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<p style="text-align: center;"><b>No. 381</b></p> <p style="text-align: center;"><b>May 2023</b></p>	<p style="text-align: center;"><b>Are Cryptocurrencies An Emerging Threat? Analysing Prevailing Scenario, India's Challenges and Concerns</b></p>

## Abstract

**In recent years, the use of Cryptocurrencies has increased substantially. There are 420 million Cryptocurrency users, of which more than 30 million users are from India. Cryptocurrencies have revolutionised the financial system by removing intermediaries i.e. decentralising the transaction process. Nevertheless, the unprecedented anonymity it provides has made it a potential tool for terror funding and money laundering. The paper discusses the global trends in cryptocurrencies with respect to terror funding and examines the debates and status of cryptocurrencies in India.**

## Key Points

- India has seen a considerable rise in the use of cryptocurrencies for global payments and investments.
- Even though the Government has raised concerns about using cryptocurrencies in money laundering and terror funding, regulating crypto assets is still a matter of consideration. Implementation of common standards is essential for a secure crypto environment.
- Trading on a decentralised exchange with lack of a regulatory oversight, could make it harder to trace terrorist financing.
- It is essential to understand that cryptocurrencies are borderless and require international collaboration to prevent money laundering and terror funding.

## Introduction

The popularisation of internet coupled with technological advancement, led India to follow the goal of digitalisation and heavily digitise its economy in the last decade. By 2025, India will have nearly 1 billion active internet users.<sup>1</sup> This rise is concurrent with the increase in digital transactions. In 2020-2021, India saw 5,554 crores of digital transactions. In 2021-2022, the same increased to 8,840 crores.<sup>2</sup> As India rapidly is adapting to new digital technologies, evaluating possible threats that could emanate from digitisation and digitalisation of the economy is necessary. One such acute threat is money laundering and terror funding through cryptocurrencies. A RAND report titled *Terrorist Use of Cryptocurrencies* (2019) suggests that the commercialised use of cryptocurrencies has the potential to increase the viability of terrorist organisations to facilitate illegal trade.<sup>3</sup>

## What is Cryptocurrency?

Cryptocurrency is a digital asset/credit/unit within the system, which is cryptographically sent from one blockchain network user to another by using digital signatures with asymmetric-key pairs.<sup>4</sup> Satoshi Nakamoto (pseudonym) first developed it. Cryptocurrency attract users because of its ability to make transfers without intermediaries and geographic limitations, finality of settlement, lower transaction costs and ability to verify transactions.<sup>5</sup> Considering these merits, many analysts have argued that cryptocurrencies might soon replace the traditional banking system.

## Facts Related to the Presence of Cryptocurrencies in India

In recent years, India has seen a considerable rise in use of cryptocurrencies for global payments and investments. In fact, India is one of the world's fastest-growing crypto markets. Furthermore, the facts presented in Table 1 infer that CryptoTech, an umbrella term for the world of cryptocurrencies, is an emerging sector of investment in India.

**Table 1: Cryptocurrencies' Presence in India (Till 2022)**

S.No.	Dimension	Figures
1.	Cryptocurrency Users	115 Million (approx) <sup>6</sup>
2.	Crypto Assets	USD 15 billion <sup>7</sup>
3.	Employees in CryptoTech	50,000+ people <sup>8</sup>
4.	CryptoTech Investment	USD 6.6 billion <sup>9</sup>
5.	Crypto Start-Ups	230 (approx) <sup>10</sup>

*Source: Compiled by the Author*

### **Cryptocurrency: A Challenge for National Security?**

Despite the numerous merits of cryptocurrencies and their irrevocable presence worldwide, certain perilous demerits are also associated with their usage. Like any other digital technology, cryptocurrencies are also not 100 per cent secure and are, in fact, breachable.<sup>11</sup> The decentralised structure and transparency of cryptocurrency, with varying oversight and regulations, have also made it an efficient mode for relationship-based transactions, such as *Hawala*, which require fewer intermediaries, lesser time and lower commissions.

