KJMR 2 (1)

Cryptocurrency: Concept, Global Scenario and Nepal – A Short Essay

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Article History: Received June 5, 2024; Reviewed July 6, 2024; Revised September 16, 2024; Accepted October 5, 2024

Abstract

In a world, witnessing an explosion of financial technology (fintech) innovations competing with traditional financial methods, cryptocurrencies and the blockchain technology underpinning them have made it difficult for the relevant socio-economic and legal modifications to keep pace with the needs of time. The legal rules that apply to cryptocurrency remain unclear and unsettled even after fifteen years of its emergence. Due to the fear that cryptocurrencies would hamper the traditional market infrastructures and break off the control of the government over the monetary system, countries like Nepal have out rightly banned them without any proper research. However, their adoption seems to be accelerating in the global economies to harness the potentialities of this baffling technology. This research employs qualitative research techniques to examine the regulatory frameworks adopted worldwide to address the concerns so that strategies may be designed that will improve the management of these financial innovations and establish a more secure environment in which it can persist because, in the end, the global economy is going to be digital.

Keywords: Cryptocurrency, regulation. FinTech, policy analysis, Nepal

Introduction

Cryptocurrencies, since their inception with the Satoshi Nakamoto's whitepaper for Bitcoin, have been gaining enormous popularity and concerns due to the use of baffling technology – blockchain. A lack of centralized control has often been touted as the reason why blockchain and cryptocurrency are so popular. This decentralized nature makes it unique but very challenging for lawmakers and regulators. Blockchain empowers cryptocurrencies to have multidimensional uses, giving rise to several characteristics they possess, including those of currencies, commodities, and payment systems.

Cryptocurrency is fully digital money which is decentralized and stored in the distributed public ledger called "blockchain" (Nakamoto & Bitcoin, 2008). The rise of cryptocurrencies shows that blockchains enable the safe, trustworthy, and verifiable conduct of financial transactions. To enable peer-to-peer transactions without the use of intermediaries in the financial sector, cryptocurrencies use cryptography to validate the transmission of transactions in a blockchain. The emergence of cryptocurrencies sparked the development of a fundamentally different system of economic relations, where the exchange of assets occurs without the use of centralized financial institutions (in particular, banks) or other middlemen, and the security and reliability of transactions between counterparties are provided by a distributed ledger system, which is a network of autonomous computers that reliably controls and records committed transactions with the help of the blockchain technology (Javaid et al., 2022 and Tapscott & Tapscott, 2017).

The exponential growth of technologies like blockchain within a relatively short period has made it difficult for the relevant socio-economic and legal modifications and make the regulations as per the need of time. There is always a challenge for the regulators. If they over-regulate, it may cripple the start-ups, constrain innovation and finally hinder the economic development. Under-regulating, on the other hand, is also bad for the economy exposing it to a higher risk of being used as a vehicle for felonies and tax evasion. Regulation must therefore be optimal but with the challenges posed by blockchain technology coupled with the vast potential of the internet in which it thrives, the conventional method of enacting laws and ensuring compliance may just be akin to chasing the wind (Antonopoulos, 2014).

Due to its complexity, cryptocurrency raises several legal and regulatory questions. Because cryptocurrencies are decentralized, it is challenging to control them. Every transaction occurs within a computer network, and tracking them individually is nearly impossible. The regulation of cryptocurrencies is further complicated by their pseudonymous nature, particularly when it comes to thwarting fraudulent operations. Transactions are not associated with individual identities, but rather with cryptographic addresses and are entered into a public ledger. This degree of anonymity makes it more difficult for regulators to stop money laundering, fraud, and other illegal activity because it can be very challenging to identify the people behind transactions without violating their right to privacy. Another difficulty is that it is cross-border, making regulation difficult without global harmonization and international cooperation (Xiong & Luo, 2024). Many people still find it difficult to fully understand the underlying principles of the technology and its consequences for shaping public policy, despite its widespread use, very broad applications, and media attention. This presents a challenge for characterizing cryptocurrency legally prior to regulating it because some nations see it as money while others see it as an asset, commodity or security. Blockchain empowers cryptocurrencies to have multidimensional uses, giving rise to several characteristics they possess, including those of currencies, commodities, and payment systems.

The blockchain technology that underpins cryptocurrencies makes it difficult for legislators to define and regulate them. Cryptocurrencies have a variety of qualities, including those of currencies, commodities, and payment systems, which are all made possible by the blockchain, which also allows them to have numerous purposes (He et al., 2016). This presents a dilemma to legislators and regulators when defining cryptocurrencies prior to regulating it: some nations regard it as a currency, while others see it as an asset, commodity, or security. Till date, only a few nations have accepted cryptocurrency as legal tender.

