

BACKGROUND GUIDE

ECONOMIC AND SOCIAL COUNCIL

## *Financial implications and regulations on crypto-currencies with special emphasis on Litecoin*

Letter from the Executive Board

Respected Delegates,

We welcome you to the **Economic and Social Council** at Utopia MUN 2017. We would like to tell you that this committee will be challenging in term of its economic approach to the issue at hand and we hope that at the end of this conference you will be able to understand the issue much better than you were previously able to.

Since you will be representing a nation you need to research on its policies and stances on certain issues apart from cryptocurrencies but closely related to it such as but not limited to taxation laws etc. A complete and thorough understanding of the policy is absolutely necessary for critical functioning. We would recommend you to watch interviews and use other forms of multimedia to get to know the various dimensions of cryptocurrencies.

Lastly, let this be a learning experience by which you shall be able to act, think and negotiate like diplomats working to solve problems that concern each and every one of us. Feel free to contact anyone of for any doubts, discrepancies or queries related to the agenda or research. We look forward to highly spirited debate in this committee.

Regards,

The Executive Board

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**CRYPTOCURRENCIES: INTERNATIONAL REGULATION AND UNIFORMIZATION OF PRACTICES**

**A HISTORY OF PRIVATE MONEY**

A private money is a widely accepted medium of exchange or payment issued by a non-governmental body in the absence of any legal privileges. Private monies do not have to be generally acceptable; they merely have to be widely accepted. Three examples of contemporary private monetary systems are the Liberty Dollar, e-gold and cryptocurrencies. The former two are based on precious metals and the best-known instance of the latter is Bitcoin.

There is a public demand for and interest in private currencies from various groups of people. Some wish to hold private currencies in the expectation that they will not diminish in purchasing power as state money has; some wish to conduct illegal activity; some wish to be part of a movement against increasing state control of economic and personal behaviour; and others just want better money.

The Liberty Dollar was based on a private mint that issued gold and silver coins; it also issued notes redeemable in precious metals. It was periodically revalued against the US dollar as the value of the latter fell over time against the precious metals. The Liberty Dollar was specifically designed to function in parallel with and in competition to the US dollar and never marketed or represented as official US currency.

The Liberty Dollar was highly successful and became the second most popular currency in the US. Though initially tolerated, the US government turned against the Liberty Dollar, declared its use a federal crime and eventually secured a conviction against its founder for counterfeiting, fraud and conspiracy against the United States. This was an extraordinary result given that the purpose of the founders of the Liberty Dollar was to produce a currency that was distinct from but superior to the greenback dollar, and there was never any attempt to pass off the former for the latter.

e-gold was a private digital gold currency, a digital payment system in which the unit of account is gold and in which user accounts are backed by gold reserves. It was an ‘offshore’ payment system rather than a money transmitter or bank as defined under then-existing regulations, not least because gold was not legally ‘money’. By 2005, e-gold had grown to be second only to PayPal in the online payments industry: it had 1.2 million accounts and transactions that year totalled $1.5 billion.

US law enforcement services also turned on e-gold and its principals were indicted in April 2007. The charges boiled down to e-gold being an unlicensed money-transmitting entity and a means of moving the proceeds of illegal activities with the principals’ tacit knowledge. These charges were never proven and even the judge in the e-gold case expressed major doubts about the government case.

Bitcoin is a totally decentralised monetary system that would be very difficult for the law enforcement agencies to shut down because it has no single ‘point of failure’. Bitcoin is produced by a ‘digital mining’ process that is intended to limit its supply in a way that is in some ways analogous to the supply process of gold under a gold standard. As with other cryptocurrencies, Bitcoin has the potential to restore financial privacy and create a peaceful crypto-anarchic social order that operates beyond government control.

The demand for Bitcoin has taken off since its launch in 2009 and it is increasingly used for both legal and illegal transactions, the latter thanks to its potential to achieve a very high degree of transactions anonymity. These illegal transactions include, most notoriously, its use to trade illegal drugs on the Silk Road dark web marketplace.

Though the supply of Bitcoin is limited, the demand is very variable; this variability has made its price very uncertain and created a bubble–bust cycle in the Bitcoin market. Perhaps the safest prediction is that Bitcoin will eventually be displaced by alternative cryptocurrencies with superior features.

