TRADING IN THE SHADOWS: THE REGULATORY GREY ZONE GOVERNING CRYPTO F&O AND ITS IMPLICATIONS FOR INVESTOR PROTECTION

- Neelanshu Kashyap and Koitoree Nag[253]

ABSTRACT

Crypto futures and options trading have emerged as a dominant and rapidly expanding segment of India's digital asset ecosystem, due to the ease of depositing money into wallets, driven by high retail participation, regulatory arbitrage, favourable tax treatment, and the availability of extreme leverage on unregulated platforms. Although these instruments closely mirror traditional exchange-traded derivatives in structure and economic substance, they continue to operate outside India's securities law framework due to the absence of a statutory classification of crypto assets. This disconnect has created a regulatory grey zone that exposes retail participants to significant market and structural risks without corresponding legal safeguards.

*This paper examines the contours of this grey zone and demonstrates how statutory exclusions and fragmented oversight by regulators enable crypto Future and Options ("**F&O**") platforms to function without enforceable market conduct norms, disclosure obligations, or investor redress mechanisms. It highlights structural features such as excessive leverage, automated liquidation protocols, opaque counterparty arrangements, absence of circuit breakers, and unregulated cross-border capital exposure, which amplify losses for retail investors while remaining outside regulatory scrutiny.*

This paper traces the rise of crypto F&O in India and identifies the legal and institutional fractures sustaining the grey zone, followed by a comparative analysis of regulatory approaches adopted in jurisdictions. The paper further proposes a substance-based, platform-centric regulatory framework for India. It concludes that regulatory silence, rather than express illegality, has allowed crypto F&O markets to replicate the risks of regulated derivatives markets without equivalent safeguards. It argues for coordinated reforms centred on legal recognition of crypto assets, regulation of crypto derivatives

[253] Neelanshu Kashyap and Koitoree Nag are students at the National University of Study and Research in Law, Ranchi.

platforms, calibrated leverage controls, and extension of investor protection mechanisms to restore accountability while preserving space for financial innovation.

INTRODUCTION

Today, India is one of the largest markets for the use and trading of cryptocurrency. On-chain transaction volumes have reached over USD 338 billion, and this can be attributed to widespread digital adoption and increasing participation of retail investors.[254] This sharp increase has shown great potential for financial innovation, especially in terms of improvement of accessibility of markets, lowered barriers to entry and the enablement of forms of investment that fall outside traditional systems of finance.[255]

Internationally, the market for crypto derivatives is one of the most active divisions of modern finance and is estimated to exceed USD 28 trillion annually soon.[256] In India, a similar trend can be noticed. However, such a growth has raised concerns about situations that the traditional understanding of fraud or market manipulation do not prove sufficient for in the current regime.

The structure of crypto derivatives, specifically F&O trading itself, poses primary risks. Heavy participation of retail investors, high leverages and a distinct imbalance in information are characteristic of these markets. The unregulated platforms offer leverage levels of 100x or 125x as a matter of practice,[257] which are exorbitantly higher than permitted levels in securities or commodities markets overseen by the regulatory watchdogs.[258] During periods of high price volatility, positions are often closed

---

[254] Chainalysis, *The 2025 Geography of Crypto Report* 34 (2025), https://go.chainalysis.com/2025-geography-of-cryptocurrency-report.html.
[255] Bhavana Sahu & Hariom Divakar, *Cryptocurrency and Its Impact on Indian Economy*, 11 J. GLOB. ECON. 401 (2023), https://www.hilarispublisher.com/open-access/cryptocurrency-and-its-impact-on-indian-economy-98448.html (last visited Feb. 25, 2026).
[256] Barry Elad, *Cryptocurrency Derivatives Market Statistics 2025: Growth, Trends, and Projections*, COINLAW, https://coinlaw.io/cryptocurrency-derivatives-market-statistics/ (last visited Feb. 25, 2026).
[257] Binance, *Binance Futures Trading: Understanding Funding Fees, Leverage, and the Difference Between Cross and Isolated Margin*, BINANCE SQUARE, https://www.binance.com/en-IN/square/post/24757521817370 (last visited Feb. 25, 2026).
[258] Securities & Exchange Board of India, Collection and Reporting of Margins by Trading Member (TM) / Clearing Member (CM) in Cash Segment – Clarification, SEBI/HO/MIRSD/DOP/CIR/P/2020/173 (September 15, 2020).

automatically through liquidation channels. Retail investors lack institutional resources and high-level risk management tools, and are thus the worst exposed to these dynamics.[259]

To take a real-life example, consider a retail investor, who, drawn by the low entry costs and apparent legitimacy of a popular exchange, enters into a highly leveraged crypto futures position. A small adverse price movement, which is magnified by a high leverage, leads to the trigger event for an automatic liquidation. Any capital that this individual has invested is wiped out almost instantly. When they seek a remedy for this, they realise that the exchange is not regulated in the Indian securities market, and thus is not subject to any enforceable market conduct norms. The loss is very real, but the law has no safeguards for it.

Such a lack of regulatory oversight is not accidental. Crypto derivatives platforms fall outside the existing statutory classification for derivatives. Thus, the platforms operate outside traditional legislative frameworks.[260] These platforms are legal not because of express regulatory permission, but simply because of statutory exclusion.

The concern here is not merely of illegality, but the structure itself. As seen in traditional derivatives markets, trading systems may produce destabilising effects without breaching explicit rules.[261] Crypto derivative platforms amplify this problem as the risk arises not from the isolated misconduct, but from the architecture of the market itself operating outside regulatory oversight.[262] The consequences are borne by retail investors, but regulatory frameworks are formally inapplicable.

