Virtual Currency

Virtual currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, Virtual currency does not have legal tender status in any jurisdiction. It is a type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific Virtual community, and it is digital unit of exchange that is not backed by a government-issued legal tender. Virtual currencies can be used entirely within a Virtual economy, or can be used in lieu of a government-issued currency to purchase goods and services in the real economy. A form of unregulated digital money, not issued or guaranteed by a central bank, which can act as means of payment. Virtual currency refers to the unit of exchange used in Virtual worlds. Originally provided to users of Virtual worlds by game creators for use in-game, a robust market has developed for these currencies offline.

Virtual currencies have come in many forms, beginning as currencies within online computer gaming environments and social networks, and developing into means of payment accepted "offline" or in "real life." It is now increasingly possible to use Virtual currencies as a means to pay for goods and services with retailers, restaurants and entertainment venues. These transactions often do not incur any fees or charges, and do not involve a bank. More recently, the Virtual currency "Bitcoin" has set the scene for a new generation of decentralised, peer-to-peer Virtual currencies often also referred to as crypto-currencies. Virtual currencies can be bought at an exchange platform using conventional currency. They are then transferred to a personalised account known as a "digital wallet." Using this wallet, consumers can send Virtual currencies online to anyone else willing to accept them, or convert them back into a conventional fiat currency (such as the Euro, Pound or Dollar).

Linden Lab, the creator of *Second Life*, has been credited with creating the first currency system in a Virtual world. The basis for Second Life's Virtual economy is the "Linden Dollar," or "L$." Users may buy and sell Linden Dollars on the "Lindex" or "Linden Exchange," which Linden Lab operates. As of September 2009, the exchange rate on the Lindex is approximately 270 Linden Dollars for each U.S. Dollar. Users may sell Linden Dollars on the Lindex and cash out the sale proceeds in U.S. Dollars into their PayPal accounts. Linden Lab monitors and manages the Lindex to keep it stable, and has implemented anti-fraud and anti-money laundering measures.

Given this framework for conducting business, "Second Life has been a starting ground for many real-life companies to explore the opportunities for Virtual business and marketing." Many users have even used Second Life to earn money by creating, advertising, and selling Virtual goods such as clothing and accessories as well as by operating entertainment venues and offering scripting and creative services to major businesses and universities. This model has been replicated in many other Virtual worlds to varying degrees.

The possibility of a globally recognized Virtual or digital currency seemed its closest ever in 2013 as Bitcoin, a cryptographically secured monetary unit (or crypto-currency) developed in the wake of the 2008 financial crisis, gained in popularity and value and began to make inroads into mainstream financial transactions.

At its core Virtual currency is decentralized “digital cash” that was designed as both a payment network and a unit of account native to the Internet and are person-to-person deals requiring no bank or money transmitter to facilitate. This means that they are irreversible, are very fast, and have very low or no costs. Unlike the procedure in a cash transaction, however, an individual does not need to be standing next to a person to transfer money. Users install free open-source “wallet” software on their computers or mobile devices, a function that allows them to send and receive the currency to and from anyone else connected to the Internet.

As a form of money, Virtual currency is a new concept. Governments around the world in 2013 began to seriously examine the technology to discern how best to regulate it, or not, and whether transactions using digital currency could be taxed. This kind of regulation is made especially difficult because they are not

operated by any company or residing in any physical location. As a result, the users can be affected by government decisions and actions, but the protocol itself cannot. In this way they represent nonpolitical competition for government-issued hard currency in a way never before seen. This could lead to a reinvention of how social programs are funded or to attempts by government entities to ban that competition in order to better protect the value of national currencies.

The Reserve Bank of India has cautioned the users and has notified various risk factors to the holders and traders of Virtual currencies (VCs), including Bitcoins, about the potential financial, operational, legal, customer protection and security related risks that they are exposing themselves to.

The Reserve Bank has mentioned that it has been looking at the developments relating to certain electronic records claimed to be "Decentralised Digital Currency" or "Virtual Currency" (VCs), such as, Bitcoins, litecoins, bbqcoins, dogecoins etc., their usage or trading in the country and the various media reports in this regard.

The creation, trading or usage of VCs including Bitcoins, as a medium for payment are not authorised by any central bank or monetary authority. No regulatory approvals, registration or authorisation is stated to have been obtained by the entities concerned for carrying on such activities. As such, they may pose several risks to their users.

- VCs being in digital form are stored in digital/electronic media that are called electronic wallets. Therefore, they are prone to losses arising out of hacking, loss of password, compromise of access credentials, malware attack etc. Since they are not created by or traded through any authorised central registry or agency, the loss of the e-wallet could result in the permanent loss of the VCs held in them.

- Payments by VCs, such as Bitcoins, take place on a peer-to-peer basis without an authorised central agency which regulates such payments. As such, there is no established framework for recourse to customer problems / disputes / charge backs etc.

- There is no underlying or backing of any asset for VCs. As such, their value seems to be a matter of speculation. Huge volatility in the value of VCs has been noticed in the recent past. Thus, the users are exposed to potential losses on account of such volatility in value.

- It is reported that VCs, such as Bitcoins, are being traded on exchange platforms set up in various jurisdictions whose legal status is also unclear. Hence, the traders of VCs on such platforms are exposed to legal as well as financial risks.

- There have been several media reports of the usage of VCs, including Bitcoins, for illicit and illegal activities in several jurisdictions. The absence of information of counterparties in such peer-to-peer anonymous/ pseudonymous systems could subject the users to unintentional breaches of Anti-Money Laundering and Combating The Financing of Terrorism (AML/CFT) laws.

The Reserve Bank has also stated that it is presently examining the issues associated with the usage, holding and trading of VCs under the extant legal and regulatory framework of the country, including Foreign Exchange and Payment Systems laws and regulations.

(Input from various agencies)