Inter-Ministerial Committee report on Virtual Currencies in India

August 20, 2019
***Source**: Monthly Policy Review of PRS*

Background

A high-level Inter-Ministerial Committee was constituted in November 2017 to study the issues related to virtual currencies and propose actions to be taken. The Committee submitted its report in the year 2019. The mandate of the Committee included examining the policy and legal framework for regulation of virtual currencies

What is Virtual currency?

Virtual currency is a digitally tradable form of value, which can be used as a medium of exchange or acts as a store of value or a unit of account. It does not have the status of a legal tender. A legal tender is guaranteed by the central government and all parties are legally bound to accept it as a mode of payment

Cryptocurrency is a specific type of virtual currency, which is decentralised and protected by cryptographic encryption techniques. Decentralisation implies that there is no central authority where records of transactions are maintained. Instead, transaction data is recorded and shared across multiple distributor networks, through independent computers. This technology is known as **Distributed Ledger Technology**

Key observations and recommendations of the Committee include:

- **Issues related to virtual currencies: The Committee**

observed that cryptocurrencies cannot replace traditional currencies due to several **issues associated with them.** These include:

1. Cryptocurrencies are subjected to **market fluctuations.**
2. Cryptocurrencies are **decentralised**, which makes them **difficult to regulate.**
3. Cryptocurrency design have several **vulnerabilities** which leave consumers open to risk of phishing **cyber-attacks** and ponzi schemes. Further, transactions are irreversible, meaning there is **no way to redress wrong transactions.**
4. Cryptocurrencies **require large amount of storage and processing power,** which can have unfavourable consequences on the country’s energy resources; and
5. Cryptocurrencies provide greater anonymity making them more **vulnerable to money-laundering and terrorist funding activities**.

- **Regulatory framework around the world: The Committee observed that different regulatory frameworks are followed in different countries with respect to cryptocurrencies. Countries such as Japan, Switzerland and Thailand allow use of cryptocurrencies as a mode of payment. In Russia, they can be used as a mode of exchange (barter exchange), but not for payments. On the other hand, China has a complete ban on virtual currencies. The Committee observed that no country has allowed the use of any virtual currency as legal tender.**

- **The Committee recommended that all private cryptocurrencies, except any cryptocurrency issued by the State, be banned in India** and any activity connected with cryptocurrencies be **criminalised** through a law.

Further, it recommended that the government may **establish a Standing Committee** to take into account the global and local technological developments in the field and revisit the issues related to virtual currencies, as and when required.

- **Official Digital Currency:** The Committee observed that an official digital currency can have several advantages over the existing payment mechanisms. These include the availability of all records of transactions, cheaper alternative for cross border payments and ease and safety of distribution.
- The Committee **noted that there are several risks and issues associated with its implementation as well**. Significant infrastructure investment would be required to issue a digital currency. Validating transactions in a distributed network would involve high electricity consumption and require high computation power. Further, there could be infrastructural challenges on account of electricity outages and internet connectivity.
- The Committee recommended that an **open mind needs to be kept regarding introduction of an official digital currency in India.** It recommended that, if required, a Committee may be setup by the Ministry of Finance with representatives from RBI and the Ministry of Electronics and Information Technology (MEITY), to examine and develop an appropriate model of digital currency in India. If such a digital currency is issued, RBI should be the regulator.
- **Applications of Distributed Ledger Technology (DLT):** The Committee observed that while cryptocurrencies do not offer any advantage as a currency, the underlying technology (DLT) has several potential applications. DLT makes it easier to identify duplicate transactions, and therefore **can be utilised for fraud-detection, processing KYC requirements,** and claim management for insurance. Further, it can be helpful for removing errors, frauds in land markets, if used for maintaining

land records.

- **The Committee recommended that the Department of Economic Affairs should identify uses of DLT and take measures to facilitate its usage**. Similarly, financial sector regulators should examine the utility of the technology in their respective fields