The first part of this paper situates the rise of crypto F&O within the broader shift away from spot crypto trading and traditional regulated derivatives, highlighting the role of

---

[259] Beth Kindig, *Retail Investors Market Losses: Financial Analysis*, I/O FUND, https://io-fund.com/broad-market/financial-analysis/retail-investors-market-losses (last visited Feb. 25, 2026).
[260] Siri Hegde K, *Is Crypto Futures Trading Legal in India?*, MUDREX, https://mudrex.com/learn/crypto-futures-trading-legal-india/ (last visited Feb. 25, 2026).
[261] Securities & Exchange Board of India v. Rakhi Trading Pvt. Ltd., 2009 SCC OnLine SEBI-AO 1.
[262] Shubham Goyal, *The Pros and Cons of Crypto Derivatives Trading*, DELTA EXCHANGE, https://www.delta.exchange/blog/pros-and-cons-crypto-derivatives-trading (last visited Feb. 25, 2026).

tax treatment, leverage, and regulatory tightening in conventional F&O markets. The second and third parts analyse the legal foundations of the grey zone, focusing on the Securities Contracts (Regulation) Act, 1956, the limits of Securities and Exchange Board of India's ("**SEBI**") jurisdiction, and the absence of recognised exchanges, market conduct rules, and investor protection mechanisms. The fourth part identifies structural risks arising from unregulated exchanges, including excessive leverage, conflicts of interest, automated liquidations, lack of circuit breakers, and unmonitored cross-border capital exposure. The fifth part undertakes a comparative analysis of regulatory approaches adopted in Hong Kong, the United Kingdom, Canada, and the British Virgin Islands to draw functional lessons for India. Lastly, the paper proposes complementary policy recommendations that are designed to work independently in order to provide holistic reform and bridge the grey zone. Further, it argues for a coordinated, substance-based regulatory response centred on legal recognition of crypto assets, platform-centric regulation of crypto derivatives exchanges, calibrated leverage controls, and the extension of investor protection mechanisms.

THE FALL OF SPOT TRADING AND THE RISE OF CRYPTO F&O AMIDST THE CRACKDOWNS IN TRADITIONAL F&O

Globally, the crypto derivative market is one of the most active sectors in digital finance, estimated to exceed USD 28 trillion in annual trading value. As per the 2025 data, 76 per cent of the total trading volume consists of derivatives, which shows a clear departure from earlier periods dominated by spot transactions. The Asia-Pacific ("**APAC**") region remains the largest contributor among all, accounting for 48 per cent of global crypto derivatives volume, supported by higher retail participation.[263]

In the Indian market, spot trading still forms the entry point of many users;[264] however, the centre of gravity in the last few years has shifted decisively away from spot markets

[263] *Supra* note 256.
[264] Sharekhan, *Spot Trading: All You Need to Know*, SHAREKHAN, https://www.sharekhan.com/financial-blog/blogs/spot-trading-all-you-need-to-know (last visited Feb. 25, 2026).

towards derivatives,[265] particularly F&O.[266] Even though the shift is not completely unique to India, the effects are most evident in the Indian market, where the volume of retail participation has gone up rapidly. Crypto futures trading on major Indian crypto platforms now averages approximately USD 3 to 5 million in daily volume, and this figure continues to grow steadily.[267]

Recent interventions in traditional F&O by SEBI

Several factors explain the sudden decline of Indian investors in spot trading and increase in crypto F&O. One of the most immediate triggers has been the regulatory scrutiny interventions in traditional F&O aimed at curbing excessive speculation by SEBI, due to the Jane Street probe, where the company had manipulated the market for stock index derivatives to unlawfully earn profits to the tune of Rs. 4,843 crore.[268]

These strengthening measures include enhanced risk management and surveillance by restricting the availability of weekly expiry contracts by limiting exchanges to a single benchmark index expiry.[269] Higher mandated margin requirements were also introduced through additional extreme loss margins ("**EML**"), making it more expensive to hold short-term positions.[270] Further, the requirement of exchanges to track derivative exposure continuously during trading hours was introduced for intraday position limit monitoring.[271] Permissible open interest was linked more closely to the

[265] Futures Industry Association (FIA), *Explainer: The Meteoric Rise in India's Equity Derivatives Volume*, FIA (Aug. 16, 2024), https://www.fia.org/marketvoice/articles/explainer-meteoric-rise-indias-equity-derivatives-volume (last visited Feb. 25, 2026).
[266] MarketBrew, *Crypto Boom India: Trading Futures & Options*, MARKETBREW, https://www.marketbrew.in/daily-insights/crypto-boom-india-trading-futures-options (last visited Feb. 25, 2026).
[267] BFSI Economic Times, *Indian Investors Turn to Crypto Derivatives Amidst Equity F&O Crackdown*, ECONOMIC TIMES BFSI (Sept. 5, 2025), https://bfsi.economictimes.indiatimes.com/articles/indian-investors-turn-to-crypto-derivatives-amidst-equity-fo-crackdown/123704804.
[268] C.P. Chandrasekhar, *Lessons from Jane Street*, INTERNATIONAL DEVELOPMENT ECONOMICS ASSOCIATES LIMITED (IDEAS) (July 19, 2025), https://www.networkideas.org/2025/07/19/lessons-from-jane-street/.
[269] Securities & Exchange Board of India, Measures for Enhancing Trading Convenience and Strengthening Risk Monitoring in Equity Derivatives, SEBI/HO/MRD/TPD-1/P/CIR/2025/79 (May 29, 2025).
[270] Securities & Exchange Board of India, Measures to Strengthen Equity Index Derivatives Framework for Increased Investor Protection and Market Stability, SEBI/HO/MRD/TPD-1/P/CIR/2024/132 (Oct. 1, 2024).
[271] Securities & Exchange Board of India, Framework for Intraday Position Limits Monitoring for Equity Index Derivatives (Circular SEBI/HO/MRD/TPD/CIR/P/2025/122, 1 September 2025); *see also*, Securities & Exchange Board of India, Operational Efficiency in Monitoring of Non-Resident Indians Position Limits in Exchange Traded Derivatives Contracts (Circular SEBI/HO/MIRSD/MIRSD-PoD/P/CIR/2025/109, 29 July 2025).

