

XI. ERROR 5XX: A CRITIQUE ON APPLICATION OF INSIDER TRADING REGULATIONS TO CRYPTOCURRENCIES IN INDIA

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ABSTRACT

In the year 2020, the Supreme Court of India struck down the Reserve Bank of India's circular that banned virtual currencies since 2018. This judgement changed India's economic scene forever by attracting millions of investors and organizations all from around the world to herald its arrival into the mainstream. Its popularity re-established the Indian cryptocurrency exchanges that were once beaten down in a gory battle with the RBI. However, these entirely unregulated exchange platforms have fostered insider trading and qua market manipulation that has no apparent recourse and Indian policymakers have done little to stop it. This article explores the concept of blockchain technology and cryptocurrency, the trend of insider trading, and the difficulties that Indian officials face as they attempt to reconcile cryptocurrency's novelty with its requirement for stability. Further, this article classifies cryptocurrencies as a class unto itself to reconcile their models with the traditional financial instruments and finally concludes this discourse by delineating and suggesting various solutions to the cryptocurrency insider trading quandary.

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I. INTRODUCTION

In the last half a century, since the Henry Maine's disparaging reference to "an anonymous lady law student," who, in a classroom discussion of insider trading, stamped her foot and angrily declaimed, "I don't care; it's just not right."

Many commentators have adopted his view that ethical considerations are alien to the debate, a "refuge for the intellectually bankrupt."¹ The insider trading debate, as it is known, is ultimately a question of market efficiency and executive compensation.² Extensive literature addressing the substance of insider trading law can already be found everywhere. However, ascertaining and demarcating the bounds of insider trading law has been obscured. The question that needs answering is how far does insider trading law pervade in a technologically driven world of Alt-Finance?

Most scholars have already assumed a fixed domain for insider trading laws limited to stocks and commodities.³ Some have even gone to argue that any adoption of insider trading laws beyond conventional financial assets is irrational.⁴ It is this principle of limited recognition that the authors wanted to refute. In constructing their case, the authors will analyse classes of fintech

¹ HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* 233 n.42 (Free Press 1966).

² Frank. H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information* 1981 SUP. CT REV. 309 (1981); David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449 (1986); Larry E. Ribstein, *Federalism and Insider Trading*, 6 SUP. CT. ECON. REV. 123 (1998).

³ Andrew Verstan, *Insider Trading in Commodities Market*, 102 VIRGINIA LAW REV 456-494 (2016); PAUL BARNES, *STOCK MARKET EFFICIENCY, INSIDER DEALING AND MARKET ABUSE*, 16-28 (Ashgate Publishing Limited, 2012); FERRARA ET. AL., *FERRARA ON INSIDER TRADING AND THE WALL*, 5-120 (Law Journals Press, 2020).

⁴ James J. Park, *Insider Trading and the Integrity of Mandatory Disclosure*, 2018 WIS. L. REV. 1133, 1172

assets such as Bitcoin, Ethereum, Altcoin, etc. that are commonly thought to be lying beyond India's insider trading laws and policy.

Fintech assets or crypto assets are a new set of financial instruments that are technologically driven wherein individual ownerships are recorded and stored in a ledger based on blockchain technology.⁵ Unlike conventional financial instruments, crypto assets are not controlled by any central authority, and it is this decentralized nature of theirs that attracts investors.⁶

The massive demand for crypto in India was rekindled after the famous *IAMAI v. RBI* judgement wherein the Supreme Court of India struck down the Reserve Bank of India's ("RBI") circular that directed financial agencies to dissociate themselves from entities involved in virtual trading or transactions relating to virtual currencies.⁷ Within a short span of time after the judgement, the demand for crypto surged drastically in India with a number of over a million users as of 2020.⁸ Their popularity helped organisations re-establish their crypto exchanges that were once beaten down in a gory battle with the RBI years back. The crypto exchanges are similar to regular stock exchanges but in defiance to their apparent appeal, these unregulated exchanges often serve as a venue for insider trading and for defrauding investors.

To date, India has no law regulating cryptocurrencies. Despite a plethora of globally adopted options, Indian regulators are determined on

⁵ ANDREW HAYNES & PETER YEOH, *CRYPTO ASSETS AND REGULATORY LEGAL ISSUES* (1 ed. Informa Law from Routledge 2020).

⁶ *Id.*

⁷ *Internet and Mobile Association of India v. Reserve Bank of India*, 2020 (2) CTC 528 (India).

⁸ Neil Borate, *Crypto trading rises in India after SC overturns RBI payments ban*, LIVESMINT (April 21 2020), <https://www.livemint.com/money/personal-finance/crypto-trading-rises-in-india-after-sc-overturns-rbi-payments-ban-11587466139986.html>.

banning these instruments as such. However, the impracticability of destroying the indestructible takes us to the next step that is regulation. But the Indian officials have put little to no clarity on how cryptocurrency should be treated by institutions and officials providing zero recourse to consumers and stakeholders. This being the case, this article will assert that it is no longer acceptable to remain inert on regulating insider trading among cryptocurrency exchanges. In order to do that, the authors will in part II discuss what blockchain technology and cryptocurrency are. Next, they will give an introduction to insider trading jurisprudence. Part IV of this paper will discuss how consumers are harmed in an unregulated cryptocurrency exchange. In part V of this paper, the authors will differentiate cryptocurrencies as a class within itself and will explain which conventional asset sets do the classified cryptocurrencies fall. Finally, this article will delineate and suggest various solutions to the cryptocurrency insider trading quandary.

II. BLOCKCHAIN TECHNOLOGY AND CRYPTOCURRENCY

A. Blockchain Technology

“Blockchain” refers to a new database of technology where information is shared across a network of users where each user holds a full and updated copy of records. The block[chain] acts as a reliable database, in the way in which information is stored, replicated, and updated on a distributed ledger, making it trustworthy and transparent.⁹ One of the appeals of the blockchain mechanisms is that the technology is not ultimately controlled by a single, centralised party. But, a blockchain functions through “nodes”, which

⁹ Boonyaorn Na Pombejra, *The Rise of Blockchain: An Analysis of The Enforceability of Blockchain Smart Contracts* (2016) (Unpublished L.L.M. B.L, Thammasat University) (on files with faculty of law, Thammasat University).

comprise a network of participating computers. These nodes act as the means that store, update, and secure the publicly transacted data.¹⁰ Every node will have a copy of the blockchain database, and each copy is kept in synchronization with the other nodes by a system of cryptographically-enforced rules called a consensus algorithm. The updates to the blockchain are secured by a cryptographic process known as a hash function that allows the network to immediately detect and reject any attempt to distribute an edited copy of the database. But how is this technology related to cryptocurrencies?

B. Crypto Assets

Crypto assets are a form of property distinguished by their use of a distributed ledger,¹¹ a system by which features of the asset and its current ownership are verified and recorded semi-publicly, with no one person serving as the official record-keeper.¹² Each cryptocurrency has its own blockchain, with its own cryptographic security measures, including public-key encryption.¹³ A 'typical' blockchain is decentralised, such that all transactions on the blockchain must be validated and recorded by holders of the cryptocurrency. This typically occurs through a process known as mining, whereby individual holders provide computational power to the blockchain

¹⁰ *Id.*

¹¹ Shermin Voshmgir, *Blockchains & Distributed Ledger Technologies*, BLOCKCHAINHUB BERLIN, <https://blockchainhub.net/blockchains-and-distributed-ledger-technologies-in-general/> (excerpt from Shermin Voshmgir, *Token Economy: How Blockchains And Smart Contracts Revolutionize the Economy* (2019)).