The appropriate government response to private money is to allow competition on a level playing field between alternative forms of money. As with the provision of other goods and services, competition would best promote good money and drive out bad.

**CRYPTOCURRENCY TODAY**

The internet has changed society as we know it affecting both human relationships and commerce, giving rise to a number of technologies that altered how society works. Between these technologies, we can find the cryptocurrencies.

Cryptocurrencies, such as Bitcoin, Liteoin and various others rely on the work of the participants of a network and not in the work of companies. Since everyone has access to a log of all the transactions that took place in the system, the verification of payments is made by the participants of the network that are rewarded with cryptocurrencies.

Since this system does not take into account where its participants are, people became able to make payments all around the world rapidly and, excepting the internet and electricity, without any costs. But cryptocurrencies are subject to very specific economic phenomenon and makes it possible for people to dodge compliance regulations and makes it almost impossible to identify its users. With that in mind, this background guide aims to briefly present the regulations regarding cryptocurrencies put forth by some countries, discussing the main difficulties faced by the regulators when dealing with this disruptive technology and presenting the basis for international standardization of a set of guidelines for the regulation of the use of cryptocurrencies.

**LITECOIN**

Litecoin was released via an open-source client on GitHub on October 7, 2011 by Charlie Lee, a Google employee.  The Litecoin network went live on October 13, 2011. It was a fork of the Bitcoin Core client, differing primarily by having a decreased block generation time (2.5 minutes), increased maximum number of coins, different hashing algorithm (scrypt, instead of SHA-256), and a slightly modified GUI.

Litecoin is different in some ways from Bitcoin.

* The Litecoin Network aims to process a block every 2.5 minutes, rather than Bitcoin's 10 minutes. The developers claim that this allows Litecoin to have faster transaction confirmation.
* Litecoin uses [scrypt](https://en.wikipedia.org/wiki/Scrypt" \o "Scrypt) in its proof-of-work algorithm, a sequential memory-hard function requiring asymptotically more memory than an algorithm which is not memory-hard.

Due to Litecoin's use of the scrypt algorithm, FPGA and ASIC devices made for mining Litecoin are more complicated to create and more expensive to produce than they are for Bitcoin, which uses SHA-256.

**LITECOIN STATISTICS FOR 11 JUNE 2018**

**Litecoin price** for 11 June is **$105.2700**. It has a current circulating supply of 56.9 Million coins and a total volume exchanged of $337,233,927

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| --- | --- |
| **Litecoin Price** | $104.88 |
| **Market Cap** | $5,993,544,710 |
| **Trading Volume** | $337,233,927 |
| **24h Low / 24h High** | $102.95 / $112.04 |
| **All Time High** | $360.66 |
| **Since All Time High** | -71% |
| **All Time High Date** | 2017-12-18 (6 months) |
| **24 Hours** | -1.5% |
| **7 Days** | -15% |
| **14 Days** | -9.7% |
| **30 Days** | -23% |
| **60 Days** | -10% |
| **1 Year** | 220% |

**BITCOIN AS AN EXAMPLE**

Given the fact that the Bitcoin system is the most successful kind of cryptocurrency currently in use and has heavily influenced other cryptocurrencies, it shall be used a basis for this paper. The Bitcoin System was created by Satoshi Nakamoto and presented on the paper “Bitcoin: A Peer-to-Peer Electronic Cash System”, where the creator sated the purpose and functioning of this new technology

1. a public system of registration of transaction, called Blockchain, serving as an accounting book of its entries and exits;
2. an encryption algorithm called asymmetric encryption - associated with a proof-of-work - which is used to validate operations with the currency; And
3. a decentralized computer network, according to the design of the users, also called miners, which verify and validate transactions with the currency and update the public registry system - Blockchain. "

On the other hand, Bitcoin or the cryptocurrencies are a monetary unit constructed by a specific and unique numerical sequence used within the Bitcoin system, which is freely traded among users

The Bitcoin system, allows its users to create Bitcoin wallets in addition to Bitcoins per se, freely transacting them. Hence, the user is, at the same time, the owner, custodian and creator of the Financial instrument, a situation that has not yet been observed in large scale cross-border transactions. The issuance and use of cryptocurrencies is not associated with any type of state or intermediary institution, thus, the adherents of the system carry out transactions and issuance of virtual currencies independently of any type of legislation or state tutelage, making it almost impossible to dismantle the system as a whole unless all its adherents are extinguished.