free float and liquidity of the underlying cash market, resulting in earlier trading restrictions once thresholds are approached.[272] Alongside all of these measures, exchanges adjusted contract specifications and lot sizes pursuant to regulatory directions, increasing the capital required to enter certain derivative positions.[273]

Tax benefit in Crypto F&O

Another factor is the tax treatment, as profits from crypto F&O are generally treated as business income under Section 28 of the Income Tax Act, 1961 ("**ITA**").[274] Unlike the transactions in spot crypto, they are not categorised as transfers of virtual digital assets subject to a flat 30 per cent tax under Section 115BBH of ITA,[275] as well as 1 per cent TDS under Section 194S of ITA.[276] This differential treatment makes crypto derivatives more appealing than spot crypto trading, as it allows numerous other advantages, like setting off losses.[277]

High leverage and ease of participation

Leverage also contributes to this shift, as crypto exchanges routinely offer leverage levels 100x or even 125x, which is far higher than those available in regulated equity derivatives markets.[278] This is coupled with the ease of participation provided by several platforms, which allow Indian users to deposit margin in INR, which is used in global derivatives markets after internally converting into stablecoins.[279]

In practice, crypto exchanges offer two principal routes for funding an account. The first and more commonly used route is the peer-to-peer ("**P2P**") route, where the

---

[272] Securities & Exchange Board of India, Master Circular for Stock Exchanges and Clearing Corporations (Circular SEBI/HO/MRD-PoD2/CIR/P/2024/00181, 30 December 2024).
[273] National Stock Exchange of India Limited, Revision in Market Lot of Derivative Contracts on Indices, Circular Ref. No. 176/2025, Download Ref. No. NSE/FAOP/70616 (Oct. 3, 2025).
[274] Income Tax Act, 1961, § 28.
[275] *Id.,* § 115BBH.
[276] *Id.,* § 194S.
[277] Sujaini Biswas, *Crypto Derivatives*, CLEARTAX, https://cleartax.in/s/crypto-derivatives (last visited Feb. 25, 2026).
[278] Yogita Khatri, *Binance Increases Leverage Up to 125x for Its Futures Trading Platform*, THE BLOCK (Oct. 18, 2019), https://www.theblock.co/linked/43746/binance-increases-leverage-up-to-125x-for-its-futures-trading-platform.
[279] BFSI Economic Times, *Indian Investors Turn to Crypto Derivatives Amidst Equity F&O Crackdown*, ECONOMIC TIMES BFSI (Sept. 5, 2025), https://bfsi.economictimes.indiatimes.com/articles/indian-investors-turn-to-crypto-derivatives-amidst-equity-fo-crackdown/123704804.

crypto exchange functions as an escrow and the user transacts with a domestic seller through domestic channels and in return purchases cryptocurrency, for e.g. USDT. The seller's USDT is temporarily locked on the platform and is released after the receipt of funds. This is considered a domestic transfer as it never enters Binance's banking system. This USDT appears in the user's spot wallet, which can be internally transferred to futures or options wallets. The other route is deposit of fiat directly to Binance through an authorised dealer bank, which constitutes an outward remittance and is treated as a capital account transaction under the Liberalised Remittance Scheme ("**LRS**"), subject to the USD 250,000 annual limit. Once credited, the same internal wallet process is followed. However, the P2P route offers easier access and greater convenience, coupled with the absence of formal outward remittance procedures.

The combination of all of the above factors is why crypto F&O is an increasingly popular alternative to both spot crypto markets and traditional F&O markets. The extent to which this growth is shaped by the absence of comparable regulatory constraints forms a *"grey zone area"* which will be further addressed.

SCHRÖDINGER'S REGULATIONS: THE LUMBERING GREY ZONE

Derivatives: forwards, swaps, F&Os

In order to assess the legality (or lack thereof) of crypto futures in India, the definition of "securities" under Section 2(h) of the Securities Contracts (Regulation) Act, 1956 ("**SCRA**") is where one must begin.[280] After the amendment in 1999, it expressly brings derivatives into its ambit,[281] and clarifies that a derivative would include any security or contract whose value is derived from any underlying instrument, loan or index of prices, as well as commodity derivatives under Section 2(ac) SCRA.[282] Section 2(a),[283] which defines a "contract" as a transaction relating to the purchase or sale of securities, also

---

[280] Securities Contracts (Regulation) Act, 1956, § 2(h).
[281] M. Sahoo, *Securities Laws (Amendment) Acts, 1999*, CHARTERED SECRETARY, May 2000, at 169–71.
[282] Securities Contracts (Regulation) Act, 1956, § 2(ac).
[283] *Id.*, § 2(a).

places derivatives within the contractual securities framework. Reading these provisions together, it can be inferred that India brings regulatory oversight over price-linked instruments through a purposive, broad and substance-based approach;[284] and derivatives are not mere peripheral products but are recognised and regulated securities.