¹² Sherwin Dowlat & Michael Hodapp, Satis Grp., *Crypto Asset Market Coverage Initiation: Market Composition*, BLOOMBERG (Jul. 18, 2018), https://research.bloomberg.com/pub/res/d28giW28tf6G7T_Wr77aU0gDgFQ.

¹³ DAVID LEE & ROBERT H. DENG, HANDBOOK OF BLOCKCHAIN, DIGITAL FINANCE, AND INCLUSION 31 (2017); ERIK BEULEN & PIETER M.A. RIBBERS, THE ROUTLEDGE COMPANION TO MANAGING DIGITAL OUTSOURCING 300 (2020).

sufficient to solve an encryption algorithm,¹⁴ thus verifying and validating the transaction and recording it on the blockchain in exchange for a small commission paid for the currency validated.

C. Bitcoin

Bitcoin is arguably the most popular example of cryptocurrency and is one of the best implementations of blockchain technology in the world.¹⁵ Though it was first introduced as a "Peer-to-Peer Electronic Cash System,"¹⁶ its popularity grew much from there to the building Bitcoin Cash, and even Bitcoin gold which was designed to resolve Bitcoin's capacity crunch with larger blocks, and to tackle the increasing centralization of the mining industry that verifies and secures Bitcoin transactions.¹⁷ It is interesting to note that Bitcoin has never officially been offered to investors in the primary market.¹⁸ In the secondary markets, on the other hand, cryptos' purchase is open to anyone, worldwide, regardless of their qualifications, subject to the "proof-of-work" requirement for block-rewards, which essentially allocates the right to

¹⁴ Krzysztof Misztal, TomazxSkuzakec& Aleksandra Kubica-Misztal, *Securing Data of Biotechnological Laboratories using Blockchain Technology*, COMPUTER INFORMATION SYSTEMS AND INDUSTRIAL MANAGEMENT 88 (JiříDvorský, Khalid Saeed, 2000).

¹⁵ PWC, *Making sense of bitcoin, cryptocurrency and blockchain* (January 20 2021), <https://www.pwc.com/us/en/industries/financial-services/fintech/bitcoin-blockchain-cryptocurrency.html>

¹⁶ Nakamoto, S., *Bitcoin: A peer-to-peer electronic cash system*. MANUBOT (2019).

¹⁷ Bazán-Palomino, W., *Bitcoin and its offspring: a volatility risk approach*, in ADVANCED STUDIES OF FINANCIAL TECHNOLOGIES AND CRYPTOCURRENCY MARKETS (pp. 233-256) (2020).

¹⁸ Frequently Asked Questions, BITCOIN, (September 23 2020), <https://bitcoin.org/en/faq#what-aboutbitcoin-and-consumer-protection>; Ameer Rosic, *What is Bitcoin?*, BLOCKGEEKS (updated April 2019), <https://blockgeeks.com/guides/what-is-bitcoin/>; *Guide what is Bitcoin and how does bitcoin work?*, BBC (October 31 2018) <https://www.bbc.co.uk/newsround/25622442>.

assign property rights in the blockchain-based on computational power.¹⁹ However, it is within this narrow space of buying and selling in the secondary market that the scope for insider trading has come in.

III. INSIDER TRADING JURISPRUDENCE

Insider trading refers to the manipulation of price-sensitive confidential information by insiders of the company.²⁰ It forms the subject matter of both securities and commodities law as it is often perpetuated to influence market prices and thereby deceiving and making economic gain out of the general public. The offence of insider trading occurs when a person with information of certain [goods] traded in a public exchange employs such information in market transactions.²¹ It is necessary that the information relied upon is specific and precise, and must not have been known to the general public, if it is known then it should have a considerable impact on the price of the goods traded.²²

Information is considered *material* if its release would affect the market price of goods traded for better or worst. For example, an announcement of a merger, an acquisition, earnings report, splits in advance, etc.²³ Insiders are those people who are privy to such non-publicised material information as a result of their connection to that business. They owe a

¹⁹ *Proof of work*, (September 23/09/2020), https://en.bitcoin.it/wiki/Proof_of_work; See Caner Taçoğlu, *Block Reward* (September 23 2020), <https://academy.binance.com/en/glossary/block-reward>.

²⁰ Report: High Powered Committee on Stock Exchange Reforms (Ministry of Company Law and Administration, 1986), GOVERNMENT OF INDIA.

²¹ GENTZ Et AL., BUSINESS LAWS ALTERNATE EDITION, 179 (Cengage Learning, 2008).

²² Narayan Prasad Sharma, *A Reading into Insider Trading: Concept, Cases, Consequences and Countermeasures*, 12 NJA L.J. 113 (2018).

²³ Agrawal, Anup & Nasser, Tareque. *Insider Trading in Takeover Targets*, J. OF CORPORATE FINANCE (2011).

fiduciary duty to the companies or the organisations due to the position they occupy, and if they trade based on such information it unfairly undermines the interest of both the shareholders and institutions to which they owe this duty. Sometimes, people outside of a company or institution use this information obtained from the insiders to seek a profit, even if the insider may not directly profit. In these situations, there is a tipper and a tippee.²⁴ The tipper is the person who has breached his/her fiduciary duty by disclosing the information and a tippee is a person who deliberately uses that confidential information to make a trading decision.²⁵

The United States of America was the first country to formally enact a legislation to regulate insider trading at a time when in many other parts of the world, the access to insider information and its use for personal benefits were regarded as perks of office and the benefits of having reached a high stage in life.²⁶ India was not late in recognising the harm that insider trading did to financial markets. Wherefore, efforts had been made to implement an insider trading framework as early as the 1940s when the president of the Bombay Stock Exchange cited instances of leading companies not disclosing swiftly and publicly the issues of bonus shares and declaration of dividend,²⁷ something which was essential for good corporate governance and standard development of the capital market in the interest of the general public.

²⁴ Cohen, D.T., *Old Rule, New Theory: Revising the Personal Benefit Requirement for Tipper/Tippee Liability under the Misappropriation Theory of Insider Trading*, (2005) BCL REV., p.547.

²⁵ Sari Rosenfeld, *The Ever-Changing Scope of Insider Trading Liability for Tippees in the Second Circuit*, (2019) 8 MICH. BUS. & ENTREPRENEURIAL L. REV. 403.

²⁶ Securities and Exchange Act, 1934, NYSE <https://www.nyse.com/publicdocs/nyse/regulation/nyse/sea34.pdf>.

²⁷ Speech of the President of the Bombay Stock Exchange, on 14th June 1947.

When the Companies Act was framed, due diligence was provided to prevent misuse of unpublished price-sensitive information. While not much emphasis was given to insider trading in the original Act of 1956, Section 195 of the Companies Act, 2013 explicitly prohibited insider trading.²⁸ But, it was only with the establishment of the Securities and Exchange Board of India (“SEBI”) in 1992 and with the issue of the SEBI (Prohibition of Insider Trading) Regulations, 1992,²⁹ the insider trading enforcement became substantially strengthened in the country. But these laws are applicable only to securities, a category that includes most stocks and bonds, as well as similar assets and instruments whose value is fundamentally linked to them.³⁰ In 2015, the Securities Contract Act,³¹ pursuant to the SEBI 2015 Guidelines,³² started covering commodity derivatives within its ambit and thereby widening the scope of SEBI in protecting the interest of investors and other stakeholders.