**COUNTRIES AND STANCES ON CRYPTOCURRENCY\***

**United States**

The Securities and Exchange Commission (SEC) has warned investors of cryptocurrency investing risks, halted several ICOs and hinted at the need for greater cryptocurrency regulation.

The Commodity Futures Trading Commission (CFTC) became the first U.S. regulator to allow for cryptocurrency derivatives to trade publicly, then organized meetings to talk about possibly changing the rules for cryptocurrency derivatives clearing (one of the meetings was postponed due to the federal government shutdown).

Secretary of the Treasury Steve Mnuchin has indicated a preference for minted fiat currency over cryptocurrency. Speaking on January 12, 2018, at the Economic Club in Washington, D.C., Secretary Mnuchin warned those in attendance that he and other regulators were looking into the possibility that cryptocurrency could be used in money-laundering activities. The secretary then announced to the group that the Financial Stability Oversight Council (FSOC) had formed a working group to explore the cryptocurrency marketplace and that he hoped to work with the G20 to prevent bitcoin from becoming a digital equivalent of a “Swiss bank account.”

Defending his stance to World Economic Forum attendees on January 25, 2018, Mnuchin explained that his number one focus on cryptocurrency was “to make sure that they're not used for illicit activities.”

On January 26, 2018, U.S. Treasury Deputy Director Sigal Mandelker echoed the secretary’s sentiments after a visit to China, South Korea and Japan. At a press conference in Tokyo, she applauded the three Asian countries for keeping tabs on cryptocurrency trading, stating, “We feel very strongly that we need to have this kind of regulation all over the world.”

It should be noted that non-U.S. investors may have concerns over clearing licensing hurdles put up individually by the states. If the U.S. treats cryptocurrencies as currency, it seems more likely that the actions by the federal government and federal regulatory agencies would preempt states’ licensing. However, if treated as “securities” (the SEC has not completely cleared the issue up), cryptocurrencies, especially ICOs, would have to clear “blue sky laws” on a state-by-state basis.

**Canada**

The Financial Consumer Agency in Canada does not consider cryptocurrencies to be “legal tender,” excluding all but Canadian bank notes and coins from that definition.

After weeks of hearings, which included testimony from experts like Andreas Antonopoulos, the Canadian Parliament approved Bill C-31 on June 19, 2014, the world’s first national law on digital currencies. The Canadian government has been communicative in its regulatory stances on cryptocurrency ever since: the Canadian Securities Administrators (CSA) sent out a regulatory notice on August 24, 2017, confirming “the potential applicability of Canadian securities laws to cryptocurrencies and related trading and marketplace operations and to provide market participants with guidance on analyzing these requirements.”

Thead of the Central Bank of Canada, Stephen Poloz, was quoted as saying on January 25, 2018, that “I object to the term cryptocurrencies because they are crypto but they aren’t currencies … they aren’t assets for the most part … I suppose they are securities technically … There is no intrinsic value for something like bitcoin so it's not really an asset one can analyze. It's just essentially speculative or gambling.” It should be noted that as part of the North American Securities Administrators Association (NASAA), Canada joined an association-wide “cautionary directive” on the risks of cryptocurrencies, with all representatives from every province in the country believing there is a “high risk of fraud.”

**Venezuela**

The country’s regulatory stance on cryptocurrencies is noteworthy because the government, under the restrictive regime of Nicolás Maduro, is seeking to skirt economic sanctions imposed on Venezuela by announcing its own oil-backed “petro” cryptocurrency.

Under Maduro, the country has been divided for years by protests and clashes between opposition parties and the government. Venezuela started off 2017 seemingly seeking to crack down on cryptocurrencies as the Venezuelan Bolivar remained relatively unusable. And even as recently as December 13, 2017, the Maduro government sought to regulate cryptocurrency mining as the newly minted superintendent of cryptocurrencies, Carlos Vargas, announced the compilation of a detailed registry of cryptocurrency miners in the country.

In a country where the fiat currency is worth little and sanctions from the U.S. continue to mount, a state-sanctioned cryptocurrency may cause Venezuela — a typically restrictive regime — to become one of the most progressive countries on cryptocurrency regulations.