Forwards and swaps are over-the-counter derivative contracts which are usually used for risk management instead of trading.[285] A forward contract is a bilateral agreement to buy or sell an underlying asset at a predetermined price on a specified date in the future, while a swap is a contract in which two counterparties exchange predetermined streams of cash flows or obligations over a period based on an underlying benchmark such as currency fluctuations or interest rates.[286]

Derivative contracts did exist in India prior to 2000 in the form of forward contracts, commodity futures and the *"badla system."*[287] In June 2000, exchange-traded equity derivatives, of which F&Os are an important subset, were formally introduced under a standardised regulatory framework.[288]

Futures contracts are standardised agreements to buy or sell an underlying asset at a predetermined price on a future date and may be based either on market indices or individual securities. As indices themselves cannot be physically delivered, index futures are mandatorily settled in cash, while stock futures link to specific equity shares.[289] An options contract is a derivative contract for the purchase or sale of a right, but not an obligation,[290] to buy or sell securities at a future date and is recognised under Section

[284] Adukia & Associates, *Concept of Derivatives in India*, https://www.caaa.in/image/05_derivatives.pdf (last visited Feb. 25, 2026).
[285] *Id.*
[286] Securities & Exchange Board of India, *FAQ on Equity and Currency Derivatives*, SEBI, https://www.sebi.gov.in/sebi_data/faqfiles/jan-2017/1485846339758.pdf (last visited Feb. 25, 2026).
[287] Ramesh Gupta, *Badla System: A Reappraisal* (Working Paper, Indian Inst. of Mgmt. Ahmedabad, June 1, 1997), https://www.iima.ac.in/publication/badla-system-reappraisal.
[288] Adukia & Associates, *Concept of Derivatives in India*, https://www.caaa.in/image/05_derivatives.pdf (last visited Feb. 25, 2026).
[289] Securities & Exchange Board of India, *Chapter 5 – Exchange Traded Derivatives*, SEBI, https://www.sebi.gov.in/sebi_data/commondocs/jul-2021/Chapter%205%20-%20Exchange%20Traded%20Derivatives_p.pdf (last visited Feb. 25, 2026).
[290] *Id.*

2(d) SCRA.[291] These instruments operate in a strictly regulated exchange and clearing framework and were designed to enable hedging, where participants in the market utilise derivative positions to offset risks from existing exposures and price recovery.

Section 18A and 19 SCRA

In order to assess the regulatory grey zone crypto F&Os operate in, the combined operation of Sections 18A and 19 SCRA must be examined. Section 18A provides that contracts in derivatives are legal and valid only if they are traded on a recognised stock exchange, settled through the clearing house of such exchange, and conducted in accordance with the rules and bye-laws prescribed thereunder, or otherwise notified by the Central Government.[292] To complement this, Section 19 prohibits the organisation or operation of any stock exchange other than a recognised stock exchange for the purpose of assisting in, entering into, or performing contracts in securities.[293] However, both these provisions work only if the instrument in question qualifies as a *"security"* under the SCRA.[294]

Crypto futures almost exactly mimic F&Os in how they are traded and economic materiality, but crypto exchanges which offer such products are not recognised as stock exchanges under Section 4,[295] read with Section 2(f) SCRA.[296] Even then, these platforms can operate and continue to do so because the very instruments they trade in are not formally recognised as securities, and thus the prohibitions under Sections 18A and 19 do not apply. This cannot be called an illegality, because the activity is neither expressly authorised nor is it banned under the securities framework in India.

SEBI lacks jurisdiction because crypto futures are not a "security".[297] The RBI does not regulate market conduct or leverage and only looks at regulating aspects of payment

[291] Securities Contracts (Regulation) Act, 1956, § 2(d).
[292] *Id.*, § 18A.
[293] *Id.*, § 19.
[294] *Id.*, § 2(h).
[295] *Id.*, § 4.
[296] *Id.*, s 2(f).
[297] *Id.*, § 2(h).

and settlement,[298] and the Financial Intelligence Unit's scope is limited only to compliance related to anti-money laundering.[299] Crypto-futures exist in a regulatory gap that is eerily similar to Schrödinger's cat, the thought experiment illustrating quantum superposition and two simultaneous and contrary states of a particle which cannot be verified until it is observed. Crypto F&O simultaneously exhibit the exact characteristics of regulated instruments in substance while remaining legally unacknowledged.[300] This gap arises from a series of regulatory fractures that compound and collectively allow crypto F&O markets to operate in the grey zone and evade established safeguards, which will be addressed in the following part of this article.

CRACKS IN THE REGULATORY ROCKFACE: WHY THE GREY ZONE PERSISTS

No Classification Framework for Crypto Assets

The most prominent gap in regulations that is causing such a grey area is the lack of a statutory classification of crypto assets. Regulators have not determined whether crypto assets should be treated as securities, commodities, currency or a recognisable asset class, which prevents any singular regulator from bringing them within their mandate. This absence of a unified regulatory framework is what allows crypto derivatives to operate outside the securities framework.[301]

In *Ruthukumari v. Zanmai Labs Pvt. Ltd.*, the Madras High Court recently recognised cryptocurrency as a "property" that is capable of being held in trust.[302] This judicial interpretation has only affirmed the legal existence of cryptocurrency, but this cannot

---

[298] Reserve Bank of India, *Organisation — Overview*, RESERVE BANK OF INDIA, https://www.rbi.org.in/commonman/english/Scripts/Organisation.aspx (last visited Feb. 25, 2026).
[299] Financial Intelligence Unit – India, *About FIU-IND*, FINANCIAL INTELLIGENCE UNIT – INDIA, https://fiuindia.gov.in/files/About_FIU-IND/About_FIUIND.html (last visited Feb. 26, 2026).
[300] JeffyJeff, *The Paradox of Schrödinger's Cat When Dealing with Risk & Uncertainty*, MEDIUM (Mar. 21, 2023), https://medium.com/@JeffyJeff/the-paradox-of-schr%C3%B6dingers-cat-when-dealing-with-risk-uncertainty-83673a7be85.
[301] Harsh Mittal & Anshupal Sing, *Cryptocurrency in India: Time for SEBI to Take the Lead*, 1 DNLU STUDENT L.J. (Special Vol.) (2024), https://dnluslj.in/wp-content/uploads/2024/05/DNLU-SLJ-SPECIAL-VOLUME-4-1.pdf.
[302] Rhutikumari v. Zanmai Labs (P) Ltd., 2025 SCC OnLine Mad 9290.

be operationalised by regulators unless the legislature recognises and situates this understanding within statute. Thus, regulatory treatment remains unchanged.[303]

Crypto assets presently only find mentions in tax provisions[304] and anti-money laundering compliance,[305] which are both measures that regulate the collection of revenue and transaction monitoring. Nothing addresses leverage, trading conduct or investor protection, and SEBI has no sectoral legislation to address these because crypto assets are not "securities". Consequently, crypto F&Os remain outside securities law in form despite functioning exactly like financial derivatives in substance.