IV. THE HARM

The success that Bitcoin - the fore-father - and Ethereum - the distant relative - had in the crypto-verse made cryptocurrency a very lucrative market, leading to the emergence of various digital currencies,³³ and the establishment of various crypto exchanges that offered the enthusiasts attractive platforms to

²⁸ The Companies Act, 2013, No. 18, Acts of Parliament, 2013, § 195.

²⁹ SEBI (Prohibition of Insider Trading) Regulations, 1992, PART III SEC. (IV), THE GAZETTE OF INDIA, <https://www.sebi.gov.in/acts/insideregulation.pdf>.

³⁰ Manchikatla, A.K. & Acharya, R.H., *Insider trading in India—regulatory enforcement*, JOURNAL OF FINANCIAL CRIME (2017).

³¹ Securities Contracts (Regulation) Act, 1956, PART III SEC. (IV), THE GAZETTE OF INDIA <https://www.sebi.gov.in/acts/contractact.pdf>.

³² SEBI (International Financial Services Centres) Guidelines, 2015, https://www.sebi.gov.in/legal/guidelines/mar-2015/sebi-international-financial-services-centres-guidelines-2015_29457.html.

³³ P Xia et al., *Characterizing cryptocurrency exchange scams*, COMPUTERS & SECURITY, p.101993.

buy, sell and transfer crypto of their choice via website, apps and digital wallets.³⁴ Although initially, the largest attraction for crypto was in the void without bounds, the coming of crypto exchanges that resemble stock exchange, and crypto-derivatives resembling traditional financial instruments attracted the mainstream investors causing more than roughly a 251.8 billion dollar infusion into the crypto-nomy.³⁵ One popular India-based exchange, Coin DCX, established in 2017, backed by Bain Capital Ventures and Polychain Capital, witnessed an enormous 47 percent growth in trading volumes and 10 times increase in signups during the first quarter of 2020 alone.³⁶ Another exchange, Wazir-X was acquired by global crypto exchange Binance and became the first of its kind to be acquired by an international one.³⁷

However, the biggest problem with the cryptocurrency trade is exactly what makes it so alluring: the lack of regulation. Though the original concept of cryptocurrency was to countervail banks and other institutions so that maximum financial gains can be made without any regulatory hassle, its implementation today suffers from an unguided expedition making itself crying out to the regulators to step in. Lack of regulation in the crypto market has opened itself to significant risks of volatility, market manipulation, lack of consumer protection, etc. Moreover, the absence of legal certainty has its own

³⁴ Chu, D., *Broker-Dealers for Virtual Currency: Regulating Cryptocurrency Wallets and Exchanges*, (2018) COLUMBIA L. REV., 118(8), pp.2323-2360.

³⁵ SCIPOL, *Crypto-Currency Act of 2020* (HR 6154, 116th Congress), <https://scipol.org/track/hr-6154-crypto-currency-act-2020>.

³⁶ Debroop Roy, *Coin DCX Is Enabling Mass Adoption of Cryptocurrencies In India*, ENTREPRENEUR INDIA (June 3 2020), <https://www.entrepreneur.com/article/351429>.

³⁷ Sanghamitra Kar, *Binance acquires Mumbai's bitcoin exchange WazirX*, THE ECONOMIC TIMES (Nov. 21 2019), <https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/binance-acquires-mumbais-bitcoin-exchange-wazirx/articleshow/72152901.cms>.

consequences as there always remains indecision regarding contract enforcement and taxations.³⁸

Crypto exchanges, being high priced and combined with code-based transactions, have made it the favourite target point for black hat hackers leaving no recourse to the victims.³⁹ Among various cryptocurrencies that have been hacked to date, Initial Coin Offerings (“ICOs”) forms the most vulnerable ones. In 2017, the project team – led by Boom Bust Blog, Reggie Middleton, faced an attack during its initial offering of VERI ERC-20 tokens losing over \$8.4mn.⁴⁰ In 2018, CoinDash suffered a massive breach as soon as it opened an ICO, losing £5.54 million in Ethereum coins.⁴¹ Furthermore, a Bitcoin exchange named Yobit filed for bankruptcy after hackers stole 20 percent of its clients' stored currency.⁴² These incidents have become very common, with around 75 crypto exchanges around the world having closed in the year 2020 alone.⁴³ Unlike central depositories where scripts of public equities are stored, cryptocurrencies exist within their own chains, and once

³⁸ Punkit Shukla, *How India's government can build better contracts with blockchain*, WORLD ECONOMIC FORUM (Oct. 04 2019), <https://www.weforum.org/agenda/2019/10/how-indias-governments-can-build-better-contracts-with-blockchain/>.

³⁹ Boireau, O., *Securing the blockchain against hackers*, NETWORK SECURITY, 2018, pp.8-11.

⁴⁰ Wolfie Zhao, *Veritaseum Founder Claims \$8 Million in ICO Tokens Stolen* COINDESK (July 26 2017), <https://www.coindesk.com/veritaseum-founder-claims-8-million-ico-token-stolen>.

⁴¹ Ari Levy, *Fraudsters just stole \$7 million by hacking a cryptocurrency offering*, CNBC (July 17 2017), <https://www.cnn.com/2017/07/17/coindash-website-hacked-7-million-stolen-ico.html>.

⁴² Eun-Young Jeong & Steven Russolillo, *Cryptocurrency Exchange Collapses, Files for Bankruptcy After Second Hack*, THE WALL STREET JOURNAL (December 19 2017), <https://www.wsj.com/articles/cryptocurrency-exchange-collapses-files-for-bankruptcy-after-second-hack-1513683519>.

⁴³ Martin Young, *75 crypto exchanges have closed down so far in 2020*, COINTELEGRAPH (OCT. 7 2020), <https://cointelegraph.com/news/75-crypto-exchanges-have-closed-down-so-far-in-2020>.

these chains have been broken, melted, and recast without the investor's knowledge, to whom should the innocent investor aggrieve?

Another serious issue with the lack of regulations and the one that forms the core of this article is insider trading. Insider trading as explained in the previous section of this paper refers to “buying or selling of securities/commodities while in possession of material non-public information about it.” In India, Section 11(2) (g) of the Securities and Exchange Board of India Act, 1992 provides SEBI with the power to prohibit insider trading in India.⁴⁴ 'Insider' as per Regulation 2(e) of SEBI (Prohibition of Insider Trading) Regulations, 1992 refers to persons who are or who were connected to or who are deemed to be connected to the company and have access to 'Unpublished Price Sensitive Information (“UPSI”)’.⁴⁵ Insider trading is a punishable crime imposing a penalty of Rs 25 crore or three times the profit made, whichever is higher.⁴⁶ But how does insider trading become relevant in the context of crypto?

Crypto exchanges are like any ordinary stock exchange in their setting. Like any stock exchange, be it National Stock Exchange or BSE, they provide a platform for buy and sell. But unlike the regulated stock exchange, crypto exchanges do not mimic the ethics of insider trading regulations. This becomes clear by looking at the two high-profile international scandals that happened recently. In 2018, South Korea's Financial Supervisory Service (“FSC”) announced it was launching an internal probe into potential incidences of

⁴⁴ Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992 § 11(2)(g).

⁴⁵ SEBI (Prohibition of Insider Trading) Regulations, 1992, PART III SEC. (IV), THE GAZETTE OF INDIA, <https://www.sebi.gov.in/acts/insideregupdf.pdf>, § 2(e).