As of today, the Nepalese Parliament has not put any effort in making any bill to regulate cryptocurrency rather the Central Bank of Nepal has issued circular to ban them. As many countries have either started creating their own cryptocurrencies or connecting their economies with this baffling technology through multiple arrangements, there are certainly better prospects of Cryptocurrency if regulated properly. So, it is necessary to analyze the changing societal and economic landscapes surrounding cryptocurrencies and explore the implications for state governance, law, and politics in adapting to these emerging phenomena to increase the country’s competitiveness, and quality of life of citizens and compete with the world economy. So, the need for this research has been realized.

This research tries to explore the works done for cryptocurrency regulation in all the major economies of the world that are actively working on the adoption or regulation of Cryptocurrency as this study necessitates extensive citation of both current and prospective laws as well as the comments of several international, supranational, and national regulatory authorities. The data from multiple years starting from 2008 is included which is supported by the fact that the exact point in time has less significance in cross-section data (Global Legal Research Center, 2018). Descriptive research dominates this study, which employs qualitative research techniques. The core of this paper is also rooted in doctrinal and comparative legal study since it allows for the identification, evaluation, and synthesis of several foreign laws (Tsindeliani & Egorova, 2020).

The research relates to the economic and legal context of cryptocurrencies and blockchain. The technical aspects will not be elaborated, except for those necessary to understand the legal context. The objectives of this research can be summarized as:

- To explore the concept of Cryptocurrency and its functioning in systematic transaction.
- To investigate the strategies taken by various economies for cryptocurrency regulation
- To make appropriate suggestions for different branches of the government in policy-making for harnessing the benefits of the progressive innovations

Literature Review

Several cryptocurrencies are gradually being accepted as virtual legal tender for products and services. Most of them are decentralized, open source and offer secure access that is difficult to compromise (Girasa, 2018). If we go back to the advent of current national currencies, we get to know that private currencies remained in use into the nineteenth century despite the fact that the first central banks were founded in the seventeenth century. States started outlawing private currencies and replacing them with national currencies as central banks started losing their independence from governments (Helleiner, 2019). As a result, the first law against them prohibited non-state-issued money. Today, several nations have explicit or implied bans on cryptocurrency. Comparing private currencies of the nineteenth century to Bitcoin and its contemporaries, it is the technical underpinning that makes them more likely to survive. Despite the apparent restriction, China and other nations have seen large levels of cryptocurrency exchange trade.

There is currently no universal strategy to cryptocurrency regulation; some nations have out rightly ban them, some recognize them legally and offer user protection, and yet others have taken no action. Many nations have banned cryptocurrencies because they are developing or have already implemented CBDCs and want to maintain control over the global economy by diverting public attention from global and decentralized cryptocurrencies (Horban, 2020). Many of the nations that permit the operation of cryptocurrency markets have passed laws imposing regulations on market participants intended to stop money laundering, terrorism financing, and organized crime.

There are countries like EI Salvador and The Central African Republic (CAR) where Bitcoin functions as a legal currency. We can't negate that cryptocurrencies whether in the form of stablecoins CBDC or tokenized coins might be extensively adopted as a form of payment by individuals and businesses, and by lowering the number of middlemen in a payment chain, it could also help to increase the effectiveness of cross-border payments. It has the potential to create a robust digital trade market where there is a free-flowing trading system without fees. Also, most importantly, the adoption of cryptocurrency is going to ease and boost tourism, investments and economic transactions.

Due to the fear that these solutions would hamper the existing requirements and safeguards that apply to traditional market infrastructures, traditional legislative requisites prevent operators of DLT market infrastructure from creating solutions for trading and settlement of transactions in digital assets. It waives certain of the restrictions imposed by current law on traditional market infrastructures for DLT market infrastructures that are only used for financial instruments issued, recorded, transferred, and stored using DLT ("DLT Financial Instruments").

The potential influence of cryptocurrencies, stablecoins, tokenized assets, and CBDCs on markets, countries, and the world economy is substantial. It is significant to note that global corporations are beginning to use this technology. This novel invention is not only a means of investment; rather, it has a variety of applications and will probably play a significant role in how businesses develop in the future. Several formerly regulated financial institutions now permit individuals and organizations to exchange cryptocurrencies across their networks. Some of the biggest companies in the industry have also looked at creating their own cryptocurrencies and stablecoins. The adoption of cryptocurrencies and stable coins seems to accelerate by a mix of products offered by cryptocurrency exchanges and conventional financial institutions, as well as possible adoption by a range of businesses.