**Japan**

Japan isn’t particularly liberal toward digital currency regulation; it’s merely winning the race to attract the best from Asia’s cryptocurrency industry, as China and South Korea have been creating hostile/uncertain environments.

Recent events may have tempered Japanese enthusiasm for cryptocurrencies, however. The hack of a Japanese exchange on January 26, 2018, resulting in the loss of $530 million worth of NEM coins, has prompted backlash from the community and closer oversight from the Financial Services Agency (FSA).

**China**

China has been taking ever-increasing actions to clamp down on all things cryptocurrency. Starting off by banning ICOs, China ordered a bank account freeze associated with exchanges, kicked out bitcoin miners, and instituted a nationwide ban on internet and mobile access to all things related to cryptocurrency trading. The People’s Republic of China appears to be the most stringent cryptocurrency regulator of the major economies regarding cryptocurrencies. This is an odd about-face given that, in 2017, Chinese bitcoin miners made up over 50 percent of the worldwide mining population and that cryptocurrency adoption in China increased at a rate higher than any other country.

**Singapore**

Until recently, the finance and banking center of Asia has been relatively lax compared to many of its Asian counterparts on cryptocurrency regulation. The Monetary Authority of Singapore (MAS), like many financial regulators, warned of risks of speculating in the cryptocurrency markets during the December 2017 peak in bitcoin prices. And Singapore’s International Commercial Court heard a trial that same month over a bitcoin trading dispute, seeming to legitimize the economic stakes in dispute.

On January 9, 2018, Singapore’s Deputy Prime Minister Tharman Shanmugaratnam said that “the country’s laws do not make any distinction between transactions conducted using fiat currency, cryptocurrency or other novel ways of transmitting value.”

**Australia**

In the wake of the August 2017 financial scandal surrounding the Commonwealth Bank of Australia, the Australian government sought to follow in Japan’s footsteps by strengthening its anti-money laundering laws and regulating digital currencies. This differed slightly from the view in 2015 that the Aussie government would seek a “hands-off” approach to cryptocurrencies. Still, the lack of more concise regulation has purportedly had a negative impact on the country as the end of 2017 saw Australian cryptocurrency brokers halt Australian dollar deposits. December 2017 also saw an issuance from the Australian Taxation Office (ATO) which hinted at the way potential future regulation could go. The ATO guidance stated:

Transacting with bitcoin is akin to a barter arrangement, with similar tax consequences. Our view is that bitcoin is neither money nor a foreign currency, and the supply of bitcoin is not a financial supply for goods and services tax (GST) purposes. Bitcoin is, however, an asset for capital gains tax (CGT) purposes.

Australia, however, has supporters of digital currencies in government, as August 2017 saw senators from both major parties (Labor and Coalition) stepping forward to call on the Reserve Bank of Australia (RBA) to accept cryptocurrencies as an official form of currency.

**United Kingdom/European Union**

On December 4, 2017, The Guardian and The Telegraph reported that the U.K. Treasury and the EU both had made plans aimed at ending anonymity for cryptocurrency traders, citing anti-money laundering and tax evasion crackdowns.

The European Union plan would require cryptocurrency platforms to conduct proper due diligence on customers and report any suspicious transactions. Likewise, the Treasury of the United Kingdom stated that they are “working to address concerns about the use of cryptocurrencies by negotiating to bring virtual currency exchange platforms and some wallet providers within anti-money laundering and counter-terrorist financing regulation.” The Treasury did, however, add that “there is little current evidence of [cryptocurrencies] being used to launder money, though this risk is expected to grow.”

While one European Union commissioner, Pierre Moscovici, stated in an interview with Bloomberg on December 18, 2017, that the EU was not looking to regulate bitcoin, the commissioner’s statements seemed out of sync with prior and consequential messaging. Two days later, Moscovici’s message was seemingly countermanded by Valdis Dombrovskis, vice president of the European Commission (the Executive for the European Union), when he told reporters in Brussels that:

There are clear risks for investors and consumers associated to price volatility, including the risk of complete loss of investment, operational and security failures, market manipulation and liability gaps.