Furthermore, the anonymity or pseudonymity built into this technology enables cyber criminals to convert this asset into traditional currency without the fear of being traced. Cryptocurrencies also often see fluctuations, and hence over-dependence on them could drive the country's economy towards destabilisation.

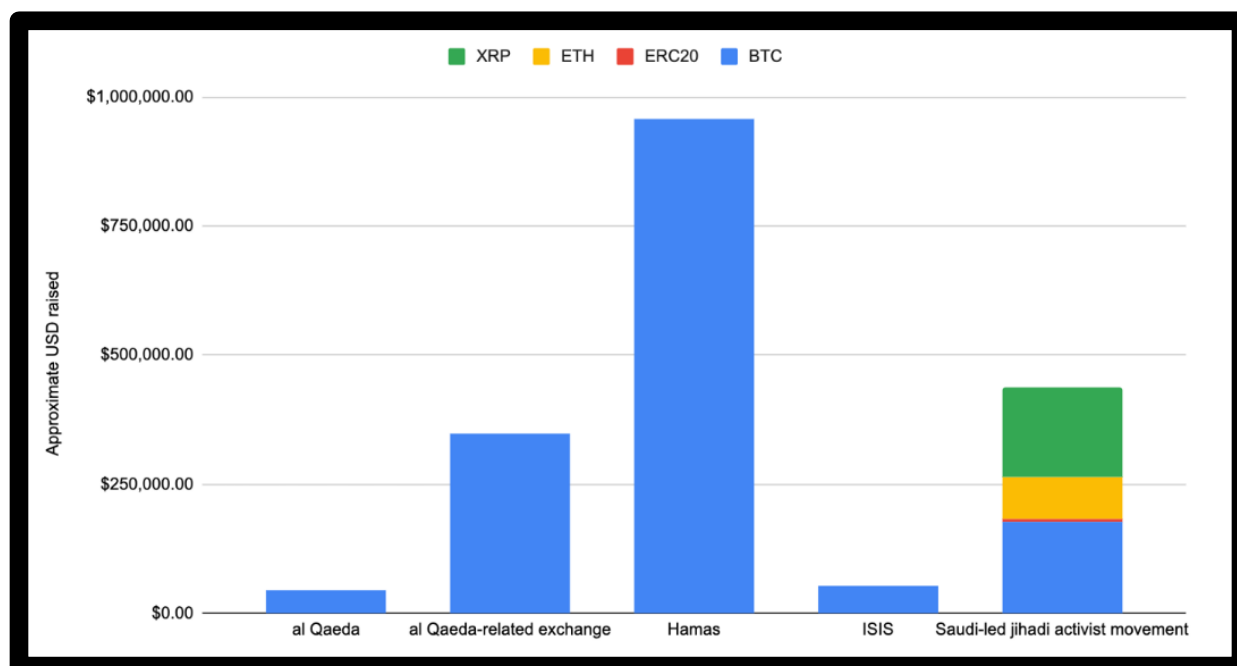
### **Prevailing Scenario: Are Terrorists Using Cryptocurrencies?**

At present, reported transactions associated with terror financing using Cryptocurrency are minuscule. In 2020, reported cases made up less than 0.05%.<sup>12</sup> However, one must take into consideration the RAND findings, which seem to indicate that if trading takes place on a decentralised exchange or in a nation lacking regulatory control, then transactions become difficult to track.<sup>13</sup>

In the last decade, there have been several reported incidents wherein cryptocurrency was misused by terrorist groups——Bitcoin being the most popular crypto (**See Figure 1**). Though the

reported usage were 'extremely low', it did increase in 2021. Amongst the terror groups, Hamas is most prominently involved in using cryptocurrencies.

**Figure 1: Terror Funding through Cryptocurrencies**



Source: Coinbase<sup>14</sup>

Several reported instances occurred in various countries wherein terror groups used cryptocurrencies in the last decade.

- **Reported Incidents of Terror Funding Via Cryptocurrencies**

A leading example of terror financing through Cryptocurrency is the 'Equip Us' online campaign that was organised by the Ibn Taymiyya Media Center (ITMC; the media wing of Mujahideen Shura Council in the Environs of Jerusalem, a jihadist group based in Gaza).<sup>15</sup> The ITMC posted their Bitcoin address on Twitter, Youtube and Telegram. However, the campaign failed as the use of social media platforms made it easy for investigating agencies to track down the ITMC and take necessary measures to foil their plan.