When it comes to regulating cryptocurrency assets, the European Union (EU) has led the way globally. A standard legal framework for crypto assets, crypto asset issuers, and crypto asset service providers was established by the regulation on markets in crypto assets (MiCA) that was enacted by the Council of the European Union on May 16, 2023. This is the first complete set of regulations in the world about crypto assets, and it aims to safeguard investors, lessen illicit activity involving crypto assets, maintain financial stability, and foster technological innovation (EU Council, 16 May 2023). With the approval of MiCA, European firms can now begin preparing for a period after MiCA since they have a better knowledge of the rules that will apply to companies that provide services related to crypto assets in Europe. This will probably provide Europe a competitive edge when luring companies that deal in digital assets. European Union has also recently approved new anti-money laundering and counter-terrorist financing (AML/CTF) rules for digital assets. It imposes stringent guidelines on crypto asset service providers (CASPs) about how to recognize users of unhosted wallets.

The Payment Services Act in Singapore permits the use of cryptocurrencies in financial transactions within the city-state. The Financial Services and Markets (FSM) Bill, adopted in April 2022, includes regulates virtual asset service providers (VASPs). VASPs were founded in Singapore with the aim of achieving anti-money laundering and countering the financing of terrorism (AML/CFT) goals. The Monetary Authority of Singapore (MAS) published two consultation papers in October 2022 outlining proposed regulations to lessen the chance of consumer harm in cryptocurrency trading and to promote the development of stablecoins in Singapore's digital asset ecosystem ("Consultation Paper on Proposed Regulatory Measures for Digital Payment Token Services" and "Consultation Paper on Proposed Regulatory Approach for Stablecoin-Related Activities"). The MAS released its Consultation Paper on Proposed Amendments to Payment Services Regulations 2019 in May of 2023. The MAS issued new rules on July 3, 2023, requiring DPT services to place customer assets in a statutory trust by the end of the year. If a DPT becomes insolvent, this will lessen the chance that client assets would be lost or misused and make it easier for them to recover. After that, the Payment Services Regulations draft legislative modifications were the subject of a public consultation conducted by the MAS. The

MAS cryptocurrency guidelines and rules, which go into effect in phases starting in mid-2024, will be used to apply the regulatory measures on DPT services (Cropper-Mawer et al., 2023).

Additionally, the Payment Services Act (PSA) of Japan recognizes cryptocurrency as legitimate property. The Financial Services Agency (FSA) registration requirements and AML/CFT guidelines must be followed by the nation's cryptocurrency exchanges. Revenue from cryptocurrency trading is regarded as "miscellaneous income" in Japan, and it is taxed accordingly. It is necessary for business owners and intermediaries involved in the buying, selling, trading, or administration of cryptocurrency to register as a provider of cryptocurrency exchange services (CAESP). Validating the customer's identification, creating verification and transaction records, storing them securely for seven years, and reporting any questionable transactions to the relevant authorities are all required of CAESPs (Blockchain & Cryptocurrency Laws and Regulations | Japan | GLI, n.d.).

The Crypto Council for Innovation (CCI), which is a global alliance working to advance innovation and inclusive regulation, has also released a whitepaper with a framework to regulate Decentralised Finance (DeFi). It has proposed three policy recommendations to help policymakers which includes mandatory disclosures by app-operating businesses, the establishment of an Independent Certification Regime Organisation (ICRO) to certify DeFi protocols and regulatory safe harbor program. International Organization of Securities Commissions (IOSCO) has also introduced nine policy recommendations for Defi which focus on the identification and disclosure of persons involved in DeFi projects (Key Elements of an Effective DeFi Framework, 2023).

Classification, which is the basic challenge of cryptocurrency regulation, is also in the verge of settlement. Many nations have started classifying it as property, say, Hong Kong court has acknowledged cryptocurrency as a form of property. The Hong Kong Court gave careful consideration to decisions made in a number of common law countries, including the UK, Singapore, the US, Canada, the British Virgin Islands, Australia, and New Zealand while classifying it as an asset. A crypto asset is not thought of as a kind of crowdfunding; rather, if it meets the criteria to be considered a security, it would be subject to the regular regulations governing securities offerings to the public in South Korea. But, there is no legislation devoted specifically to cryptocurrencies. Many countries are working to make provisions to regulate business operators and intermediaries to mitigate the risks associated with Cryptocurrencies.