⁴⁶ Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992, § 15G.

insider trading by FSC employees. According to their reports, several FSC employees sold their Bitcoin holdings right before South Korean Justice Minister Park Sang-ki announced a potential ban on cryptocurrency trading.⁴⁷ In another incident in the USA, the crypto exchange Coinbase announced that it was investigating reports of insider trading among its employees.⁴⁸ The issue arose when, just hours before Coinbase announced it was going to support trade in Bitcoin Cash (“BCH”), trading of BCH increased and its price soared 700 percent. However, an internal investigation concluded that no insider trading of Bitcoin Cash took place,⁴⁹ and later a class-action lawsuit against the exchange was dismissed by the Northern District Court of California.⁵⁰

The case in India is relatively different. Even if a scandal happens, Indians are afraid to report it to the authorities because of the stigma that the Indian government has created around crypto traders surrounding its legality. But this does not mean that crypto scams are happening unexposed; the case is more about lack of recourse even if exposed. The alleged EBT coin scam,⁵¹

⁴⁷ Alex Belov, *Korean Regulator Investigating Staff Insider Trading of Cryptocurrencies*, COINTELEGRAM (January 18 2018), <https://coinstelegram.com/2018/01/19/korean-regulator-investigating-staff-insider-trading-of-cryptocurrencies/>.

⁴⁸ Wolfie Zhao, *Coinbase Hit by Lawsuit Over Alleged Insider Trading*, COINDESK (March 5 2018), <https://www.coindesk.com/coinbase-hit-lawsuit-alleged-insider-trading>.

⁴⁹ Helen Partz, *Coinbase Internal Investigation Concludes No Insider Trading Took Place*, COINTELEGRAPH (Jul. 25, 2018), <https://cointelegraph.com/news/coinbase-internal-investigation-concludes-no-insider-trading-took-place>.

⁵⁰ Marie Huillet, *US Court Dismisses Lawsuit Against Coinbase for Alleged BCH Insider Trading*, COINTELEGRAPH (October 25 2018) <https://cointelegraph.com/news/us-court-dismisses-lawsuit-against-coinbase-for-alleged-bch-insider-trading>.

⁵¹ TNN, *Gujarat: 6 arrested in Rs 43 crore cryptocurrency scam*, THE TIMES OF INDIA (October 25 2019), <https://timesofindia.indiatimes.com/city/ahmedabad/6-arrested-in-rs-43cr-crypto-scram/articleshow/71748030.cms#:~:text=This%20is%20the%20first%20cryptocurrency,marketing%20structure%20in%20January%202018..>

GainBTC scam,⁵² MTC scam,⁵³ KBC scam,⁵⁴ and Pluto Exchange scam⁵⁵ all fall into the long list of Ponzi schemes devised by the scammers to defraud millions of investors in the dim light of regulatory guidance that should prompt even SEBI to step despite its uncertainty over lack of regulatory authority.⁵⁶ In fact, between 2017 and 2019, Indian investors have lost more than \$500 million to cryptocurrency scams operated within the country and abroad.⁵⁷ But this is not all. The massive selling that happened in Indian exchanges right before and after, an anonymous government insider tipped the information that the government was planning to ban crypto is a visible example of the impact that unregulated price-sensitive material non-public information could have on the crypto-verse,⁵⁸ and how a large-scale journalistic organisation walks unaccounted after pulling a digital wildfire. In another instance, a massive surge in the price of Bitcoin Cash was observed right before the California-

⁵² Suprita Anupam, *Amit Bhardwaj And The Massive GainBitcoin Scam: Is The Investigation Going Nowhere?*, INC 42 (September 18 2019), <https://inc42.com/features/gainbitcoin-scam-amit-bhardwaj-and-the-massive-case-investigation-timeline/>.

⁵³ Sagar Rajput, *Mumbai's Rs 500-crore cryptocurrency scam: Main accused believed to be in Dubai*, THE INDIAN EXPRESS (June 14 2019), <https://indianexpress.com/article/cities/mumbai/mumbai-main-accused-believed-to-be-in-dubai-in-rs-500-crore-cryptocurrency-scam-5779661/>.

⁵⁴ Michael Lavere, *Four Arrested in India Over \$14 Million KBC Coin Scam*, THE INDIAN EXPRESS (July 06 2019), <https://www.cryptoglobe.com/latest/2019/07/india-crypto-scam-14-million-kbc-coin-pyramid-scheme-july-2019/>.

⁵⁵ Mohammed Mushraff, *Indian Police probe into alleged 270K cryptocurrency exchange scam*, COINTELEGRAPH (September 22 2020), <https://cointelegraph.com/news/indian-police-begin-probe-into-alleged-270k-cryptocurrency-exchange-scam>.

⁵⁶ TT Bureau, *SEBI gets whiff of Bitcoin scam*, THE INDIAN EXPRESS (December 18 2017), <https://www.telegraphindia.com/business/sebi-gets-whiff-of-bitcoin-scam/cid/1471073>.

⁵⁷ *Id.*

⁵⁸ Deepshikha Sikarwar, *With a law, India plans lasting ban on cryptos*, THE ECONOMIC TIMES (June 20 2020) <https://economictimes.indiatimes.com/news/economy/policy/with-a-law-india-plans-lasting-ban-on-cryptos/articleshow/76330403.cms>; See Trading View, *WRX traded Volume*, <https://www.tradingview.com/x/83mksStu/> (around 20% decline from 5 June till 27 June, 11.743 million Wrx volume traded in a day before the news was published, the day ended in the red as the selling pressure was high)

based cryptocurrency exchange Coinbase announced its addition of Bitcoin Cash for regular trading, prompting the question if Coinbase employees acted on insider knowledge. Although this type of trading was prohibited by Coinbase's employee policy,⁵⁹ what could be the possible remedy in an Indian cryptocurrency exchange where super fluctuation of crypto prices has become a common phenomenon before listing the assets? In India, the absence of any regulatory or legal authority over insider trading by crypto exchange employees, only implies that it can happen anytime with possibly no recourse for a level playing field.

V. CLASSIFICATION

“There are three eras of currency: commodity-based, politically based, and now math based.”⁶⁰ Since the advent of Bitcoin in 2009, the world economy has witnessed an unprecedented arrival of virtual currencies as transnational monetary phenomena into the market space. In a news article dated January 2018, the Financial Express reported a total number of 1300+ types of virtual currencies functioning including many Ponzi schemes.⁶¹ It is because of this immense number that they have both in variety and in quality a classification becomes all the more important.

⁵⁹ Brian Armstrong, *Our employee trading policy at Coinbase*, THE COINBASE BLOG (December 20 2017), <https://blog.coinbase.com/our-employee-trading-policy-at-coinbase-1d4e860b7837>.

⁶⁰ Chris Dixon (@cdixon), Twitter, (20/09/2020), <https://twitter.com/cdixon/status/563223999543382017?lang=en>.

⁶¹ FE Online, *Crackdown against black money to span Cryptocurrencies too; check out government strategy*, THE FINANCIAL EXPRESS (January 14 2018), <https://www.financialexpress.com/market/crackdown-against-black-money-to-span-cryptocurrencies-too-check-out-government-strategy/1014674/>.

