-operative Banks in Unauthorized Electronic Banking Transactions**

In view of increasing customer grievances related to unauthorized debit transactions to their accounts/cards, RBI has revised the liability of the customers of Co-operative Banks. In case the fraudulent activity is reported within three days, the liability of the customer shall be zero. For activities reported between four to seven days, the maximum liability of the customer shall be decided based on the type of account and the value of transaction (Rs 25000 being the maximum). Liability of customer in case of reporting beyond seven days shall be decided as per banks boards approved policy. The details of the customer liabilities can be viewed [here](#).

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### **Other Regulatory News**

#### **Launch of Motor Insurance Service Provider Portal**

To recognize the role played by automotive dealers in distributing and servicing motor insurance policies, IRDAI has issued guidelines for Motor Insurance Service Providers (MISP). Insurers and Intermediaries are supposed to upload the details of MISPs to Insurance Information Bureau of India (IB). Details of this notification can be accessed [here](#).

#### **Innovations in insurance involving wearable/portable devices**

To understand the implications of various technology trends on insurance, particularly wearable and portable devices, IRDAI has constituted a working group for the same. The objective of the working group is to understand the practices of other jurisdictions in this area and suggest a policy framework that

keeps the interests of policyholders in mind. The official communication by IRDAI can be viewed [here](#).

### **Investment by FPIs in Hybrid Securities**

SEBI has allowed FPI's to invest in REITs and InvITs which are classified as hybrid securities, presently the said investments are not reflected in the daily FPI net investment data or the monthly, fortnightly FPI AUC data.

[Here](#) are the details of the disclosures to be made in this regard.

### **Modification to Enhanced Supervision Circular**

SEBI has issued modification guidelines on broad areas for enhanced supervision. Details regarding End of day securities balances ISIN, ISIN wise number of securities pledged if any have been modified as per the revised guidelines.

Other details of the notification can be viewed [here](#).

### **Increasing Max age of joining NPS from 60 to 65 years**

The Pension Fund Regulatory and Development Authority (PFRDA) has issued a circular on increasing maximum age of Joining National Pension Scheme (NPS) from the present 60 yrs to 65 yrs in NPS – private sector i.e. under All Citizen Model and Corporate model has been increased to 65 yrs from the existing 60 yrs. Other details of the notification can be viewed [here](#).

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### **Global Regulatory News**

#### **Bank & FCA launch next phase of sterling Libor transition work**

The Bank of England and FCA have announced the next phase of work with market participants on LIBOR transition. The working group's new mandate would be to catalyze a broad based transition to SONIA over the next four years across sterling bond, loan and derivative markets.

For the next phase it is expected to have an active arrangement is required from participants across all sectors and Markets. Membership of the working group will be broadened to include investment managers, infrastructure firms etc. The detailed article on this can be viewed [here](#).

### **FCA launches Wholesale Insurance broker's market study.**

In order to ensure that the sector is working well and to foster innovation and competition in the interests of its diverse range of clients, FCA has launched a market study to assess how competition is working in the wholesale insurance broker sector. The detailed article can be viewed [here](#).

### **Monitoring Group proposes reforms to global audit standard setting**

With a view to enhance the transparency, independence and relevance of international audit standard – setting process, the Monitoring Group has released a consultation paper setting out options and recommendations to enhance the governance and oversight of audit standard setting. The proposal addresses main concerns regarding the structure, number, remit and size of Standard Setting Boards (SSBs); accountability of SSBs to International Federation of Accountancy (IFAC) among other things. The consultation process is open until Feb 9, 2018 and more details on the same can be viewed [here](#).

### **EBA publishes final Guidelines on the estimation of risk parameters under the IRB Approach**

To reduce the variance in the outcomes of Advanced IRB approaches used by various institutions, the European Banking Authority (EBA) has issued final guidelines on the estimation of risk parameters under the IRB approach. The guidelines provide clarifications on the main concepts and definitions of the underlying risk calibration parameters along with discounting factors used to calculate the realized LGD on historical observations. The discounting rate shall be specified as Euribor or an equivalent interbank rate for currencies other than euro plus a fixed add-on of 5%, which will have to be applied by institutions. Details of the guidelines that shall be applied latest by Jan 1, 2021, can be viewed [here](#).

### **EBA publishes methodology for the 2018 EU-wide stress test**

EBA has published the final methodology to be used for 2018 EU-wide stress testing. The methodology, which incorporated IFRS9 accounting standards as well, will primarily focus on

impact of risk drivers on solvency of the banks. The test exercise is supposed to be formally launched in January 2018.

[Here's](#) the official communication.

### **Basel Committee issues proposed technical amendment to the Net Stable Funding Ratio**

Basel committee issued technical amendment related to the treatment of extraordinary monetary policy operations in the Net Stable Funding Ratio. The Committee invites comments on the proposed amendment by 5 February 2018. [Here](#) is the official press release.

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