

LEGAL IMPLICATIONS OF CBDC ISSUED BY RBI

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ABSTRACT

Transaction of money drives the society. Changing forms of money has effects not only on financial state but also social-economic-political stability of nation. The implementation of regulated virtual currency (e.g. CBDC) is faster than the transition from fiat currency to unregulated virtual currency (e.g. cryptocurrency). This rapidity cajoles the process to be more vigilant. The concept of Central bank digital currency and its legal implications in India are analysed in this paper to understand the efficiency of this new form of currency and thus to bring insights on necessary changes.

INTRODUCTION

Money is a part of human life since BC 3000¹. But a currency which is now an synonym to money in common parlance has not much history. The world's first known minting mill is located at Henan in China which minted coins around BC 640. The first coins were minted in BC 770 and currencies were printed in BC 700. First official currency was printed by Lydia's king Alayttes in BC 600 named Lydian stater, before which bartering was the mode of transaction of values², like, giving three unit of wheat for half one unit of salt. During CE 1260 China moved to paper currency³. These changes reflected all over in Asia. But till 16th century Europeans continued use of coins as their sole form of money. Gradually bank notes were issued by banks and private institutions for deposits and borrowings, which were interchangeable to gold or silver coins. It was the beginning of modern currency⁴. The tangible money was used to be interchanged with intangible money in past centuries. But in 21st century new forms of money was introduced and are also intangible. Mobile payments which rendering money for goods or services through mobile phones or tablet devices (example google pay, apple pay...) and virtual currencies (example Bitcoin) which have not

¹Glyn Davies, "A History of Money," 2 University of Wales Press Cardiff (2016).

²A. Mitchell Innes, "Credit and State Theories of Money," 2 Edward Elgar Publishing Limited, (2004).

³Hans Ulrich Vogel, "Marco Polo Was in China: New Evidence from Currencies, Salts and Revenues," BRILL, 24 (2012).

⁴Charlemagne and the Carolingian coinages, available at: <https://www.britannica.com/topic/coin/Charlemagne-and-the-Carolingian-coinages> (last visited on December 29, 2022).

physical coinage are new forms of money. Bitcoin was introduced in 2009. Virtual currencies are more users friendly. But most of them (unregulated virtual currencies) have no backing as currencies issued by central banks. So Bahamas has introduced regulated virtual currency namely, Central bank digital currency in 2020 and many other countries including India is stepping to develop own Central Bank Digital Currency (CBDC). India has launched pilot experiments on CBDC. The major difference between Bitcoin like virtual currency and CBDC is the legality. How much CBDC provides legal protection to consumers is imperative, as of now.

RESEARCH OBJECTIVE

- To understand the legal implications Central Bank Digital Currency recently launched by Reserve Bank of India
- To suggest effective measures to the way forward of Central Bank Digital Currency.

CENTRAL BANK DIGITAL CURRENCY

Concept of Money and Legal Tender

Money is not defined by statutes. The Supreme court of Canada defines money as “any medium, which, by practice, fulfils the function of money which everyone will accept in payment of a debt is money in the ordinary sense of the words, even though it may not be legal tender”. Money is described in *Moss V. Hancock* as “that which passes freely from hand to hand throughout the community in final discharge of debts and full payment for commodity, being accepted equally without reference to the character or credit of the person who offers it and without the intention of the person who receives it to consume it or apply it to any other use than in turn to tender it to others in discharge of debts or payment for commodity”. Thus money has three major functions; medium of exchange store of value standard for payments Money may or may not be a legal tender. Commonly money is considered as legal tender, but during wars grains or any other movable or immovable commodities were also counted as money⁵. But in modern economy legal tender refers to “money that a creditor is not privileged to reject if it is tendered by a debtor to repay its debt,

⁵Nussbaum, *Money in the Law National and International: A Comparative Study in the Borderline of Law and Economics*, 45, available at: <https://archive.org/details/money9000nussbaumenlawofmoneynationalandinternationalred/mode/1up> (last visited on December 29, 2022).

whereby this obligation on the creditor can be created only by law”⁶. It is evident that tangible currency or coin is here referred as money.