Functionally, virtual currencies can be organised into three types based on their relation with traditional real money and the real economy.⁶² They are, (i) The closed virtual currency schemes used in an online game with no value outside the game, e.g., a gold coin from the coin rush game. (ii) Virtual currency schemes having a unidirectional flow with a conversion rate for purchasing the services of particular company/companies. (iii) Virtual currency schemes having a bidirectional flow, where they act like any other convertible currency with two exchange rates (buy and sell) which can subsequently be used to buy virtual goods and services as well as real goods and services, for e.g., Bitcoin, USDT, etc. The first two categories have no real value outside their respective domain and do not vest any actual interest in their investors with respect to the general market space. However, the value of these third categories of virtual-currencies is always subject to market sentiment and it is here, where the insider trading laws should be applied.

The third category of virtual currency schemes that we mentioned, traded in an exchange can be further divided into three categories: 1) Payment token that is intended to be used in lieu of legal tender, e.g., Bitcoin, USDT, 2) Initial Coin Offerings or security tokens that are used for raising money for a company, e.g., Antshares, Telegram ICO, 3) Utility tokens that give users future access to companies product or services, e.g., Basic Attention Token (“BAT”), Ethereum ERC-20, Sirin Labs Token (“SRN”).

But questions about what treatment should be given to these crypto-assets - whether it should be treated as a commodity or if it should be treated as a security, has always been an issue of debate. The truth is that the question

⁶² European Central Bank, *Virtual Currency Schemes (October 2012)* (Jun. 18, 2018), <http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf>.

as to what treatment should be given to crypto [as such] to invoke insider trading laws, does not matter in the Indian context. This is because India's insider trading law until 2015 covered only securities and it was only after the 2015 SEBI Guidelines,⁶³ that it started covering commodity derivatives. Moreover, an overall reading of the Insider Trading Regulations suggests that they deal only with the prohibition of insider trading in corporate securities since that was the intention of the lawmakers until 2015. Nevertheless, a classification of crypto into both securities and commodities becomes relevant because one of the grand failings of the former works of literature on this subject was that they tend to classify crypto wholly as either a commodity or as a security.⁶⁴ And such classification becomes impractical because all cryptos are not the same.⁶⁵

A. Currency

Crypto assets, mainly payment tokens, are used as a form of payment in many parts of the world. For example, many electrical companies allow users to pay their consumer bills using Bitcoin. In the United States, many brands like Microsoft, Subway, and Overstock have started allowing users to use Bitcoin as a form of payment.⁶⁶ The Internal Revenue Service of the

⁶³ SEBI (International Financial Services Centres) Guidelines, 2015, PART III SEC. (IV), THE GAZETTE OF INDIA, https://www.sebi.gov.in/legal/guidelines/mar-2015/sebi-international-financial-services-centres-guidelines-2015_29457.html.

⁶⁴ Philipp Et Al. *Regulating Blockchain: Techno-Social And Legal Challenges*, 209-350, (Oup Oxford, 2019); Also see C. D. Leonard, *The Future Of Crypto Currency*, 12-90 (2019); See Elena Perez, *How the US and Europe regulating crypto in 2020*, COINTELEGRAPH 15 February 2020), <https://cointelegraph.com/news/how-the-us-and-europe-are-regulating-crypto-in-2020>.

⁶⁵ Härdle, Wolfgang K. & Harvey, Campbell R. & Reule, Raphael C. G., *Understanding Cryptocurrencies* (March 26, 2019) SSRN: <https://ssrn.com/abstract=3360304>

⁶⁶ Kathleen Elkins, *Here's the one thing you need to buy a house with Bitcoin*, CNBC (January 3 2020) <https://www.cnbc.com/2018/01/03/heres-the-one-thing-you-need-to-buy-a-house-with-bitcoin.html>.

United States Department of the Treasury has recognised that a virtual currency can function in the same manner as a country's traditional currency.⁶⁷

In India the word “currency” is defined in Section 2(h) of the Foreign Exchange Management Act, 1999⁶⁸ (“FEMA”) that includes only currency notes, postal notes, postal orders, money orders, cheques, drafts, travelers' cheques, letters of credit, bills of exchange and promissory notes, credit cards and other instruments as was/may be notified by the Reserve Bank. FEMA also defines “Indian currency” under Section 2(q) to only mean currency that is expressed or drawn in Indian rupees and does not include special bank notes and special one-rupee notes issued under Section 28A of the RBI Act.⁶⁹

The argument that crypto-assets do not fall under the domain of a currency is not without merits. The main reason for the same is that crypto-assets, be it payment token, utility token or securities token, has yet to behave like a currency, as it lacks the relative stability of most fiat currency. For example, in 2019 alone, the price of Bitcoin had risen from about \$3000 to \$11000 and then slid down to \$7000.⁷⁰ Similarly, Wazir X, an Indian utility token's price surged more than 25 percent in an hour when the company announced its decision to move to Defi.⁷¹ The story of ICOs is also no better.

⁶⁷ IRS, *IRS reminds taxpayers to report virtual currency transactions*, IRS (March 23 2018), <https://www.irs.gov/newsroom/irs-reminds-taxpayers-to-report-virtual-currency-transactions>.

⁶⁸ Foreign Exchange Management Act, 1999. The Foreign Exchange Management Act, 1999, No. 42, Acts of Parliament, 1999, § 2 (h).

⁶⁹ § 28(A), Reserve Bank of India Act, 1934, <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/RBIA1934170510.PDF>.

⁷⁰ Yessi Bello Perez, *Bitcoin's price rose 87% in 2019 — here's what happened in Q4*, THE NEXT WEB (January 14 2020), <https://thenextweb.com/hardfork/2020/01/14/bitcoin-price-rose-84-2019-q4/>.

⁷¹ Mohammed Musharaff, *Indian Crypto Exchange WazirX to enter DeFi amid uncertain regulations*, COINTELEGRAPH (August 1 2020), <https://cointelegraph.com/news/indian-crypto->

\$NES when debuted was around \$0.30 in 2014 but its price as of 2019 was \$185. Another type of currency that falls within payment tokens but has relatively greater stability are Stable coins. These coins are usually backed by fiat (e.g., \$TUSD) or crypto (e.g., \$nUSD), and sometimes even controlled by algorithms (e.g., \$Basis). Though they have a greater potential to be defined as a currency, it is highly unlikely that the Indian government would actually announce its currency-acceptability because the government would not be the issuer.

B. Securities

Securities are generally financial instruments that are tradable or that can be bought and sold.⁷² They represent either ownership or a debt position or both, or it can also mean rights or entitlements. The key aspect is that it should be transferable.⁷³ In India, the word "securities" is defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 ("SCRA").⁷⁴ As per the section, securities include shares, scrips, stocks, bonds, debentures, debenture stock, or other *marketable securities of a like nature* in or of any incorporated company or other body corporate. Under the given definition, securities can belong to either capital market or money market, but the determining factor as to what constitutes a security is its marketability. Moreover, in the case of *Sahara v. SEBI*,⁷⁵ it was observed that entities that

exchange-wazirx-to-enter-defi-amid-uncertain-regulations.; See WRX/USDT, *TRADING VIEW*, (September 23 2020), <https://in.tradingview.com/chart/kQYmJocN/>.

⁷² *Securities*, COLLINS DICTIONARY, (August 8 2020), <https://www.collinsdictionary.com/dictionary/english/securities>

⁷³ *Bhagwati Developers (P) Ltd. v. Peerless General Finance Investment Co. Ltd.*, (2013) 5 SCC 455 (India).

⁷⁴ § 2 (h), Securities Contracts (Regulation) Act, 1956, PART III SEC. (IV), THE GAZETTE OF INDIA <https://www.sebi.gov.in/acts/contractact.pdf>.