Calls for greater cryptocurrency regulations echoed across Europe in January 2018. On January 15, 2018, French Minister of the Economy Bruno Le Maire announced the creation of a working group with the purpose of regulating cryptocurrencies. Similarly, Joachim Wuermeling, a board member of the German Bundesbank, called for effective regulation of virtual currencies on a global scale.

On January 22, 2018, Dombrovskis furthered his regulatory agenda for cryptocurrencies by writing three of the EU’s watch dogs warning them of a bubble in bitcoin. On January 25, 2018, embattled U.K. Prime Minister Theresa May joined the fray, echoing the sentiments of International Monetary Fund head Christine Lagarde and U.S. President Donald Trump. When speaking to Bloomberg during the World Economic Forum at Davos, the prime minister stated, “We should be looking at these very seriously — precisely because of the way they can be used, particularly by criminals.”

**Nigeria**

Last year Africa’s largest economy witnessed a struggle through a recession that caused a “crunch” to its fiat currency. Bitcoin trading boomed as Nigerians used cryptocurrencies to end-run currency controls restricting access to the dollar put in place to curtail the recession. January 2017 started off with the Central Bank of Nigeria (CBN) seeming to ban cryptocurrencies, only to have CBN Deputy Director Musa Itopa Jimoh walk back the position by stating, the “Central bank cannot control or regulate bitcoin. [the] Central bank cannot control or regulate blockchain. Just the same way no one is going to control or regulate the internet. We don’t own it.” Bitcoin trading boomed by 1500 percent during 2017.

Though the IMF report from December 2017 said the country has exited its recession, tepid GDP growth forecasts and reliance on crude oil exports make calls on January 25, 2018, from CBN Governor Edwin Emefiele to regulate cryptocurrencies seem tenuous. The CBN governor stated, “Cryptocurrency or bitcoin is like a gamble … We cannot, as a central bank, give support to situations where people risk their savings to ‘gamble.’”

**Ghana**

The governor of the Bank of Ghana, Dr. Ernest Addison, stated on January 22, 2018, that “Bitcoin is not yet legal tender” at a media briefing. While there is a bill before Ghanaian parliament which will allow for the use of cryptocurrencies (seemingly with companies registered as “Electronic Money Issuers” by the government), the current stance of bitcoin (and other cryptocurrencies) is, according to Graphic Online, one of “six countries that have outlawed [bitcoin].” Addison’s statements come weeks after a recommendation from the Ghanaian investment bank, Group Ndoum, suggested that the Bank of Ghana invest 1 percent of its reserves in bitcoin.

**South Africa**

South Africa is relatively progressive on the subject of cryptocurrencies compared to others on the list. While the 2014 position paper on virtual currencies issued by the South African Reserve Bank seemed promising for the industry, the South African government began in July of 2017 to work with Bankymoon, a blockchain-based solutions provider, on creating a “balanced” approach to bitcoin regulation.

The country has had valuation issues with its fiat currency, the South African Rand, being devalued several times over the past decade. The 2015 devaluation saw the rand drop 26 percent in response to the Chinese yuan devaluing by a mere 2 percent.

**[\* these statements are taken from media houses and should not be substituted for evidence, they are provided to generate a basic idea of the situation in certain countries with respect to the agenda]**

**Cryptocurrency Transactions and Tax Implications \***

* Trading cryptocurrencies produces capital gains or losses, with the latter being able to offset gains and reduce tax.
* Exchanging one token for another — for example, using Ethereum to purchase an altcoin — creates a taxable event. The token is treated as being sold, thus generating capital gains or losses.
* Receiving payments in crypto in exchange for products or services or as salary is treated as ordinary income at the fair market value of the coin at the time of receipt.
* Spending crypto is a tax event and may generate capital gains or losses, which can be short-term or long-term. For example, say you bought one coin for $100. If that coin was then worth $200 and you bought a $200 gift card, there is a $100 taxable gain. Depending on the holding period, it could be a short- or long-term capital gain subject to different rates.
* Converting a cryptocurrency to U.S. dollars or another currency at a gain is a taxable event, as it is treated as being sold, thus generating capital gains.
* Air drops are considered ordinary income on the day of the air drop. That value will become the basis of the coin. When it's sold, exchanged, etc., there will be a capital gain.
* Mining coins is considered ordinary income equal to the fair market value of the coin the day it was successfully mined.
* Initial coin offerings do not fall under the IRS's tax-free treatment for raising capital. Thus, they produce ordinary income to individuals and businesses alike.