Concept of CBDC

The physical cash and central bank reserve/settlement account are the two form of money in a country. Central Bank Digital Currency or CBDC is a new variant of money⁷. CBDC refers to different concepts of Digital currency issue by Central Banks⁸. The design and concept of CBDCs are changing according to the developments in technology. Now different countries have their own CBDC the core concept of those are same but their understandings are different. According to the Bank of England, CBDC is money issued by the central bank in digital or electronic form (not in traditional banknotes and coins) stored on a computer or similar device⁹. The United States Federal Reserve defines CBDC as digital form of central bank money that is widely available to the public, bearing digital liability to central banks¹⁰. People’s Bank of China (PBOC) defines its digital fiat currency or e-CNY as a digital version of fiat currency circulated by PBOC that is operated by authorized stakeholders¹¹. E-CNY covers a value-based, quasi account based and account-based hybrid payment instrument with the status as legal tender and loosely-coupled account linkage¹². CBDC is a liability of central bank, not that of commercial banks. It is medium of exchange and store of value. According to Reserve Bank of India CBDC is "the legal tender issued by a central bank in a digital form. It is the same as a sovereign currency and is exchangeable one-to-one at par (1:1) with the fiat currency”¹³.

⁶*Ibid.*

⁷Concept Note on Central Bank Digital Currency available at: <https://m.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1218#:~:text=The%20report%20by%20the%20CPMI,and%20a%20store%20of%20value> (last visited on December 29, 2022).

⁸ Bank for International Settlements Central Bank Digital Currencies available at: <https://www.bis.org/cpmi/publ/d174.pdf> (last visited on December 29, 2022).

⁹UK central bank digital currency available at: <https://www.bankofengland.co.uk/research/digital-currencies> (last visited on December 29, 2022).

¹⁰Board of the Governors of the Federal Reserve System available at: <https://www.federalreserve.gov/> (last visited on December 29, 2022).

¹¹Fransiska Ari Indrawati”Central Bank Digital Currency Under The State Theory Of Money: A Preliminary Legal Analysis” 1 *Journal of Central Banking Law and Institutions* 375 (2022).

¹²*Ibid.*

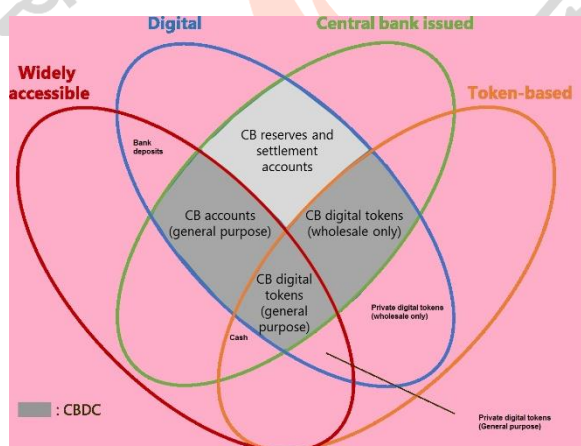
¹³*Supra* note 7.

Design of CBDC

‘Money Flower’ is one of the design concept accepted by different scholars and also included in the concept not of Reserve Bank of India. It was introduced by Bech and Garratt in 2017¹⁴. While combining the taxonomies of virtual currency of central banks and cryptocurrency CBDC has four fundamental elements.

Fundamental elements of CBDC are;

1. Universal accessibility
2. Electronic format
3. Central bank of country is the issuer
4. Exchange mechanism on peer-to-peer



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The core principles given by Kumhof and Noone clarify the design of CBDC¹⁶. The core principles are; the interest rate is adjustable, CBDC cannot be converted to reserve money and reserve money cannot be converted to CBDC, bank deposits may be converted to CBDC (not guaranteed), and CBDC issues against eligible securities. CBDC are of two types based on purpose;

1. Wholesale CBDC:

W-CBDCs are accessible to particular entities only. It is limited to financial institutions and markets.

¹⁴ Bech and Garratt- Central Bank Cryptocurrencies available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3041906 (last visited on December 29, 2022).

¹⁵ *Supra* note 7.

¹⁶ Michael Kumhof and Clare Noone - Central Bank Digital Currencies – Design Principles and Balance Sheet Implications, Bank of England – Staff Working Paper, no. 725, available at: <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/central-bank-digital-currencies-design-principles-and-balance-sheet-implications> (last visited on December 29, 2022).