⁷⁵ *Sahara India Real Estate Corpn. Ltd. v. SEBI*, (2012) 10 SCC 603 (India).

issue instruments which provide the holder with some right/entitlement, and if the issued instrument is marketable then it would become "a security" under SCRA even if the name of the kind of security is not mentioned under the securities definition. Further, it was held that entities issuing securities becomes person associated with the securities market and therefore, are amenable to SEBI jurisdiction.

Keeping this settled law in mind, we will move forward to determine if cryptocurrency can be defined as security. All the types of cryptocurrencies mentioned above are marketable, so no question arises on marketability. Therefore, our task herein is to ascertain whether it fulfils other requirements.

First, we will take the example of payment token-Bitcoins. This token, though it fulfils the condition of marketability, does not qualify as security because it does not have an identifiable issuer, unlike the items in the definition of security under Indian law. Moreover, it lacks an underlying asset and its value is determined solely based on supply and demand, which makes it ineligible to be defined as a security.

Secondly, let us take the example of other payment tokens like TUSD and nUSD that have both an underlying asset, and an identifiable issuer.⁷⁶ One might be tempted to say that since these coins have both an underlying asset and an identifiable issuer then they should be classified as securities. It is here that we would like to caution the readers. Securities indicate an interest based on investment in a common enterprise.⁷⁷ Any asset to be regarded as security

⁷⁶ *Trust Token*, (23/09/2020), <https://www.trusttoken.com/company/>; *The Neutral Project*, <https://neutralproject.com/>.

⁷⁷ Maura K. Monaghan, *An Uncommon State of Confusion: The Common Enterprise Element of Investment Contract Analysis*, 63 *FORDHAM LAW REV* 6 2135-2175 (1995).

should functionally fulfil the purpose that generally normal security fulfils—to secure something. The functionality of an asset has to be determined from both the intention of its issuer and the role it has in the normal affairs of the market. The TUSD and nUSD coins only mimic the value of fiat or whatever their underlying asset is. It does not have any functional role in regards to the affairs of its original issuer.

Utility tokens on the other hand act as an advance against future services. But to categorise them as a "security" we must first determine as stated above what their original function in the market is and what the intention of the issuer was. For example, the Wrx tokens. This utility token is issued by the cryptocurrency exchange Wazir X. Its holder is entitled to advance against future services. And its issuer is also a known person—Wazir X exchange. So, can a Wrx token be regulated as security? Though the intention of its issuer was to use it as a utility token, in the normal market operations, Wrx tokens function has become deeply embedded with the state of affairs of its parent company. For example, in 2019 when Wazir X was acquired by Binance, its price nearly doubled,⁷⁸ and they were introduced as an IEO on the Binance platform in February 2020.⁷⁹ Also, Wazir X exchange represents a common enterprise and its token an interest based on it. This means that utility tokens, as long as they do not show the behaviour of regular securities, should not be treated as such. But when they do, as seen in the case of Wrx tokens where it gave both the right of service and fulfils the requirement of marketability, they can be treated as a security.

⁷⁸ WRX/USDT *supra* note 60.

⁷⁹ Vireshwar Tomar, *India's First IEO Gives Local Community a Much-Needed Breath of Fresh Air*, COINTELEGRAPH (February 7 2020), <https://cointelegraph.com/news/indias-first-ieo-gives-local-community-a-much-needed-breath-of-fresh-air>.

Security tokens fulfil all the criteria of marketability, interest in the form of right or entitlement, common enterprise requirement as well as the functionality rule as newly laid down in the previous Wrx example. Moreover, Sections 23 and 24 of the Companies Act provide that if more than 200 people subscribe to a token sale, it may be deemed a public issue that would be regulated by SEBI.⁸⁰ This means all the initial coin offerings (“ICOs”) or the security tokens traded in a cryptocurrency exchange at the outset falls within the ambit of the Companies Act 2013 and the SCRA if they are issued from an Indian entity and meet the above jurisprudence.

C. Commodity

Commodities are defined as goods sold in the market with a quality and value uniform throughout the world.⁸¹ Although a definition as to what forms a commodity is not found in any Indian legislation, the above definition gives an idea of what a commodity actually means. It would be ideal for regulators to treat all the classes of cryptocurrencies that do not fall within the meaning of securities nor currencies in the above discussion as a commodity because it realistically reflects the economic behaviour of the users and squares with traditional economic conceptions of exchange. Like money-commodity – cryptocurrencies are easily divisible, easy to transport, and are valued by a community around the world. Instead of acting as a claim on any monetary commodity, it acts as the money commodity itself. The pricing of these commodities varies depending on their supply and demand. And similar to commodities, cryptocurrencies are not available in an unlimited supply

⁸⁰ The Companies Act, 2013, No. 18, Acts of Parliament, 2013, §§23-24.

⁸¹ Nikolei M. Kaplanov, *Comment, Nerdy Money: Bitcoin, the Private Digital Currency, and the Case Against Its Regulation* 25 LOY. CONSUMER L. REV. 147 (2012).

because the algorithm that controls the number of Bitcoins released into the market through mining is designed to taper the supply of Bitcoins until no more are created.

The major argument against the classification of crypto assets as a commodity is that it lacks any value as a separate entity, unlike regular commodities such as gold and silver. However, it is often overlooked that the inherent value of these cryptocurrencies lies in their technology itself. Before the advent of cryptocurrencies, every transaction online involved an intermediary that acted as a middleman, like a bank or services like PayPal. These intermediaries charged a certain amount as fees for their services. With the advent of cryptocurrencies like Bitcoin, these intermediaries are no longer required for online transactions. Thus, the transactional fees that are now no longer required can also be considered as their inherent value. In the United States, Bitcoins and other cryptocurrencies have been determined to be commodities under the Commodity Exchange Act (“CEA”).⁸² The Commodity Futures Trading Commission’s (“CFTC”), jurisdiction is implicated when a virtual currency is used in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce. Its jurisdiction comes from the definition of a “commodity” under the CEA.

⁸² CFTC, *Federal Court Finds that Virtual Currencies Are Commodities* (October 32018), <https://www.cftc.gov/PressRoom/PressReleases/7820-18>.

In India, according to the Securities and Exchange Board of India Circular⁸³ read with a central government notification⁸⁴ under the SCRA, the central government has notified certain goods for the purpose of the term commodity derivative and it does not include any virtual currency. While this notification is only applicable to commodity derivatives and not ready delivery contracts, it provides the closest guidance on the point of what may be considered a commodity exchange at the moment. But it should be noted that the central government may at any time choose to notify virtual currencies in general, or any class of them as commodities under the above notification. This would bring derivatives contracts in virtual currencies within the SCRA and hence, SEBI will have jurisdiction over it.

VI. THE WAY FORWARD

Regulation is the solution for market failures and adverse outcomes.⁸⁵ The failure of crypto exchanges to privately regulate insider trading has led to adverse outcomes for non-insider investors and, market as a whole.⁸⁶ This part of the article will suggest two possible solutions to dealing with the insider trading problem.

⁸³SEBI/HO/CDMRD/DMP/CIR/P/2016/105, List of Commodities Notified under SCRA, SEBI, https://www.sebi.gov.in/sebi_data/attachdocs/1475059402243.pdf.

⁸⁴ S.O. 3068(E), PART III SEC. 3(II), THE GAZETTE OF INDIA, MINISTRY OF FINANCE, DEPARTMENT OF ECONOMIC AFFAIRS, <http://egazette.nic.in/WriteReadData/2016/171934.pdf>.

