



CRYPTOCURRENCY AND DECENTRALISED FINANCE (DEFI) REGULATION IN INDIA: ADDRESSING LEGAL UNCERTAINTY, CONSUMER PROTECTION, AND FINANCIAL STABILITY

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ABSTRACT

The rapid growth of cryptocurrency markets and decentralised finance (DeFi) platforms has significantly disrupted conventional financial regulation. In India, this disruption has been met with a fragmented and often inconsistent regulatory response. While cryptocurrencies have been indirectly acknowledged through taxation and judicial scrutiny, decentralised finance—defined by the absence of intermediaries and centralised control—continues to operate largely outside the scope of existing legal frameworks. This regulatory ambiguity raises serious concerns regarding consumer protection, financial stability, and the State's ability to exercise effective oversight over emerging financial technologies. This article critically examines India's evolving approach to cryptocurrency and DeFi regulation, focusing on judicial developments, policy responses, and legislative gaps. It argues that India's current stance reflects regulatory indecision rather than a coherent regulatory strategy, resulting in heightened risks for investors and systemic vulnerabilities for the financial system. By analysing the limitations of existing financial and consumer protection laws and drawing limited comparative insights from international regulatory models, the article contends that prohibition or prolonged uncertainty is neither practical nor desirable. It concludes by advocating for a balanced and adaptive regulatory framework that prioritises legal clarity, consumer protection, and financial stability while accommodating technological innovation.

Keywords: Cryptocurrency, Decentralised Finance (DeFi), Financial Regulation, Consumer Protection, Indian Legal.

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INTRODUCTION

The emergence of cryptocurrency and decentralised finance (DeFi) represents one of the most profound challenges to traditional financial regulation in the twenty-first century. What began as an alternative digital payment mechanism has evolved into a complex financial ecosystem encompassing crypto-assets, decentralised lending and borrowing platforms, automated trading protocols, and blockchain-based financial services. In India, the rapid expansion of this ecosystem has occurred in the absence of a comprehensive regulatory framework, resulting in persistent legal and policy uncertainty.

Cryptocurrency adoption in India has increased substantially over the past decade, driven by technological accessibility, speculative investment, and growing interest in decentralised financial alternatives. Despite this growth, Indian regulators have struggled to articulate a consistent legal position. Regulatory responses have oscillated between restrictive measures, cautious accommodation, and legislative inaction. While concerns regarding consumer protection, financial stability, and illicit financial flows are frequently invoked, these concerns have not translated into a coherent regulatory strategy.

This prolonged ambiguity has significant implications. From the perspective of market participants, legal uncertainty undermines compliance, discourages legitimate innovation, and exposes investors to unregulated risks. From a constitutional and rule-of-law standpoint, regulatory indecision erodes legal certainty and accountability. This article argues that India's current approach to cryptocurrency and DeFi regulation reflects regulatory uncertainty rather than deliberate regulatory design. By analysing judicial interventions, policy developments, and comparative regulatory approaches, the article seeks to demonstrate the need for a principled and structured regulatory framework that balances innovation with public interest concerns.

CONCEPTUALISING CRYPTOCURRENCY AND DEFI: A LEGAL DISTINCTION

Cryptocurrency is generally defined as a digital or virtual asset that relies on cryptographic techniques and distributed ledger technology to facilitate peer-to-peer transactions. From a legal standpoint, cryptocurrencies resist easy classification. They do not function as legal tender, nor do they neatly conform to existing definitions of commodities or securities. Their

decentralised issuance, volatility, and speculative character complicate their treatment under traditional financial laws.¹

Decentralised finance represents a more complex and disruptive development within the broader cryptocurrency ecosystem. DeFi platforms utilise smart contracts—self-executing code deployed on blockchain networks—to provide financial services such as lending, borrowing, trading, and yield generation without intermediaries. Unlike traditional financial institutions, DeFi protocols operate without centralised control, governance structures, or regulatory oversight.²

This distinction has profound regulatory implications. Conventional financial regulation is premised on the existence of identifiable intermediaries who can be licensed, supervised, and held accountable. DeFi platforms, by design, eliminate such intermediaries, replacing institutional governance with algorithmic processes and decentralised communities. As a result, regulatory concepts such as licensing, compliance, and liability become difficult to apply. Existing legal frameworks, which remain institution-centric, are ill-equipped to regulate systems intentionally structured to function without institutions.

EVOLUTION OF CRYPTOCURRENCY REGULATION IN INDIA

India's regulatory engagement with cryptocurrency has been characterised by caution, inconsistency, and judicial intervention. In 2018, the Reserve Bank of India (RBI) issued a circular directing regulated entities to refrain from dealing with cryptocurrency-related businesses, citing concerns over consumer protection and financial stability.³ Although the circular did not impose a statutory ban, it effectively paralysed cryptocurrency exchanges by denying them access to the formal banking system.

The Supreme Court's decision in *Internet and Mobile Association of India v Reserve Bank of India* marked a critical turning point in this regulatory trajectory.⁴ Applying the doctrine of proportionality, the Court held that the RBI's blanket restriction was unconstitutional in the absence of empirical evidence demonstrating harm caused by cryptocurrency activities. While

¹ Satoshi Nakamoto, 'Bitcoin: A Peer-to-Peer Electronic Cash System' (2008).

² Primavera De Filippi and Aaron Wright, *Blockchain and the Law* (Harvard University Press 2018).

³ Reserve Bank of India, 'Statement on Developmental and Regulatory Policies' (2018).