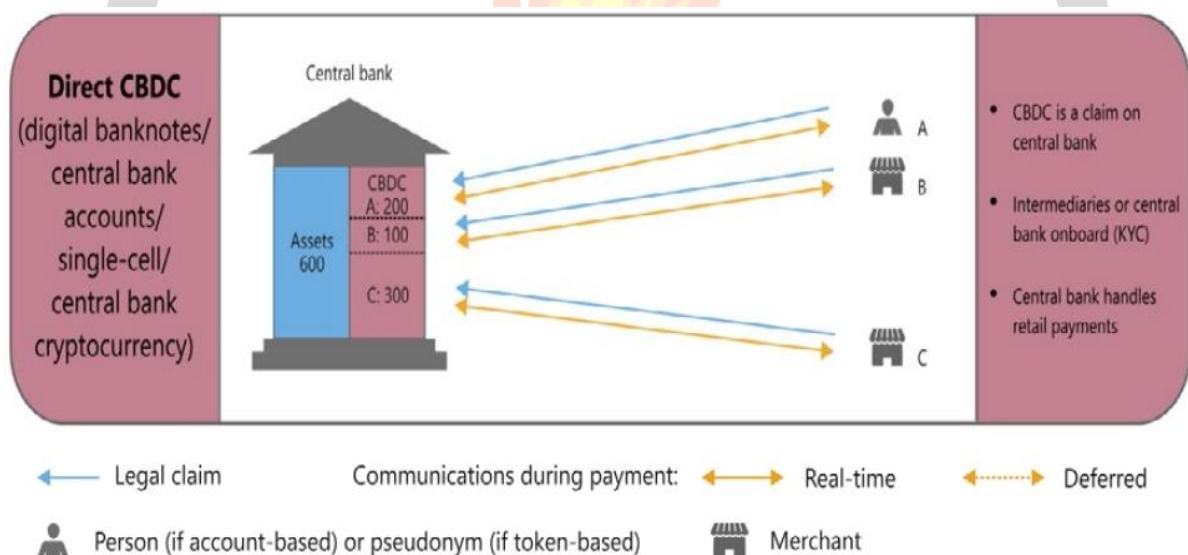
2. Retail CBDC:

r-CBDCs are accessible to everyone. They are of two designs; digital currency tokens and deposit accounts with central bank.

Although different technologies are used by different countries, block chain technology is more accepted. But whole features of block chain technology are not applicable in CBDC. Issuance and management of CBDC across the world can be classified into three models, namely,

A. Single Tier Model or Direct CBDC model:

Central bank is the issuer of and liable for money. Central bank operates retail ledger. The system is very resilient because all information are available to central bank and thus verification is readily possible. But private sector involvements are marginalized.¹⁷



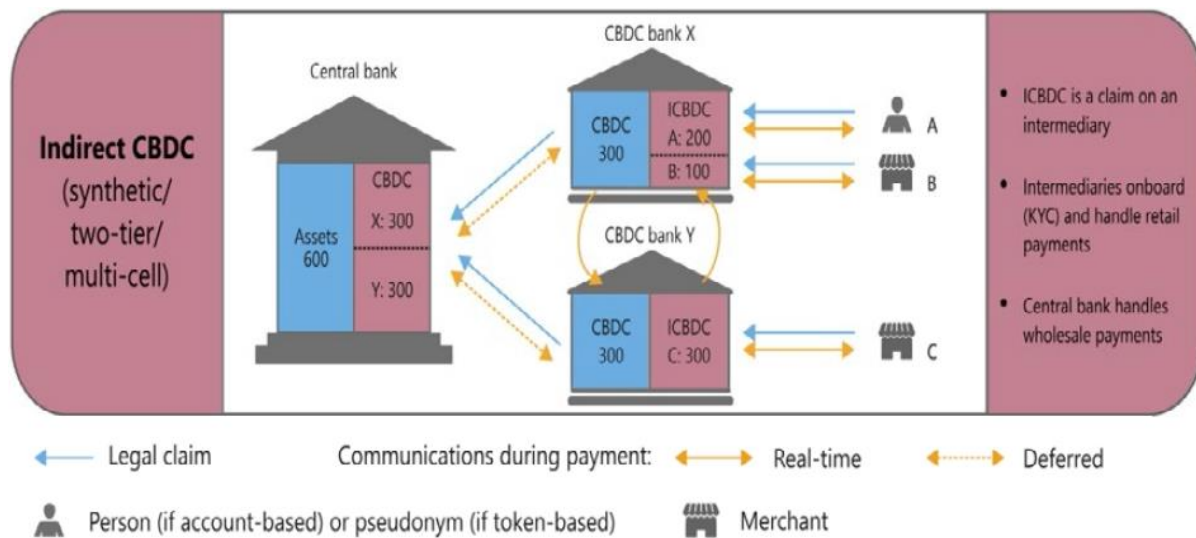
B. Two Tier Model or Intermediate model:

Central bank as well as other service providers plays significant roles in intermediate model.

a) Indirect model:

¹⁷Supra note 7.

