THE KEN

The second coming: RBI's move on crypto assets dubbed 'demonetisation-2'

In one fell swoop, the RBI has cut the oxygen supply of cryptocurrency exchanges in India. While most exchanges struggle to breathe, some see a business opportunity

Sidhartha Shukla

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In an arbitrary decision, RBI has excluded cryptocurrency exchanges from India's payments network.

The move has impacted over two dozen exchanges and about 50 million crypto traders in the country..

Exchanges are not willing to go down without a fight and are clutching at as many straws as they can.

New business models and ways to circumvent the RBI's directive are now being explored.

"We haven't received a notice from our banks; we don't know whether we have one week or three months."

Shubham Yadav, co-founder of cryptocurrency exchange Coindelta, is talking about the grave uncertainty that is his future. On Friday, the Reserve Bank of India (RBI) released a circular which notes the provisions of law under which it can prohibit banks and financial institutions from dealing with cryptocurrency businesses. Yadav, and others like him, are now planning ahead.

"We plan to move our office outside of India and from there we will operate in the country. Also, we are looking for alternate ways by which people can still buy cryptocurrency using Rupee by bypassing the RBI's directive. There are a couple of business models we are looking into and we are working on that," he says.

Certain that crypto trade is no longer a lucrative option in India, Yadav explains, "There is now a blockade for customers who would want to trade in crypto to crypto pairs."

So, is this the end for cryptocurrency exchanges?

In its first bi-monthly monetary policy announcement for this financial year, the central bank gave a shocker to the Indian crypto community. It stated that it will be prohibiting banks and financial institutions regulated by it from dealing with virtual currencies.

As per the circular, RBI governed entities cannot engage in services like maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral, opening accounts of exchanges dealing with them, and the transfer/receipt of money in accounts relating to purchase/sale of VCs.

This means that all legit modes of trading Rupee for cryptocurrencies are now shut and all the exchanges have been completely excluded from the country's financial system.

"In his Union Budget speech, Finance Minister Arun Jaitley clearly said that virtual currencies are not legal tender. It is a fallout of that decision of the government that this move has come from the Reserve Bank," says former RBI Deputy Governor R Gandhi.

RBI has traditionally prevented banks from interacting with anything that has a volatile valuation, he says. "For virtual currencies, because of its wild price movement, the Reserve Bank has come to this conclusion. That's my understanding," he adds.

There are over two dozen cryptocurrency exchanges in India, with some that were preparing to launch. Around 5 million people trade (or have invested) in them. And while governments across the world are regulating businesses based on cryptocurrencies, RBI took a measure so drastic that it could mean the end of an entire industry. In this light, it becomes important to understand what the central bank is trying to achieve here, what repercussions this will have, and whether this was the best way to go about it.

Demonetisation – A sequel

Citing concerns of "consumer protection, market integrity and money laundering", the RBI made this move to cut off the crypto industry from India's formal payment network. Some in the crypto-community are calling it a second demonetisation of sorts, as the reasoning behind the first was similar, and to be fair, that didn't work out so well.

Notably, the government has not yet banned Bitcoin and other cryptocurrencies. "People on their own can buy-sell virtual currencies; there is no ban on that. As an individual, if you sell cryptocurrencies, you can receive profits from there in your account," Gandhi says. Also, there's no ban on giving cheques or on electronic transfers to buy virtual currencies from other parties, he adds.

An inter-ministerial committee was tasked with making suggestions for the technology's regulation, back in April 2017. However, there is no clarity on the recommendations the committee has given to the government, or for that matter, on when it will release its first draft.

“Before even you have made up your mind on whether it is going to be legal or illegal or if its legal then how it is to be regulated, you have caused chaos in the market, which results in losses to traders and cripples down the businesses of compliant exchanges,” says Anirudh Rastogi, Managing Partner at TRA Law, a technology law firm advising on cryptocurrency ventures and initial coin offerings (ICOs).

Rastogi further stresses that stakeholders from the industry shouldn’t have been left out of the conversation, as in the case of any such policy, and a public consultation should’ve been held “for the sake of reasonable and sane regulation”. He gives the example of how Trai (Telecom Regulatory Authority of India) proceeded with data privacy and net neutrality.