However, no legislation governs or regulates the dealing in cryptocurrencies in Nepal. In this regard, the first press release of Nepal Rastra Bank formally branded Bitcoin as an illicit financial instrument in Nepal and vowed to take tough action, including the detention of Bitcoin exchange operators. In August 2022, NRB released a concept report entitled “Central Bank Digital Currency (CBDC): Identifying Appropriate Policy Goals and design for Nepal” for public consultation. And in another circular, NRB unveiled the Cryptocurrency Risk Assessment Report. In the Report, the NRB concluded that cryptocurrency cannot be brought into use as transactions in it would be financially risky. It states that prohibition on cryptocurrency is necessary as it has risks including destabilizing the overall economic balance, risk on financial stability, risk in terms of implementing the monetary policy and risks of fraud and tax evasion, among others (NRB Circular, April 2023).

Challenges and Way Forward

Anything with significant advantages has drawbacks as well. Because cryptocurrencies are growing at a lightning rate, managing them while there is no regulatory authority is the largest challenge. Tracing the transactions needs a serious effort to be decentralized. The irreversible nature of currency transactions also makes security an issue as well. Once the money is gone, it's gone. Another challenge is its utilization for illegal operations like financial terrorism because there is no proper method to oversight the exchanges and no format for auditing the transaction trail. Additionally, it takes specialized understanding to deal with cryptocurrencies, so everyone can't just jump in this right away.

If we negate the potentialities over the risks, banning is far more easy than regulating. But, if we concentrate in regulating this baffling technology, it could help this small economy in several ways right from attracting investments to using the country’s largest resource i.e. hydropower in mining. Government can legalize it so that investors have more freedom and security, impose taxes, and generate an attractive source of income. By establishing a regulatory body, the government can enforce the tax. Additionally, since automation and virtual worlds are on the rise, this might be a boon for the related startups and industries. Also, this can increase the flow of cash through legitimate channels. Therefore, the question at hand is not if NRB will issue CBDC or adopt cryptocurrency, but rather when the regulator will make the bold move. It's crucial to know the answer since it will have a significant impact on the nation's banking sector and financial system. The regulation of Cryptocurrencies is highly topical not just because of its popularity, but also for the massive potential of crypto-assets, as further anticipated financial growth and adoption looms on the horizon.

Conclusion and Recommendations

Nepal has envisioned a future of digital governance through its Digital Nepal strategy, which consists of three national goals—accessible contemporary infrastructure and extensive connection, quantifiable sustainable output and productivity, and excellent governance. Securing a multidimensional change in the economy is the primary goal of Digital Nepal. The famous adage "Early bird catches the worm" seems relevant to the scenario where there is a dire need for the development and/or adoption of digital money to increase the country's competitiveness, and quality of life of citizens and compete with the world economy. Thus, the adoption of cryptocurrency can be a step towards use of digital currency. Blockchain technology is the new revolution in banking and finance and is being adopted gradually. It can facilitate bankless transactions for millions of people with minimal charges without the involvement of middle agencies just with the help of smartphones. This currency can be a better means for cross-border payments and can help to flourish trade, and tourism and attract a lot of business and investments in the country.

In Nepal, certain existing regulatory regimes needs to be updated addressing the regulation of cryptocurrencies, CBDCs, Tockenized coins and stablecoins, including the Electronic Transaction Act (ETA), Asset (Money) Laundering Prevention Act, Nepal Rastra Bank (NRB) Act, the Securities Act and the Commodities Act.

Being a peer-to-peer system, cryptocurrency fills the gap in the present financial system and resolves issues with traditional banking. It enables online transactions for unbanked users without the need for a third party. Without unforeseen intermediate expenses, the transactions might be completed throughout the world.

The regulation depends on whether the cryptocurrency falls within the jurisdiction of a particular existing regulation. For that, the government needs to classify or categorize the Cryptocurrency first. For example, if cryptocurrency is categorized under security, then it may be regulated by the amendment in the Securities Act, of 2063. If cryptocurrency is considered a payment instrument, then it may be regulated by the amendment in the current Negotiable Instrument Act. The Foreign Exchange Regulation Act, 2019 may regulate crypto assets that are considered securities or payment instruments once they are transmitted overseas. Crypto assets that are considered goods may be regulated by the Value-Added Tax Act, and income earned by individuals by transferring or lending crypto assets can be considered ’other income’ under the law and, thus, can be subjected to income tax. Further, cryptoassets considered criminal proceeds, which are confiscated, may be regulated by the Criminal Procedure Code.

To prevent money laundering activities, regulated entities (eg, banks, stock exchanges, financial institutions or parties carrying out designated business) should be mandated to comply with the requisite AML or KYC requirements under Nepalese laws (including conducting KYC checks on customers). If the government only permits cryptocurrencies that are backed by a basket of assets from which they can derive their value, as opposed to the current system where the value of the cryptocurrency is derived based on demand, which is the primary cause of unexplained volatility, then investors will be able to take calculated risk and it may attract more investment.

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