Another example that probably qualifies as the most sophisticated use of cryptocurrency, is its usage by Hamas. In January 2018, Hamas launched a single donation address for

accepting Bitcoin donations. In contrast to the ITMC, they sent direct and private emails to share the Bitcoin address.<sup>16</sup> As Cryptocurrency's address is traceable, Hamas, fearing exposure to the security agencies, went on the defensive and provided the account details only to the prospective donors who contacted them directly through social media. This way, Hamas maintained secrecy on the recipient's account. Apart from getting direct funds in cryptocurrency for terror activities, there have been some reported incidents in the past where ransomware attacks took place in exchange for cryptocurrencies.

- ***Incidents of Ransomware Attacks in the Exchange of Cryptocurrencies***

In 2017, the 'Wannacry' ransomware attacked thousands of computer systems and hacked them until the victims paid hackers a ransom in Bitcoins. <sup>17</sup>Authorities stopped the 'Wannacry' hackers before they could convert the ransom into real money, but the attack resulted in an estimated USD 8 billion loss to hospitals, banks and businesses across the world.

In 2021, the world's second-largest meat processor, JBS, paid USD 11 million in Bitcoin after a cyber attack forced the shutdown of its plants in the US, Canada and Australia.<sup>18</sup>

## **Analysing India's Concerns and Challenges**

In India, the use of cryptocurrencies for terror financing and money laundering although is at a nascent stage, but is emerging as a critical cause of concern for the Government. Both the Finance Minister and the Home Minister have raised their concerns vis-a-vis cryptocurrencies on different platforms. India's Finance Minister further emphasised that money laundering and terror financing are the country's two biggest concerns posed by crypto assets as also the key obstacles to fostering and recognising the innovation they offer.<sup>19</sup> At the 'No Money for Terrorism' Conference in New Delhi, held on 18 November 2022, the Home Minister reflected upon the fact that terrorists are fomenting violence, radicalising youth, and coming up with new means to fund their activities. He further claimed that the number of terrorist organisations exploiting digital assets like cryptocurrency is increasing.<sup>20</sup> In fact, there are two reported cases in India as well. First, in 2020, the National Investigation Agency (NIA) claimed that it had arrested an Islamic State (IS) operative using Bitcoins to fund terrorism.<sup>21</sup> Second, in February 2022, the Delhi Police Special Cell discovered a terrorist financing module using cryptocurrencies linked to *Al-Qassam brigades*, the military wing of the terrorist group Hamas. <sup>22</sup> Moreover, in a written response to a question in Lok Sabha in April 2023, Minister of State for Finance, Pankaj Chaudhary, stated that the Enforcement Directorate (ED) is looking into several cases of

cryptocurrency fraud, in which some digital exchanges have also been discovered that were involved in money laundering.<sup>23</sup>

### **Legal Status of Cryptocurrencies in India**

In India, cryptocurrencies have been under the radar for some time. In 2018, the Government refused to recognise cryptocurrencies as legal tenders. The Reserve Bank of India (RBI) curbed the cryptocurrency trade. However, the Supreme Court revoked it in 2020 due to lack of law no to justify the ban.

As per the RBI, cryptocurrencies are not currencies as they have no issuer, no intrinsic value, and are not considered to be a form of payment for goods or services. They also undermine the integrity of the financial system, such as the Anti- Money Laundering and Counter Terror Funding legislation and the Know Your Customer (KYC) regime. Hence, RBI recommends broad assessment and consideration of all aspects before validating cryptocurrencies.<sup>24</sup>