To curb money laundering, a formal channel needs to be put in place for safe transactions. Such restrictions, as mentioned in our earlier story, will leave traders with no choice but to conduct deals over-the-counter with cash, which would be untraceable.

Arvind Ravindranath, who practices law with the Technology Media and Telecom team at Nishith Desai Associates, says that virtual currencies are here to say. Stating that the RBI may actually be powerless when it comes to curbing the technology itself, he says, “This can only impact its potential in India. People are likely to find ways to circumvent the regulation and trade will move overseas.” Which, of course, is already happening.

What’s truly puzzling in all of this is that the officials seem to be cognizant of this fact, and yet, seem unfazed.

When CNBC-TV18 asked the Secretary of Economic Affairs, Subhash Chandra Garg if the crypto assets people hold are dead now, he said: “They (traders) can still trade amongst themselves. That is possible. They can transfer. That is what their system is. They can transfer by trading, they can also use **cash and other means** but not the banking system and the credit cards.”

Cryptocurrencies were always demonetised, says @SecretaryDEA while speaking to @ShereenBhan at the #CNBCTV18IBLA. Adds that there is 'no ban on trade of crypto assets but it can't enter via banking channels' @Manisha3005

— CNBC-TV18 News (@CNBCTV18News) April 6, 2018

Let’s talk about consumer protection. The worst impacted by this decision are customers, especially the new ones. After the announcement, a panic sell-off was triggered in the Indian market and probably for the second time in history, the price of crypto assets in India were at a 10-15% discount compared to global markets. Prices in India otherwise have always been at a premium compared to the rest of world.

Cryptocurrency	Lowest price after RBI announcement on April 5
Bitcoin	Rs 3,26,576
Ethereum	Rs 18,500
Ripple	Rs 20
Litecoin	Rs 6,001
Bitcoin cash	Rs 26,000

Source: Coindelta

Those who are, let's say 'crypto-savvy', didn't sell their tokens but instead transferred them to wallets where they control the private key. They are 'hodling'; in fact, they even bought more during the dip as they know how to trade on global exchanges, a trader says.

The private key is an alphanumeric code. Think of it as a password that allows you to send and receive cryptocurrencies from your wallet to another, and like passwords, they shouldn't be shared. If someone gains access to the private key of a user, they gain total control over their funds.

Had the RBI been conscious of these implications, perhaps, it may not have acted in haste and waited for the inter-ministerial committee report.

End of the road?

A drowning man would clutch at a straw. Exchanges and traders both are in this sinking ship together and are looking to find as many straws as possible.

One trader tweeted asking whether exchanges could shift all their operations to the State Bank of Sikkim as it is not regulated by the RBI. Traders are not the only ones who are contemplating this option, even exchanges are looking at possibilities. This is made evident by a certain text message I received from the owner of one such exchange who sent it by mistake.

A few exchanges are looking at crypto to crypto trading as a short-term survival mechanism. Crypto exchange Coinome made an announcement about it the very same day.

CoinDCX, India's first pure crypto-crypto exchange went ahead and launched their platform on Saturday. "It makes sense to [launch] as soon as possible now," says Sumit Gupta, co-founder and CEO of CoinDCX.

"We have three months right now; we'll support the salaries of employees till then from our funding and see what kind of solutions we could come up in within the time we have," he adds.

But crypto-to-crypto will not help exchanges survive for long as existing cryptocurrency holders in India conduct inter-crypto trade on global platforms like Binance. Making them switch to a new platform is one challenge, but the likes of CoinDCX also need to get new customers onboard. Besides, new users will first have to buy established cryptocurrencies like Bitcoin and Litecoin with Rupee in order to trade it with other tokens.

In addition to this, the trading fees that exchanges collect will have to be converted into Rupee at some point to meet their operational expenses, pay taxes and salaries. Being excluded from the entire banking system won't let them do so.

Edul Patel, co-founder of Mudrex—a crypto exchange which was supposed to launch around now—says that they are adjusting their launch and product roadmap. They, too, will register their company and operate outside of India.