⁸⁵ THOMAS A. LAMBERT, HOW TO REGULATE: A GUIDE FOR POLICYMAKERS 14-15 (2017).

⁸⁶ Simon Chandler, *Crypto Insider traders runs free, Hurting unregulated market*, CRYPTONEWS (July 19 2020), <https://cryptonews.com/exclusives/crypto-insider-traders-run-free-hurting-unregulated-market-7159.html>; See Timothy G. Massad, *Its Time To Strengthen The Regulation Of Crypto Assets*, 19 BROOKINGS ECONOMIC STUDIES (2019), <https://www.brookings.edu/research/its-time-to-strengthen-the-regulation-of-crypto-assets/#:~:text=Massad%20discusses%20how%20better%20regulation,elsewhere%20in%20our%20financial%20system..>

A. Creation of New Regulatory body

The biggest and the most effective scheme for curbing insider trading in crypto exchanges would be the making of a new regulatory body-centered specifically on crypto exchanges. This becomes all the more essential especially in light of the conflicting opinions of various government institutions. The RBI, for example, has always pushed for the banning of crypto.⁸⁷ While SEBI was of the opinion that it does not have the power to regulate all ICOs.⁸⁸ Similar claims were also made by DEA, DoR, DoLA, Consumer Affairs, and MeitY as to their powers to regulate crypto.⁸⁹ But the naked reality is that cryptocurrency and crypto exchanges essentially fall into the grey areas between existing institutions and legal definitions. Therefore, it is highly tenacious to put it under one head.

Nevertheless, the problem with creating a new regulatory body is that it would be extremely expensive. Moreover, requiring crypto exchanges to comply with Indian regulations will increase current transaction costs and decrease efficiency, thereby making them behave similarly to existing traditional exchanges that the crypto community dislikes. Furthermore, it is no

⁸⁷ RBI Press Release: 2013-2014/1261, <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/IEPR1261VC1213.pdf>; RBI Press Release: 2017-2018/2642, <https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR264270719E5CB28249D7BCE07C5B3196C904.PD>.

⁸⁸ See *Internet and Mobile Association of India v/s Reserve Bank of India*, ¶2.30; See *Express Computer, Now to regulate cryptocurrencies in India*, (April 14, 2020), <https://www.expresscomputer.in/news/now-to-regulate-cryptocurrencies-in-india/53021/>.

⁸⁹ *Report of the Committee to propose specific actions to be taken in relation to Virtual Currencies*, DEA, MINISTRY OF FINANCE (Feb. 28, 2020), <https://dea.gov.in/sites/default/files/Approved%20and%20Signed%20Report%20and%20Bill%20of%20IMC%20on%20VCs%2028%20Feb%202019.pdf>; See, *Internet and Mobile Association of India v. Reserve Bank of India*, ¶ 2.14 Writ Petition (Civil) No.528 of 2018 (India).

secret that drafting, proposing, and implementing a scheme for a regulatory body is both challenging and time-consuming.

The one-stop answer to solve this dilemma to a certain extent would be the creation of a Self-Regulatory Organization (“SRO”). An SRO with certain statutory backing in the context of cryptocurrencies represents a social organisation that is empowered to oversee and create certain touchstones for the smooth functioning of digital assets under regulatory oversight. A similar plan to lay down regulations in the domain of the virtual currency market was hatched by a few Bitcoin start-ups like Zebpay, Unocoin, Coinsecure and Searchtrade, when they came together to set up the Digital Asset and Blockchain Foundation of India (“DABFI”) to lay down self-regulatory regimes for the trading of Bitcoins and other blockchain-based digital assets.⁹⁰ The foundation is mandated to standardise KYC (Know Your Customer), AML (Anti-Money Laundering), and STR (Suspicious Transaction Report) norms for the member companies and create awareness about the benefits and risks of cryptocurrency.

While the promoters of the idea of self-regulation consider the formation of an SRO to have a significant advantage over the direct government regulations the reality is often bleaker than what it seems.⁹¹ There are numerous questions that threaten the working of an SRO such as whether it would truly be independent under its parent organisation? Whether there will

⁹⁰ Ashish Rukhaiyar, *Crypto currencies, ICOs under SEBI lens*, THE HINDU, (November 1 2017), <https://www.thehindu.com/business/crypto-currencies-icos-under-sebi-lens/article19956679.ece>.

⁹¹ *A Self-Regulatory dharmasankat: An Outlook on The Future of Fintech Through RBI's SRO Policy*, THE CBCL BLOG (December 8 2020), <https://cbcl.nliu.ac.in/contemporary-issues/a-self-regulatory-dharmasankat-an-outlook-on-the-future-of-fintech-through-rbis-sro-policy/>.

be a sufficient balance of power in the SRO among the independent directors and private stakeholders? And to what extent can the SRO enforce its decision? The RBI has recently created a framework for the recognition of SROs for payment system operators and the disparity of power and the optimum oversight that RBI has over these SROs are glaringly visible in the structure proposed.⁹² That being the case, what is the most efficient way to regulate insider trading in cryptocurrency?

B. Expanding interpretation of existing Securities and commodities regulation

Although multiple government bodies have asserted a claim on their power to regulate crypto, the discussion that has taken place in part V suggests that ultimately the power to regulate crypto will fall into the hands of SEBI even if it is regulated as securities or commodities. SEBI is the regulatory authority set up by the government of India to regulate the securities market. Coming into existence in 1988 and given the statutory status in 1992 it acts as a "watchdog"⁹³ by keeping a check on various manipulative activities and thereby keeping the market safe from manipulators and fraudsters.⁹⁴ It is because of this power that it has historically made it the best existing contender to take authority over cryptocurrency and insider trading as well.

⁹² *Id.*

⁹³ Kaushik Dhar, *Securities Exchange Board of India (SEBI) Act, 1992: A Summary*, (March 1 2012), <https://ssrn.com/abstract=2014351>.

⁹⁴ Shantanu Mishra, *Securities Fraud In India: SEBI As An Investigator And Enforcer*, LEGAL ERA (Jan. 13, 2013), <http://www.legaleraonline.com/articles/securities-fraud-in-indiasebi-as-an-investigator-and-enforcer>.

Under the current legal framework, there are two methods to bring cryptocurrencies under the ambit of SEBI.

1. Expanding the meaning of securities and commodities to include cryptocurrencies

In order for SEBI to take control of unregulated crypto exchanges the first step would be expanding the meaning of securities to include cryptocurrencies of the nature of securities and under commodities to include cryptocurrencies having the nature of commodities. But the problem with such a classification is that in a crypto exchange, cryptocurrencies of both natures are traded hand to hand. And any regulation, delineating the expansion of the meaning of word securities will have serious implications in its functioning.

For example, when a class of cryptocurrencies is recognised as securities, the crypto exchange trading in them will have to apply to the central government for recognition under Section 3 of SCRA,⁹⁵ in order to safeguard the interest of the general public, and further make rules and bye-laws to regulate and control its contracts. And if virtual currencies are classified as commodities, the activity of operating an exchange for trading cryptocurrency can be regulated as a commodities exchange, having implications under India's regulation on inward foreign direct investment ("FDI"), that is, the Consolidated FDI Policy Circular of 2017 (FDI Policy)⁹⁶ and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 ("TISPRO").⁹⁷ These regulations restrict the

⁹⁵ § 3, Securities Contracts (Regulation) Act, 1956, PART III SEC. (IV), THE GAZETTE OF INDIA <https://www.sebi.gov.in/acts/contractact.pdf>.