Exchanges Remain Unregulated, raising transparency, counterparty and leverage concerns

The second regulatory crack enabling the grey area is the operation of exchanges enabling crypto F&Os outside the securities framework. These function similarly to securities exchanges, performing price discovery, matching orders, margining and liquidation; but are not constrained by market conduct, surveillance or risk management regulations.[306]

Approximately 97% of global crypto derivatives trading by volume is processed through unregulated exchanges according to industry estimates,[307] which is what occurs in India as well, with no recognised or regulated exchanges offering crypto derivative trading. This raises serious questions about transparency and accountability because none of the standards for disclosure, reporting or audit requirements applicable in regulated F&O markets can be enforced.[308] If there are any system failures, manipulations or mass

[303] Harsh Mittal & Anshupal Sing, *Cryptocurrency in India: Time for SEBI to Take the Lead*, 1 DNLU STUDENT L. J. (Special Vol.) (2024), https://dnluslj.in/wp-content/uploads/2024/05/DNLU-SLJ-SPECIAL-VOLUME-4-1.pdf.
[304] Income Tax Act, 1961, § 2(47A).
[305] Financial Intelligence Unit – India, Registration of Virtual Digital Asset Service Providers in FIU-India as Reporting Entity, F. No. 9-8/2023/COMPL/FIU-IND (Issued on July 4, 2023).
[306] Securities Contracts (Regulation) Act, 1956, § 2(h).
[307] *Supra* note 256.
[308] BFSI Economic Times, *Indian Investors Turn to Crypto Derivatives Amidst Equity F&O Crackdown*, ECONOMIC TIMES BFSI (Sept. 5, 2025), https://bfsi.economictimes.indiatimes.com/articles/indian-investors-turn-to-crypto-derivatives-amidst-equity-fo-crackdown/123704804.

liquidations, it is almost legally impossible to identify who is responsible and allocate liability.[309]

Another structural risk in the unregulated crypto derivatives market is the murkiness encircling counterparties.[310] On regulated exchanges, trades are routed through independent clearing corporations or houses but many crypto F&O platforms step in effectively as the central clearing counterparty to the trades made by users. This mimics dabba trading or contracts-for-difference models, where such platforms profit from losses of the customer and vice versa.[311] Such practices lead to a fundamental conflict of interest because the exchange's commercial impetus is against its users, which subsequently compromises market fairness due to a lack of disclosure, segregation and independent clearing mechanisms.

Risk is also amplified through excessive leverage by these unregulated exchanges, with crypto platforms routinely offering 100x to 125x leverage, which is excessive compared to permitted limits in regulated equity or commodity derivatives markets. Such a practice increases speculative participation and hastens losses during volatile price movements, often via automated mechanisms for liquidation, owing to which it is banned in certain states.[312] The combination of unregulated exchange infrastructure and exorbitant leverage widens the regulatory gap as crypto F&O remains more lucrative but also more hazardous without any corresponding safeguards for retail participants.

Lack of Effective Investor Protection Frameworks

Due to the unregulated state of crypto derivatives, there is also little to no protection for investors. Under the current regime, Section 11 of the SEBI Act, 1992,[313] provides a statutory basis for investor protection mechanisms, and this is taken further by

---

[309] *Id.*
[310] Yash Kamal Chaturvedi, *India's Top Broker Raises Red Flag on Unregulated Crypto Derivatives*, ETHERWORLD (Nov. 26, 2025), https://etherworld.co/indias-top-broker-raises-red-flag-on-unregulated-crypto-derivatives/.
[311] *Id.*
[312] BFSI Economic Times, *Indian Investors Turn to Crypto Derivatives Amidst Equity F&O Crackdown*, ECONOMIC TIMES BFSI (Sept. 5, 2025), https://bfsi.economictimes.indiatimes.com/articles/indian-investors-turn-to-crypto-derivatives-amidst-equity-fo-crackdown/123704804.
[313] Securities and Exchange Board of India Act, 1992, § 11.

subordinate regulations like the SEBI (Investor Protection and Education Fund) Regulations. These protections, however, only apply to defined "investors", who by definition participate in regulated markets.[314]

Since crypto assets as well as crypto exchanges remain outside the scope of the SCRA, participants in crypto F&O trades do not qualify as "investors" for the purposes of SEBI's regime. The preventative, supervisory and remedial powers of SEBI under Section 11 SEBI Act, therefore, do not apply to losses arising from such transactions even when market outcomes are substantially similar to regulated F&O markets.[315]

This gap is not resolved even by the proposed Securities Market Code,[316] which aims to consolidate and modernise the current framework, because it still links investor protection to the same framework based on definition and institutions. It relies on existing concepts of "securities", "investors" and recognised market structures and fails to extend to investor losses resulting from crypto derivatives and F&Os, which are not unlawful per se but legally unrecognised.[317]

<u>Absence of Circuit Breakers in Crypto F&O Markets</u>

The situation is exacerbated by a complete lack of circuit breakers in crypto F&O markets. Circuit breakers are emergency safeguards that pause trading briefly when there is a rapid price fluctuation or breach of predefined thresholds in regulated securities and derivative markets.[318] These halts are designed to allow market participants time to examine information and adjust their positions, prevent hasty trades and reduce scattered price discovery, especially in times of volatile price movements.[319]

There is no analogous mechanism in crypto F&O markets, where trading can continue without interruption at all times. Sharp price movements are addressed through

[314] Securities & Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.
[315] Securities and Exchange Board of India Act, 1992, § 11.
[316] Securities Markets Code, 2025, Bill No. 200 of 2025, § 125.
[317] Securities and Exchange Board of India Act, 1992, § 11.
[318] Securities & Exchange Board of India, Index Based Market Wide Circuit Breaker in Compulsory Rolling Settlement, SMDRPD/Policy/Cir-37/2001 (Issued on June 28, 2001).
[319] *Id.*

automated liquidation protocols that close individual positions by force rather than a holistic market-wide pause. This structure gives less priority to market stability or investor well-being over the solvency of the exchange, and strategies for hedging often fail to function properly in such scenarios because liquidation of positions may occur before offsets can be created.

