

"Supreme Court has set aside an RBI ban on banks dealing with virtual currency holders. How do these currencies work, how did the court rule on the RBI concerns, and what happens after the ban is lifted?"

On Wednesday, the Supreme Court set aside a ban by the Reserve Bank of India (RBI) on banks and financial institutions from dealing with virtual currency holders and exchanges.

The court held that the ban did not pass the "proportionality" test. The test of proportionality of any action by the government, the court held, must pass the test of Article 19(1)(g), which states that all citizens of the country will have the right to practise any profession, or carry on any occupation or trade and business.

In a circular in 2018, the RBI had banned banks from dealing with virtual currency exchanges and individual holders on the grounds that these currencies had no underlying fiat and that it was necessary in the larger public interest to stop banks from providing any services related to these.

What are virtual currencies? Are they different from cryptocurrencies?

There is no globally accepted definition of what exactly is virtual currency. Some agencies have called it a method of exchange of value; others have labelled it a goods item, product or commodity. In its judgment on Wednesday, the Supreme Court observed, "Every court which attempted to fix the identity of virtual currencies, merely acted as the 4 blind men in the Anekantavada philosophy of Jainism, who attempt to describe an elephant, but end up describing only one physical feature of the elephant."

Satoshi Nakamoto, widely regarded as the founder of the modern virtual currency bitcoin and the underlying technology called blockchain, defined bitcoins as "a new electronic cash system that's fully peer-to-peer, with no trusted third party". This essentially meant there would be no central regulator for virtual currencies as they would be placed in a globally visible ledger, accessible to all the users of the technology. All users of such virtual currencies would be able to see and keep track of the transactions taking place.

Virtual currency is the larger umbrella term for all forms of non-fiat currency being traded online. Virtual currencies are mostly created, distributed and accepted in local virtual networks. Cryptocurrencies, on the other hand, have an extra layer of security, in the form of encryption algorithms. Cryptographic methods are used to make the currency as well as the network on which they are being traded, secure. Most cryptocurrencies now operate on the blockchain or distributed ledger technology, which allows everyone on the network to keep track of the transactions occurring globally.

Are cryptocurrencies dangerous?

The jury is out on that. Organisations across the globe have called for caution while dealing with virtual currencies, while also warning that a blanket ban of any sort could push the entire system underground, which in turn would mean no regulation.

In June 2013, the RBI had for the first time warned users, holders and traders of virtual currencies about the potential financial, operational, legal and customer protection and security-related risks that they were exposing themselves to. The following year, the Financial Action Task Force came out with a report that highlighted both legitimate uses and potential risks associated with virtual currencies. In a different report, it again said use of such virtual currencies was growing among terror financing groups.

Why did the RBI ban virtual currencies?

Owing to the lack of any underlying fiat, episodes of excessive volatility in their value, and their anonymous nature which goes against global money-laundering rules, the RBI initially flagged its concerns on trade and use of the currency. Risks and concerns about data security and consumer protection on the one hand, and far-reaching potential impact on the effectiveness of monetary policy itself on the other hand, also had the RBI worried about virtual currencies.

In its arguments in the Supreme Court, the RBI said it did not want these virtual currencies spreading like contagion, and had therefore, in the larger public interest, asked banks not to deal with people or exchanges dealing in these non-fiat currencies. The RBI argued that owing to a “significant spurt in the valuation of many virtual currencies and rapid growth in initial coin offerings”, virtual currencies were not safe for use.

What did the petitioners say?

The petitioners, who included virtual currency exchanges operational in the country, told the Supreme Court that the RBI action was outside its purview as the non-fiat currency was not a currency as such. They also argued that the action was too harsh and there had been no studies conducted either by the RBI or by the central government.

Arguing that the ban was solely on “moral grounds”, the petitioners said the RBI should have adopted a wait-and-watch approach, as taken by other regulators such as the Directorate of Enforcement or the Securities and Exchange Board of India.

What did the Supreme Court rule?

In its 180-page judgment on Wednesday, the Supreme Court held that the RBI directive came up short on the five-prong test to check proportionality — direct and immediate impact upon fundamental rights; the larger public interest sought to be ensured; necessity to restrict citizens’ freedom; inherent pernicious nature of the act prohibited or its capacity or tendency to be harmful to the general public; the possibility of achieving the same object by imposing a less drastic restraint.

The court did not agree, however, with any other submission made by the petitioners. The petitioners had submitted that the acceptance of Distributed Ledger Technology, or blockchain, and the rejection of virtual currencies by the RBI as well as the government, is a “contradiction” in terms.

Apart from domestic agencies, the RBI could not be faulted for not adopting a “light-touch” approach as adopted by other countries, the court said, adding that there could be no comparison with other countries such as the US, the UK, Japan, or Singapore as they were developed economies. “Therefore, we will not test the correctness of the measure taken by RBI on the basis of the approach adopted by other countries,” the court said.

What happens now?

The Supreme Court's judgment could lead to the RBI rethinking its policies surrounding virtual currencies. It is expected, said L Viswanathan, partner at Cyril Amarchand Mangaldas, that the RBI will reconsider its approach to cryptocurrency and come up with a new, calibrated framework or regulation that deals with the reality of these technological advancements. Abhishek A Rastogi, Partner at Khaitan & Co, said that the decision will help those investors who had used legitimate money through banking channels.

Other experts said that although the RBI's reasons for prohibition could have been right, it was never going to be successful as operations had predictably gone underground. Salman Waris, founder of TechLegis, said the verdict removes the arbitrariness of regulatory actions without disregarding the power of RBI to regulate. "A reluctance on part of the regulator to regulate cannot be the reason enough to stifle or kill a full industry," Waris said.

Expected Questions (Prelims Exams)

Q. Recently, the Supreme Court has repealed the ban on Bitcoin by RBI. Consider the following statements in context of Bitcoin:

1. Bitcoin has a central regulator that regulates it.
2. Transactions of Bitcoin are peer to peer.
3. Bitcoin is a virtual currency based on the blockchain technology.

Which of the above statements is / are correct?

- (a) 1 and 2 (b) Only 2
(c) 1 and 3 (d) 2 and 3

Note: Answer of Prelims Expected Question given on 04 March., is 1 (c)

Expected Questions (Mains Exams)

"Crypto currency has emerged as the currency of the current digital world, in which India cannot separate itself from its operations." How the Supreme Court's recent decision on crypto currency can change the Indian monetary regulation system? Discuss in reference to the statement given in the question. (250 words)

Note: - The question of the main examination given for practice is designed keeping in mind the upcoming UPSC main examination. Therefore, to get an answer to this question, you can take the help of this source as well as other sources related to this topic.