- ***Cryptocurrency and Regulation of Official Digital Currency Bill (2021)***

In 2021, the Government of India released the details of a draft Bill on the regulation of cryptocurrencies in the public domain. It was inferred that the Bill, if turned into an Act, will prohibit all private cryptocurrencies in India. The Bill will allow cryptocurrencies issued by the RBI, with a view to promote the underlying technology of cryptocurrency and its uses.<sup>25</sup> The RBI has already issued a concept note on Central Bank Digital Currency (CBDC) dated 07 October 2022 and launched pilots of CBDC in both Wholesale and Retail segments, with components based on blockchain technology. It also offers features of trust, safety and settlement finality.<sup>26, 27</sup>

The Finance Minister of India proposed a tax regime for crypto assets in the Union Budget 2022, which included a requirement from investors to mention gains as part of their income while filing for the Income Tax Return, charging 30 per cent tax on gains from crypto assets, deducting 1 per cent tax if the threshold limit is crossed, and not balancing losses against other income. The proposed tax regime can be accepted as the Government's first step to legally recognise cryptocurrencies, which has not given any official clarification. On 19 December 2022, responding to a query on the status of the Bill, the Minister of State for Finance replied that the Bill is under review.<sup>28</sup>

## Critical Challenges for India to Counter Terror Funding and Money Laundering Via Cryptocurrencies

A significant problem in regulating cryptocurrencies is its varying legal status in different countries. On one hand, the feature of anonymity in transactions associated with cryptocurrencies, can lead to a lack of control over illegal trade, thereby raising concern for the governments of different countries. This is the primary reason wherein countries like China, Bangladesh, Egypt, Morocco, Nepal, Iraq, Tunisia and Qatar have banned the use of cryptocurrencies. On the other hand, under the Anti-Money Laundering and Counter-Financing of Terrorism Laws, some countries like the US, Japan, the European Union, the UK and Canada have introduced cryptocurrency regulations. However, each country has its unique version of regulations. Two examples are: (a) In the US, several regulators oversee crypto companies, and there are various federal laws. Moreover, each state can implement its regulations on digital assets. (b) Recently, in April 2023, the European Parliament passed a landmark cryptocurrency legislation called Markets in Crypto Assets (MiCA), to bring transparency to the sector and create a regulatory framework across all 27 European Union countries. According to the legislation, during the 18-month implementation period, operators of stable coins will have to comply with stringent requirements such as producing a white paper that discloses information about the issuer, capital raised, obligations, and technology underlying it.<sup>29</sup>

In India, cryptocurrencies are, at present, neither legal nor banned. However, before banning or legalising or regulating them, it is essential to understand that cryptocurrencies are borderless and requires international collaboration to prevent money laundering and terror funding.

### Way Forward

- ***India must regulate cryptocurrencies as advised by the Financial Action Task Force (FATF).*** FATF has advised its members to regulate cryptocurrencies to narrow the scope of money laundering and terror financing via digital platforms. In October 2021, the FATF released revised guidelines vis-à-vis digital assets,<sup>30</sup> post which, member countries were advised to assess and implement necessary measures to mitigate risks associated with virtual financial activities and subject them to strict vigilance by competent national authorities.
- ***Initiate Detailed Discussions in Parliament and with Experts.*** An outright ban on private cryptocurrencies would not be a prudent way forward. There are many cryptocurrency investors in India. Therefore, the Government should undertake a detailed

discussion on the implications of its actions on investors. The Indian Government should engage and build partnerships with the private sector to gain insights into Cryptocurrency and hasten the process of passing the Cryptocurrency Bill in the Parliament.

- **Advocate International Cooperation.** Regulation, oversight and international cooperation between law enforcement and the intelligence community in cybersecurity domains and cryptocurrency markets would be essential to prevent terrorist organisations from using cryptocurrencies for terror funding. Countries need to implement the FATF's measures. This will ensure transparency of virtual asset transactions and keep funds with links to crime and terrorism out of the crypto sphere.

## Conclusion

Cryptocurrencies have revolutionised the financial system, but their anonymity has made them a potential tool for terror funding and money laundering. To counter these threats, progressive regulations are needed to ensure stability and security of the crypto market. Standardised and collaborative regulations can prevent illegal activities.

India needs to establish the legality of cryptocurrencies before the issue of terrorism funding via the crypto assets materialises into a serious national security problem.

## End Notes

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