⁴ *Internet and Mobile Association of India v Reserve Bank of India* (2020) 10 SCC 274.

the judgment did not legitimise cryptocurrency, it underscored the necessity of measured regulation rather than sweeping prohibitions.

Despite this judicial intervention, subsequent policy developments have remained inconclusive. Legislative proposals aimed at banning private cryptocurrencies were periodically introduced but never enacted. Instead, the State adopted a taxation-based approach through the Finance Act, 2022, recognising virtual digital assets for the limited purpose of taxation.⁵ This approach has been criticised for its inherent contradiction: while crypto-assets are taxed as a source of revenue, their legal status remains undefined, and investors are afforded no corresponding regulatory protections. Such asymmetry reflects policy pragmatism rather than principled regulation.

REGULATORY UNCERTAINTY AND ITS CONSEQUENCES

The absence of a comprehensive statutory framework governing cryptocurrency and DeFi has resulted in a regulatory vacuum with significant consequences. Market participants operate in an environment of uncertainty regarding compliance obligations, enforcement risks, and legal rights. Legitimate enterprises face structural difficulties in aligning their operations with existing laws, while fraudulent actors exploit regulatory gaps to evade oversight.

This uncertainty is compounded by fragmented regulatory authority. Multiple agencies, including the RBI, SEBI, and enforcement bodies, exercise overlapping or ambiguous jurisdiction over crypto-related activities. The lack of coordination among regulators results in inconsistent policy signals and undermines effective enforcement. In the context of DeFi platforms, which often operate across jurisdictions without physical presence, enforcement challenges are further intensified.

From an innovation perspective, regulatory ambiguity discourages responsible development while failing to deter illicit activity. Prolonged uncertainty neither protects consumers nor fosters innovation; instead, it creates a grey market where accountability is diffused, and risk is externalised onto users.

⁵ Finance Act 2022, ss 115BBH, 194S.

CONSUMER PROTECTION IN THE CRYPTO AND DEFI ECOSYSTEM

Consumer protection concerns lie at the heart of the regulatory debate surrounding cryptocurrency and DeFi. Retail investors are frequently drawn to crypto-assets by promises of high returns, often without a clear understanding of the associated risks. Price volatility, technological vulnerabilities, cyber fraud, and regulatory uncertainty expose consumers to significant financial harm.

DeFi platforms exacerbate these risks by offering complex financial products without standardised disclosure requirements or investor safeguards. While the Consumer Protection Act, 2019, provides remedies against unfair trade practices and misleading representations, its applicability to decentralised platforms remains uncertain.⁶ DeFi protocols often lack identifiable service providers against whom consumer claims can be enforced, and cross-border operations further complicate jurisdictional questions.

Additionally, the immutable nature of blockchain transactions heightens consumer vulnerability. Unlike traditional financial systems, erroneous or fraudulent crypto transactions are typically irreversible. In the absence of regulatory safeguards, dispute resolution mechanisms, or investor education, consumers bear the full burden of loss. This highlights the inadequacy of existing consumer protection frameworks in addressing decentralised financial technologies.

FINANCIAL STABILITY AND STATE INTERESTS

From the State's perspective, cryptocurrency and DeFi raise legitimate concerns regarding financial stability, monetary sovereignty, and illicit financial flows. The decentralised and pseudonymous nature of crypto transactions complicates compliance with anti-money laundering and counter-terrorist financing norms.⁷ DeFi platforms, which operate without intermediaries, further weaken traditional surveillance and reporting mechanisms.

Systemic risk is another significant concern. DeFi ecosystems rely on interconnected protocols and automated smart contracts, creating the potential for cascading failures triggered by technical vulnerabilities or market shocks. Increased institutional exposure to crypto-assets

⁶ Consumer Protection Act 2019.

⁷ Financial Action Task Force, 'Virtual Assets and Virtual Asset Service Providers' (2019).

may amplify these risks, particularly during periods of heightened volatility. These considerations underpin the State's cautious approach to regulation.

However, excessive restriction or outright prohibition may prove counterproductive. Restrictive measures risk driving crypto activity underground, reducing regulatory visibility and oversight. A calibrated regulatory framework that balances innovation with financial stability is therefore essential.

COMPARATIVE REGULATORY PERSPECTIVES

International regulatory approaches provide valuable insights into potential regulatory pathways. The European Union's Markets in Crypto-Assets (MiCA) Regulation represents a comprehensive attempt to regulate crypto-assets while fostering innovation through legal clarity and risk-based oversight.⁸ By establishing uniform standards, MiCA seeks to enhance consumer protection and market integrity without stifling technological development.

The United States, by contrast, adopts a fragmented regulatory model, with multiple agencies asserting jurisdiction based on asset classification. While this approach offers flexibility, it has also resulted in regulatory uncertainty and inconsistent enforcement. These comparative experiences demonstrate that regulatory clarity and institutional coordination are essential for sustainable crypto regulation.

CONCLUSION

India stands at a critical juncture in regulating cryptocurrency and decentralised finance. The current approach—marked by piecemeal measures, regulatory ambiguity, and legislative inertia—fails to adequately protect consumers or ensure financial stability. Prolonged uncertainty undermines both innovation and accountability.

This article argues that the challenge posed by cryptocurrency and DeFi is not technological but legal. A coherent regulatory framework must move beyond ad hoc responses and embrace principled regulation grounded in transparency, proportionality, and consumer protection. Regulation, rather than prohibition, offers a sustainable path forward.

⁸ Regulation (EU) 2023/1114 on Markets in Crypto-Assets (MiCA).