**[\*US model for simplicity in comprehension]**

**Drawbacks of Cryptocurrency and Issues to be adressed**

While cryptocurrencies can be used for legitimate purposes, they are also well suited to support illicit transactions. From a tax-evasion point of view, they are particularly attractive. Cryptocurrencies possess the two most important characteristics of a traditional tax haven. First, because there is no jurisdiction in which they operate (they are "held" in cyberspace accounts known as online "wallets"), they are not subject to taxation at source. Second, cryptocurrency accounts are anonymous. Users can start as many online "wallets" as they want to buy or mine Bitcoins and trade them with¬ out ever providing any identifying information. Significantly, Bitcoin (and other cryptocurrencies) offer one additional major advantage to tax-evaders that traditional tax havens do not: the operation of Bitcoin is not dependent on the existence of financial intermediaries such as banks. Bitcoin is exchangeable peer-to-peer by definition. Bitcoin thus seems immune to the developing international anti-evasion regime.

Illegal activity accounts for a substantial proportion of the users and trading activity in bitcoin. For example, approximately one-quarter of all users (25%) and close to one-half of bitcoin transactions (44%) are associated with illegal activity. The estimated 24 million bitcoin market participants that use bitcoin primarily for illegal purposes (as at April 2017) annually conduct around 36 million transactions, with a value of around $72 billion, and collectively hold around $8 billion worth of bitcoin.

To give these numbers some context, the total market for illegal drugs in the US and Europe is estimated to be around $100 billion and €24 billion annually. Such comparisons provide a sense that the scale of the illegal activity involving bitcoin is not only meaningful as a proportion of bitcoin activity, but also in absolute dollar terms. The scale of illegal activity suggests that cryptocurrencies are transforming the way black markets operate by enabling 'black market e-commerce'.

In recent years (since 2015), the proportion of bitcoin activity associated with illegal trade has declined. There are two reasons for this trend.

The first is an increase in mainstream and speculative interest in bitcoin (rapid growth in the number of legal users), causing the proportion of illegal bitcoin activity to decline, despite the fact that the absolute amount of such activity has continued to increase.

The second factor is the emergence of alternative cryptocurrencies that are more opaque and better at concealing a user's activity (eg, Litecoin, Monero, and ZCash). Despite these two factors affecting the use of bitcoin in illegal activity, as well as numerous Darknet marketplace seizures by law enforcement agencies.

The ecosystem of the mainstream financial environment, international transfer transactions require entities like clearing houses, banks, and SWIFT. SWIFT stands for Society for Worldwide Interbank Financial Telecommunication. It is an organization that provides a network for financial institutions all over the globe to transmit information to each other in a safe and secure network. Think of it like WhatsApp, but for banks and other financial institutions. No international money transfer can happen outside of the SWIFT network. There are transaction fees and it takes several days for some transactions to be processed.

In steps Bitcoin, Litecoin, Dash, and all the other transfer protocol cryptocurrencies and the suddenly the environment becomes different. The middleman is no longer required for authorizing and authenticating transactions. The transaction fees are minimal, as low as a couple of cents in some of these cryptocurrencies. Not to mention, the added allure of anonymity and privacy that is associated with cryptocurrencies. Just when you thought that was all, you then realize that transactions occur in a matter of seconds and minutes.

By cutting out the middleman in the payment processing market, cryptocurrencies are causing a huge disruption to the global payment system. One of the reasons for the centralized payment processing protocol is to prevent funding for money laundering, terrorist activities, and illicit trade in drugs and ammunition. With cryptocurrencies, it becomes that much harder to trace transactions and ascertain the identities of the participants. Central banks and other financial institutions seem to have no control over its operations. In September of 2017, [Christine Lagarde](https://www.cnbc.com/2017/10/13/bitcoin-get-serious-about-digital-currency-imf-christine-lagarde-says.html), head of the International Monetary Fund (IMF) warned that cryptocurrencies have the potential to disrupt the Central Banking system and to revolutionize the concept of money.

Based on this there is an urgent need for stringent regulation of cryptocurrency and that is what this committee aims to achieve by laying down a framework for countries to abide by while regulating such trade.