Unregulated Cross-Border Capital Flows

Another major regulatory crack leading to the grey zone is how crypto derivatives markets enable cross-border capital exposure without being subjected to traditional controls on capital accounts. The RBI has raised concerns about capital flight, cross-border transaction pathways that remain undetectable and unregulated, and movement of crypto assets to foreign wallets beyond the regulated system.[320] Crypto F&Os usually allow domestic fund deployment for Indians, but create offshore exposure in effect without being classified as foreign investment or remittance by conducting processes like trading, price discovery and settlement on international order books.[321]

Commentary and reports by regulators admit that it is difficult to trace cryptocurrency through conventional financial channels, as cryptocurrencies can now move seamlessly across borders.[322] The RBI's Financial Stability Report cautions that stablecoins and crypto-linked activities can contribute to volatile capital flows and pressurise external accounts and exchange rates. Due to a lack of clear regulations, crypto F&O allows participation of Indian capital internationally without any of the necessary oversight,

---

[320] *RBI Reiterates Cautious Stance on Crypto Assets, Stablecoins for Stability*, BUSINESS STANDARD (Jan. 1, 2026), https://www.business-standard.com/finance/news/rbi-reiterates-cautious-stance-on-crypto-assets-stablecoins-for-stability-126010101094_1.html.

[321] BFSI Economic Times, *Indian Investors Turn to Crypto Derivatives Amidst Equity F&O Crackdown*, ECONOMIC TIMES BFSI (Sept. 5, 2025), https://bfsi.economictimes.indiatimes.com/articles/indian-investors-turn-to-crypto-derivatives-amidst-equity-fo-crackdown/123704804.

[322] Junaid Rahman et al., *Regulatory Landscape of Blockchain Assets: Analyzing the Drivers of NFT and Cryptocurrency Regulation*, 5 BENCHCOUNCIL TRANSACTIONS ON BENCHMARKS, STANDARDS & EVALUATIONS 100214 (2025), https://doi.org/10.1016/j.tbench.2025.100214.

reporting or required limits and amplifies the systemic risks created by the broader regulatory gap in practice.[323]

LESSONS FROM OTHER JURISDICTIONS

Hong Kong: Cryptocurrency as property

As a jurisdiction, Hong Kong has legally characterised cryptocurrencies as property capable of ownership, transfer and proprietary protection in *Re Gatecoin Ltd (in liquidation)*.[324] The Hong Kong Court of First Instance held that issues such as ownership claims, security interests and voidable transactions related to cryptocurrencies in insolvency matters must be in accordance with principles of insolvency and company law. Alongside this, crypto assets used as security interests must mandatorily be registered with the Hong Kong Companies Registry, and failure to do so may result in them being rendered void against creditors and liquidators.[325]

Hong Kong has situated crypto assets within pre-existing frameworks of company and property law, and thus secures enforceability and accountability standards even without a specific statute for this purpose. Market participants can thus operate in a space where proprietary rights, market structures and registrations have clear requirements. Unlike in India, where crypto remains unrecognised by law, Hong Kong recognises crypto assets early at the level of property law, and this reduces the regulatory gap.[326]

United Kingdom: Gatekeeping leverage

The United Kingdom ("**UK**") regulates crypto by aiming to reduce risk where market access begins, instead of a post hoc enforcement approach. A targeted gatekeeping mechanism for leverage, especially for retail participation, has been proposed through

[323] BFSI Economic Times, *Indian Investors Turn to Crypto Derivatives Amidst Equity F&O Crackdown*, ECONOMIC TIMES BFSI (Sept. 5, 2025), https://bfsi.economictimes.indiatimes.com/articles/indian-investors-turn-to-crypto-derivatives-amidst-equity-fo-crackdown/123704804.

[324] *Re Gatecoin Ltd. (in liquidation)*, [2023] HKCFI 914.

[325] Oraz Kereibayev, *Hong Kong's New Crypto Exchange Licensing Regime: What You Need to Know*, SUMSUB, https://sumsub.com/blog/hong-kongs-new-crypto-exchange-licensing-regime/ (last visited Feb. 26, 2026).

[326] *Id.*

FCA Consultation Paper CP25/40.[327] The FCA reiterates that firms have obligations under COBS 10.2.1R to assess their client's experience and knowledge before providing them with access,[328] and this provides an ex-ante control to restrict free access to highly leveraged crypto products for inadequately informed retail investors merely because the product is not technically illegal.

In conjunction, the UK is also attempting to integrate crypto assets into its existing financial market frameworks. Through CP25/15, the proposals address custody, prudential capital limits, admission and disclosure standards, and trading venues. Significantly, the proposed framework directly attempts to reduce concerns of exchange dominance and opaque trading practices by providing for segregation of custody and obligations at the venue level.[329] Unlike India's complete regulatory silence, which allows crypto F&O to thrive, the UK model implements an incremental and functional basis to regulate and curb excessive leverage, amending pre-existing frameworks immediately or absolutely to define crypto assets as traditional securities.