"The announcement is an end of the road for many of the Indian exchanges and a clear let down for the new investors who had missed the boat in the first wave of cryptocurrency boom," says Praveen Kumar, CEO of Belfrics, another crypto exchange. Belfrics, in anticipation of this move, stopped its operations in India a few months ago.

It's panic station for Indian crypto exchanges. But there is one platform which seems unperturbed by the RBI's decision. Instead, it's planning to capitalise on the moment.

Instashift is a peer-to-peer crypto exchange which matches buyers and sellers on its platform. It stores Bitcoins of sellers in an escrow and then finds matching buyers for the order. The buyer directly sends Rupee to the seller's bank account, and once the money is received, the exchange releases Bitcoins from the escrow.

Instashift is based out of Estonia, and thus, don't need to have a banking operation for the company in India. "We collect our fee in Bitcoin and pay our employees in them as well," says Rahul Chitale, co-founder of Instashift. The employees then convert Bitcoins to Rupee on the platform itself by placing a sell-order of their assets.

Using the RBI's verdict as an opportunity, as of Thursday, Instashift has started a promotion to attract more customers on to its platform. It is also considering a lucrative referral program.

Adapt, decentralise, survive

Exchanges don't plan to go down without a fight. Plus, legal experts say that they can challenge this arbitrary move, one which has deprived an entire industry of the banking system.

“Banking is an essential service and you cannot deprive anyone of it until there is a really good reason and nothing short of illegality. The state can put some reasonable restrictions only if they are reasonable and in line with the regulatory objectives,” Rastogi says.

“The restrictions placed under the law are not reasonable for that reason,” he adds.

In a public statement, Sohail Merchant, CEO of crypto exchange PocketBits said that as a part of the Blockchain and Cryptocurrency Committee of India (BACC), the company will intervene as an impacted party and will fight for proper regulations.

As lawyer Ravindranath says, “The provisions cited by the RBI will need to be studied to see whether or not it has gone a step too far and breached the constitutional liberty that is granted for the freedom of trade and business.”

Rastogi believes that this is also a violation of Article 14 of the Indian Constitution—Right to Equality and Article 19(1)(g) which confers a right to trade. “If the law is making any distinction between businesses that deal in cryptos and those that do not, then there has to be a very solid, strong basis for the differential treatment under the law. Given the grave implication of this circular, which amounts to imminent death of exchanges, the legal reasoning for differential treatment has to be even stronger, which I think is missing,” he says.

Desperate times call for innovation and Indian crypto exchanges can’t be any more desperate than they’re right now.

Bitcoin, the first cryptocurrency, was created in 2009, to remove the need for trusted third parties like central banks. But to go mainstream, it ended up depending on centralised exchanges, which lack security and can be easily censored.

To solve this conundrum, people around the world started to build decentralised exchanges.

Decentralised exchanges like EtherDelta, do not have any administrator to hold the funds of a trader. On these platforms, the funds are held under a smart contract which allows only the user to deposit and withdraw their assets when they want.

These exchanges are more secure as the funds are held in the traders’ own wallet and not the exchange. This provides more privacy to the users as it does not require them to go through a Know Your Customer (KYC) process. Only in the case of a bank transfer are buyer-seller identities revealed, that too to one another, as in the case of Instashift. And since the network is distributed, it is more resistant to censorship attacks.

“Decentralised exchanges are fairly interesting; we’ve been thinking of going down that path for some time now but the technology is not ready yet,” says Edul Patel of Mudrex.

“From a crypto-crypto perspective, decentralised exchanges are the future, once the problems of user experience are solved and more liquidity is there,” he says.

He is right; user experience is a big challenge on these platforms as they only provide a place for the basic exchange of currency and tokens at a fixed value. Features like margin trading, meaning trading with borrowed funds instead of your own, are not yet available on them and will be hard to build. There are also risks of users doing a chargeback—the return of funds to a customer if she raises a dispute—after a purchase as well.

Instead of making every individual their own bank, cryptocurrencies got dependent on banks to reach their audience. And that is why the very existence of Indian crypto exchanges is threatened today.

Having said so, maybe their story isn’t over yet. This verdict is likely to be challenged in court. Besides, alternative ways of survival are already being explored.