

# Business Standard

## Fear of virtual currencies

**The April 6 notification barring financial institutions from dealing in virtual currencies can be termed RBI's most retrograde step**

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The internet is possibly the greatest enabler of the 21st century. It has shrunk the world around us. Strangely, the internet was also once feared as a product of technology. When the internet was new, criminals were the first ones to adopt it. Believe it or not, there were calls to ban the internet. Once people realised the benefits of the internet, they focused on rooting out the criminal activity and not at banning the internet.

It is for this reason that the Reserve Bank of India's (RBI) recent move can be termed its most retrograde.

The RBI in a notification issued on April 6, 2018, prohibited financial institutions from dealing in virtual currencies such as bitcoin or providing services to facilitate any person or entity in dealing with or settling virtual currencies. The RBI's move now means that incorporated technology platforms dealing with virtual currency will be cut off from the financial system and will not be able to operate bank accounts or deal with any financial institutions regulated by the RBI. This may have same effect of indirectly banning an organised cryptocurrency sector in India.



*Illustration: Ajay Mohanty*

The intention of the RBI appears to clampdown on alleged money laundering activities, tax evasion and to protect the consumer from the incessant speculation that is being conducted through virtual currency transactions at these exchanges. However, the net effect of sucking the oxygen out of this nascent industry will be just the opposite. How is this possible?

Without a functioning bank account, the exchanges will either be forced to deal in cash or shut shop altogether. Currently most of the organised cryptocurrency exchanges in India do extensive KYC of customers and do not take cash to ensure traceability of transactions. However, this step will only hamper operations of exchanges that want to do things in a legitimate way with high transparency. Rogue players will still continue to operate through cash or in some other covert manner.

The RBI is behaving like an ostrich that believes that by hiding its head in sand, it can wish away the troubles. The RBI believes that by indirectly banning virtual currencies, no one will be able to trade in VCs and all their troubles will go away. Is the RBI being naïve? Doesn't it realise that this will only affect the legitimate players? Does the RBI think that people will stop dealing with virtual currencies?

It will only mean that trade in the fast-growing virtual currency space will move to overseas. People will buy and sell on exchanges outside India. There are various ways individuals can transfer money (including through LRS) outside India which can be later used to purchase virtual currencies. After selling the virtual currencies they may not even declare such income and deprive the tax authorities of revenue. How will the tax authorities ask such exchanges for transaction details as they recently obtained transaction information for tax purposes from Indian cryptocurrency exchanges.

The police as well as other enforcement agencies regularly reached out to Indian exchanges for details of suspicious transactions and they got the details. It resulted in solving some crime too. Now how will they get such details? Also, since Indian virtual currency companies are still permitted to work using cash, some may result only in magnifying the aforementioned risks. Further, withdrawing banking facility for a legitimate business is not only contrary to the government vision to enhance digital payments but also against the fundamental right for virtual currency companies to carry out any legal occupation, trade and business.

Most exchanges operating in India tried their best to ensure that regulatory risks were suitably mitigated and at the same time permit the citizens of the country to engage in trade and commerce with virtual currency. However, the RBI has failed to recognise the work of these exchanges who tried to ensure the recording of information almost on par with a financial institution. Instead, the RBI has given the perverse incentive for clandestine underground cryptocurrency transaction, which will now get a boost. The RBI needs to understand that just like the internet, virtual currencies are not going anywhere. Instead of short-sighted steps like withdrawing banking facilities, the RBI or the Central Government should instead provide a clear regulatory framework which would mitigate the risks outlined by RBI. It is apparent that the RBI lacks understanding of the concept of virtual currencies and it seems it doesn't realise cryptocurrency transactions are inherently more traceable than cash itself.

Furthermore, the RBI has failed to appreciate the technological potential of virtual currency in India. Called, the “Internet of Money” by crypto expert Andreas Antonopoulos, virtual currencies are an inherent enabler of public blockchain technology and it is very difficult or impossible to separate virtual currencies from public blockchains. RBI's step is now likely to put a question mark in the minds of global investors and entrepreneurs on whether India is an ideal location for innovation.

While most developed countries like Japan, US etc have taken the stand of encouraging such technologies because they see a huge potential in innovation, India, courtesy the recent RBI step, has opted to shut the door on innovation in this space.

One can only sigh in relief that the RBI was not in charge of introducing the internet to India. For all you know, we would have still been stuck in an analogue era in this digital age.

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