⁹⁶ Consolidated FDI Policy Circular of 2017.

⁹⁷ Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017.

number of foreign investments in commodity spot exchanges up to 49 percent of the share capital.⁹⁸ The virtual currencies being a trans-boundary digital instrument in any scenario could have more than 49 percent stake by foreign entities, thus creating further hodgepodge in its prospective regulation. In this light, legislating entities before expanding the current meaning of securities and commodities will have to provide certain leeway for crypto-based instruments to make sure that any legal framework that they create does not impair the fundamental nature of cryptocurrencies and their purpose.

2. Bringing crypto under ‘collective investment schemes’

Under Section 11(c) of the SEBI Act, 1992, SEBI has jurisdiction over the registration and regulation of ‘collective investment schemes.’ It refers to any scheme or arrangement made or offered by any company under which the contributions, or payments made by the investors, are pooled and utilised with a view of receiving profits, income, produce or property, and is managed on behalf of the investors. In the case of *Paramount Bio-Tech Industries v. Union of India*,⁹⁹ the Allahabad High Court had ruled that the Howey Test can be used to articulate what constitutes a ‘collective investment scheme’. The test was developed in the *SEC v. W.J. Howey Co.*,¹⁰⁰ where the US Supreme Court used it to determine whether an asset can fall under the domain of an ‘investment contract’ under the US Securities Act of 1933.

⁹⁸ Akhoury Winnie Shekhar, Rahul Tiwari & Jaidrath Zaveri, *FDI Policy, 2020: Does It Really Consolidate The Extant FDI Regime?*, MONDAQ, (Nov. 6 2020), <https://www.mondaq.com/india/inward-foreign-investment/1002434/fdi-policy-2020-does-it-really-consolidate-the-extant-fdi-regime>.

⁹⁹ *Paramount Bio-Tech Industries v. Union of India*, 2004 49 SCL 77 All (India).

¹⁰⁰ *SEC v. W.J. Howey Co.*, 328 U.S. 293, 294 (1946) (US).

The three prongs of the Howey test are - there is an investment of money; the investment of money is in a common enterprise, and there is an expectation of profits from the investment and this profit comes from the efforts of a promoter or third party. All the three kinds of bi-directional cryptocurrencies – payment, security, and utility tokens, satisfy the first prong of the Howey Test – there must be an investment of money. However, they fail the second prong of the test - the existence of a common enterprise. The commonality is mostly analysed under the standards of horizontal commonality and vertical commonality. The former refers to a type of commonality that involves the pooling of assets from multiple investors so that all share in the profits and risks of the enterprise. On the other hand, vertical commonality examines the relationship between investors and the promoter, and how closely the investors' profits are tied to the promoter's efforts.¹⁰¹

The essential requirement for horizontal commonality is that the investors are exposed to the same risks. However, this is not always the case in cryptocurrencies. People buy them for various reasons, and thus the risks associated with each of them are not identical. Investors might be concerned about the overall growth of the price in case of security tokens, while those who use them as a utility token to purchase goods or services might be more concerned about the short-term rise/fall of the price of the cryptocurrency.

In the case of vertical commonality, the main requirement is that the efforts of the promoters are tied to the investor's profits. In the case of cryptocurrency, developers and computer programmers can be said to

¹⁰¹ SEC. & Exch. Comm'n v. SG Ltd., 265 F.3d 42 (1st Cir., 2001).

constitute promoters. However, even though the promoters work to create new applications to aid in the use of these tokens, which would likely increase the worth of crypto assets, it should be kept in mind that they work for making a profit for themselves. Some of them might even be competing against each other, so the assumption that they are working towards a common goal does not stand.

Whether crypto assets meet the third prong of the Howey's Test is hard to determine. This factor involves two parts - the expectation of a profit, and the efforts of a third party. The first part is met in cases of security tokens where most people hold on to them in the hopes that their value will rise and that they will be able to exchange it for more value. But there are exceptions like in the cases of those who use them for business transactions, i.e., payment tokens. Coming to the next part, it is often hard to determine who constitutes a third party. The value of cryptocurrency mainly depends on government regulations, political and economic upheaval, and media and trader enthusiasm. Thus, the question of whether crypto assets satisfy the third prong of the Howey test would depend on whether these factors can be considered as a third-party.

The two methods mentioned above represent the two most practical ways of regulating cryptocurrencies. The first one pre-empts the need for creating a new regulatory body and all the supererogatory expenses it ensues. The second solution suggests bestowing the power to regulate cryptocurrencies with the SEBI which is already the market watchdog and regulates various investment schemes and protects the interests of the investors. Even if a token does not fall within the definition of a collective investment scheme it could still be regulated under the expanded meaning of

securities or under the commodities and thus maximum protection can be ensured.

However, the regulators will have to be very prudent in expanding their functions over cryptocurrencies. As mentioned in part I, cryptocurrencies are a product of incredulity that the investors have developed over traditional government-controlled finance, and the only way they can remain within the turf of legality and still continue their fundamental nature is if they are allowed to continue with minimum government intervention. While prohibition on insider trading in crypto will ensure the investor faith in regulatory bodies, any transgression beyond what is required will create a ripple effect in the current equilibrium functioning of cryptocurrencies that would only result in investor losses and a mass exodus of these tokens back to the subterranean from where it started.

VII. CONCLUSION

Law is a product of social relations and a longstanding mediator of disputes, transactions, and agreements.¹⁰² Legal recognition is a philosophical ideal highly necessary for maintaining justice between the parties.¹⁰³ It is indisputable that cryptocurrencies have taken the attention of mainstream investors and it is going to stay for a very long time. The unparalleled efficiency, accessibility and decentralization of cryptocurrency has given rise to numerous unregulated exchanges that permit insider trading and thereby allowing market manipulators to defraud investors. Although India's distrust

¹⁰² Adarsh Vijayakumaran, *Legally Blocked: Evolution and legality of smart contracts*. S. RAIZADA ET. AL., *ADVANCEMENT IN LEGAL RESEARCH: TRANSDISCIPLINARY AND INNOVATIVE DIMENSION*, 231 (2019).

¹⁰³ *Id.*

towards cryptocurrencies may be justified, this ought not to prevent the state from framing legislations to regulating their use in the country.

The regulation of crypto exchanges with regard to insider trading will help to bring the transactions occurring under those Exchanges under a cognizable legal framework. It will ensure that these transactions are discernible by the Indian regulatory bodies providing consumers with a form of recourse for harm caused by insider trading. Regulations will further foster the development of novel economic opportunities that cryptocurrency provides. Furthermore, people who are not interested in regulation are always free to buy and sell cryptocurrency as it was originally designed to be traded-directly peer-to-peer.

On the other hand, regulation of crypto exchange will give rise to some major concerns. Among them, few are a mass exodus of people leaving the crypto exchange. Cryptocurrencies were made to avoid the regulatory red taping created by financial institutions and government authorities. Regulations of any nature that will bring the cryptocurrencies under government purview will make investors refrain from investing in these technological innovations. Moreover, the fear always will exist that such regulation will make the market inefficient and full of hassles, similar to the traditional financial instruments.

So, the real requirement is a regulation that will actualise the real need of investors, that is, removal of the plague that insider trading is, but also at the same time not make the platform similar to the regular financial instrument.