<u>European Union: Substance-based regulation</u>

The European Union ("**EU**") adopts a substance-based regulatory approach to crypto derivatives. The European Securities and Markets Authority regulate those derivatives that meet the definition of a contract for differences ("**CFDs**"), which would be subject to measures including leverage limits, a mandatory risk warning, a margin close-out, negative balance protection, and the prohibition of monetary and non-monetary benefits.[330]

In this, derivatives marketed as "perpetual futures" or similar instruments, including those linked to crypto-assets such as Bitcoin or Ethereum, are likely to fall within the scope of product intervention measures. While this framework formally distinguishes

[327] Financial Conduct Authority, Regulating Cryptoasset Activities, Consultation Paper CP25/40 (Dec. 2025), ¶ 5.19.
[328] *Id.*
[329] Financial Conduct Authority, Regulating Cryptoasset Activities, Consultation Paper CP15/40 (Dec. 2025).
[330] European Securities and Markets Authority, Decision (EU) 2018/796 of May 22, 2018, 2018 O.J. (L 136) 50 (EU); *see also* Regulation (EU) No. 600/2014 of the European Parliament and of the Council art. 40, 2014 O.J. (L 173) 84.

CFDs from other derivative instruments such as futures, it simultaneously adopts a substance-based approach by emphasising that classification depends on the economic characteristics of the product rather than its commercial label.[331]

In addition, investor protection obligations under MiFID II apply, including product governance requirements, appropriateness assessments, and conflict of interest safeguards, particularly where platforms act as both venue and counterparty.[332]

This prevents classification arbitrage by aligning regulation with substance rather than form, and how regulatory design can close the grey zone by focusing on economic reality rather than formal classification.

Canada: Regulating crypto trading platforms

Canada, instead of creating a bespoke statute for crypto assets, addresses the challenges brought up by crypto trading platforms by applying existing securities laws. The Canadian Securities Administrators ("**CSA**"), through Staff Notice 21-330[333] and CSA Staff Notice 46-308 (2018)[334] clarifies that securities legislation may apply to crypto trading platforms because the contractual rights granted to users of such platforms may comprise a security or a derivative, despite the crypto asset in question itself not necessarily being a security. In cases where platform intermediaries trade, hold custody or provide leveraged exposure, the user or retail investor's claim against the platform itself can be enforced through securities law.[335]

Based on this, the CSA has imposed dealer and marketplace requirements like registration, disclosure, custody and conduct obligations on a case-by-case basis on

331 European Securities and Markets Authority, Public Statement on Identifying Derivatives Within the Scope of National Product Intervention Measures on CFDs, ESMA35-243228190-8024 (Feb. 24, 2026).
332 European Securities and Markets Authority, Guidelines on MiFID II Product Governance Requirements, ESMA35-43-620 (June 2, 2017).
333 Canadian Securities Administrators, CSA Staff Notice 21-330: Guidance for Crypto-Asset Trading Platforms (2021).
334 Canadian Securities Administrators, CSA Staff Notice 46-308: Securities Law Implications for Offerings of Tokens (2018).
335 *Id.*

certain crypto assets trading platforms.[336] This is a functional and substance-over-form approach which directly addresses the grey zone because it focuses on how crypto F&O platforms function instead of the classification of crypto assets itself. Unlike India's position, where lack of regulations is directly based on the absence of classification, the Canadian framework regulates the economic relationship between platforms and users, thus allowing regulators to assert jurisdiction and restore accountability in the crypto trading market without first concluding on the broader legal nature of crypto assets.

All of these jurisdictions take different approaches, but they all provide great lessons for India, which can be used to build a framework which is practical for India.

POLICY RECOMMENDATIONS TO STRENGTHEN REGULATORY OVERSIGHT

Regulatory responses to the push for cryptocurrency regulations, including SEBI's proposal for a model comprising oversight of multiple regulators, have addressed the problem in a fragmented manner instead of taking a holistic approach.[337] Several jurisdictions have resolved discrete aspects, such as classification, exchange oversight or leverage control, but none have tackled the combined risk profile of crypto derivatives. An effective framework must thus go beyond sectoral regulation and address financial risks as well as behavioural dynamics that differentiate crypto F&O from traditional securities markets.

Recognition of Crypto Assets as Securities through a Neutral, Substance-Based Definition

India should formally recognise crypto assets through a neutral, technology-agnostic definition that treats them as representations of value recorded on distributed ledger

[336] Canadian Securities Administrators, CSA Staff Notice 21-330: Guidance for Crypto-Asset Trading Platforms (2021).
[337] Charltons Quantum, *SEBI Proposes Multi-Regulator Oversight for Cryptocurrency Trading in India*, CHARLTONS QUANTUM (Apr. 21, 2025), https://charltonsquantum.com/sebi-proposes-multi-regulator-oversight-for-cryptocurrency-trading-in-india/.

technology, without predetermining their legal character. Such recognition would allow regulators to assess crypto assets based on their underlying economic substance rather than their technological form. Indian regulators are already institutionally equipped to do so. SEBI has repeatedly expressed its willingness to regulate crypto markets,[338] and the Madras High Court in *Rhutikumari v. Zanmai Labs Pvt. Ltd.*[339] expressly recognised cryptocurrency as property capable of being held in trust, thereby affirming that crypto assets create enforceable proprietary interests. While judicial recognition alone cannot substitute legislation, it provides a doctrinal foundation that Parliament may adopt and codify.

Similar to Hong Kong, where *Re Gatecoin Ltd (in liquidation)* recognised cryptocurrencies as property,[340] following which the legislature operationalised accountability through a dedicated virtual asset regulatory framework. India can adopt a similar "same risk, same outcome" approach, whereby crypto instruments that function like securities are regulated as such under existing securities law principles, with suitable enhancements to address DLT-specific risks. By anchoring regulation in substance rather than form, crypto derivatives can be brought within the securities definition under Section 2(h) of SCRA, closing the grey zone and enabling the regulation of exchanges, market conduct, and investor protection without the need for an entirely new regulatory architecture.

Regulation of Crypto Derivatives Exchanges through Platform-Centric proto CCP rules

Firstly, India should bring crypto derivatives exchanges within a defined legal perimeter by regulating them as trading platforms rather than attempting to categorise each underlying crypto asset in advance. A useful reference point is the Canadian Securities Administrators ("**CSA**") Staff Notice 21-330,[341] which clarifies that regulatory

[338] *Id.*
[339] *Supra* note 302.
[340] [2023] HKCFI 914.
[341] Canadian Securities Administrators, CSA Staff Notice 21-330: Guidance for Crypto-Asset Trading Platforms (2021).

obligations may arise not because the crypto asset itself is a security, but because the contractual relationship and trading architecture offered by the platform create securities or derivatives-like exposure. Crypto trading platforms pose risks that are structurally distinct from conventional securities exchanges, including opaque order books, offshore settlement, automated liquidations, and leverage-driven retail participation. Recognising these platforms as regulated exchanges, subject to registration, disclosures, and ongoing supervision by SEBI, would address transparency and accountability gaps without imposing a blanket prohibition. Much like FIU registration for AML purposes, this would introduce regulatory visibility, but focused on market conduct rather than financial crime.

Secondly, the regulatory framework must address conflicts of interest inherent in current crypto derivatives platforms. Mandatory structural separation should be introduced, prohibiting exchanges from acting as counterparties to customer trades and confining their role to neutral trade matching and execution. In parallel, an independent clearing utility, or a "proto-CCP," should be mandated to interpose between buyers and sellers.[342] This entity would hold customer margins in segregated accounts, apply transparent and pre-declared margin methodologies, and perform settlements without engaging in proprietary trading. Such a model avoids the complexity of a full central counterparty while restoring neutrality to the clearing process and ensuring that exchanges do not profit directly from customer losses.

Thirdly, regulated crypto derivatives platforms should be required to implement circuit breakers adapted to 24×7 trading. Temporary trading halts during extreme volatility would prevent cascading liquidations, protect hedging strategies, and reduce the risk of sudden account wipeouts, aligning crypto F&O markets with established risk-management standards.[343]

---

[342] Yash Kamal Chaturvedi, *India's Top Broker Raises Red Flag on Unregulated Crypto Derivatives*, ETHERWORLD (Nov. 26, 2025), https://etherworld.co/indias-top-broker-raises-red-flag-on-unregulated-crypto-derivatives/.
[343] *Why 24/7 Trading Is a Bad Idea*, THE ECONOMIST (July 23, 2025), https://www.economist.com/finance-and-economics/2025/07/23/why-247-trading-is-a-bad-idea.

Leverage and Margin Regulation as a Risk-Containment Measure

Firstly, a waterfall mechanism for the absorption of losses arising from crypto derivatives markets must be mandated by the regulator. Losses should be borne in sequence based on the defaulting trader's open position and margin, then by a specified insurance or dedicated reserve fund maintained by the clearing corporation and then by the capital of the exchange itself. Only as a last resort should socialisation of losses across other market participants be conducted. By establishing such an escalating mechanism, these exchanges will be held liable and will internalise any consequences of exorbitant leverage and volatility. This will further discourage products designed to be prone to liquidation as well as encourage prudent risk management, instead of the current practice of rapid forced liquidations.[344]

Secondly, inspiration should be taken from the UK model for a gatekeeping mechanism applicable to leverage access. Exchanges should be mandatorily required to assess a client's knowledge, experience and understanding of leveraged crypto derivatives before granting access beyond basic thresholds, instead of high leverage being universally available to all retail participants by default, as is the current practice. Leverage thresholds linked to demonstrated risk awareness and competence should be established tier-wise, and these would prevent uninformed retail speculation while allowing participation. This skill-based approach would treat access to leverage, by recognising it as a high-risk trading feature, as a regulatory privilege instead of a marketing tool.[345]

CONCLUSION

SEBI's central mandate, as set out in the Preamble of the SEBI Act, is to protect the interests of investors in securities and promote the development of, and to regulate, the securities market. Investor protection is thus its core objective, instead of incidental to

[344] *Id.*
[345] Canadian Securities Administrators, CSA Staff Notice 21-330: Guidance for Crypto-Asset Trading Platforms (2021).

regulation.[346] However, retail investors are exposed to significant risks in the current crypto F&O markets, which are outside the scope of all regulatory frameworks. Most retail participants do not fully understand or knowingly assume the exorbitantly high leverages, uninterrupted round-the-clock trading, undisclosed counterparty arrangements and automated liquidation mechanisms that operate within this regulatory grey zone.

The investors are placed at risk because of regulatory silence, which has allowed market innovation to outpace the evolution of governing regulations instead of outright illegality. Historically, India's regulator-led models balance innovation with systemic stability and aim to allow time for markets to develop while being able to intervene when risks arise. It is time for India to propose and enforce a model that addresses the structural concerns in the crypto derivatives market regarding leverage, liquidity and counterparty exposure, to name a few.

The recommendations proposed in this paper are independent of one another, yet aim to be complementary interventions, with each addressing a particular fault line in the regulatory rockface. Their true efficacy will depend on coordinated implementation: jurisdiction will be enabled by the legal recognition of crypto assets, incentives will be aligned via leverage controls, and gatekeeping mechanisms will protect retail participants by allowing synchronised investor protection to operate in substance rather than merely in form. India, by adopting a risk-aligned and regulator-driven framework, can regulate crypto F&O markets clearly, protect retail investors, and create regulatory and enforcement coherence out of the existing grey zone.

[346] Securities and Exchange Board of India Act, 1992.