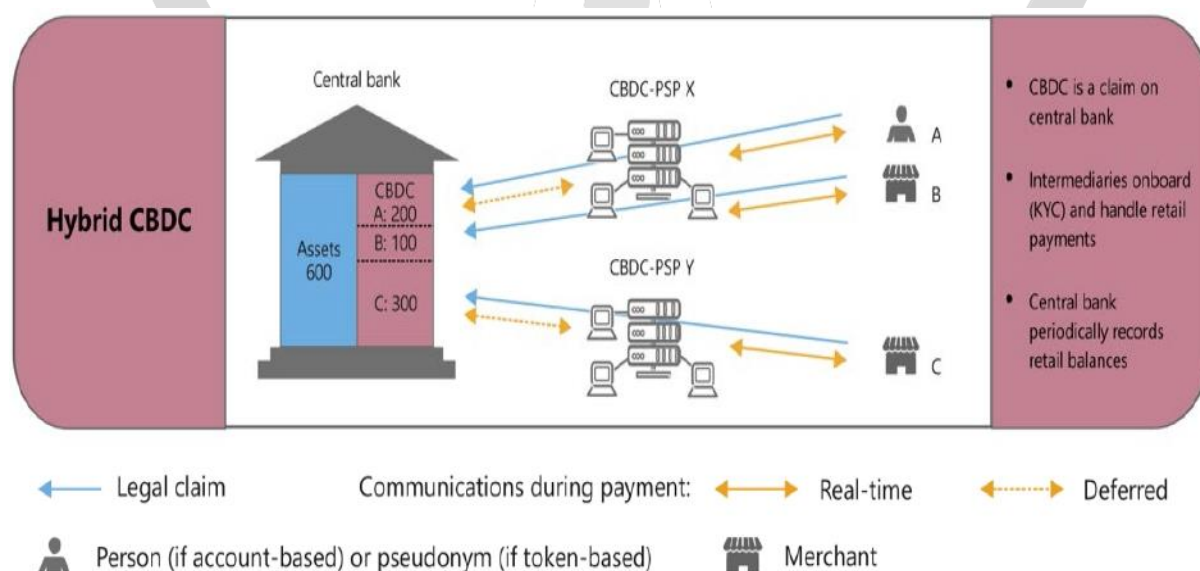
CBDC of consumers are kept with account or wallet of bank or any other service providers. Central bank issues w-CBDC and intermediaries distributes r-CBDC. Intermediaries holds



ledger.¹⁸

b) Hybrid model:

CBDC of consumers are kept with account or wallet of bank or any other service providers. Central bank issues w-CBDC and intermediaries distributes r-CBDC. Intermediaries as well as central bank hold ledger.¹⁹



¹⁸Supra note 7.

¹⁹Supra note 7.

Current Status

Majority of the central banks, about 86% across the world are researching on CBDC. Out of which 60% of Central banks are experimenting²⁰. The countries including Nigeria, Bahamas and Jamaica have launched CBDC with e-Naira, sand dollar or digital Bahamas dollar and Jam-Dex respectively²¹.

Reserve Bank of India has launched Central Bank Digital Currency pilot project on December 1st, 2022.²² Account based w-CBDC and token based r-CBDC is exploring by India and follows two-tier indirect model.

LEGAL IMPLICATIONS OF CBDC

Change in Central Bank Law

As of now CBDC of India lacks legal certainty. This legal uncertainty will certainly lead to risks in finance and reputation of whole banking system. Though the acts which regulating money are enacted pre-digital era it is necessary to make changes in legal frame work according to the needs of digital world. The foremost legal implication required by RBI on CBDC is the power to issue digital form of fiat currency. This power depends on technological design of CBDC as well as operational design features. Account based CBDC and token based CBDC have different legal implications. Account based CBDC are not considered as new form of money. They resemble account form of money already exist. They are digital form of book money and are credit balance on account. But token based CBDC is considered as new form of money. The token incorporate the liability of central bank. Central bank of a country has power to issue money. Some central banks have narrow remit to issue money in the form of banknotes and coins only, whereas some central banks have wider power to issue money not only in banknotes and coins but also in the form of book money and bills. This general power is required to issue digital money or CBDC based on tokens. If the central bank can issue money only in bank notes and coins, they are not even empowered to issue token based CBDC. To issue account based CBDC some amendments on acts which regulate issuance of money are required. Generally accounts in Central bank can be held by

²⁰Supra note 11.

²¹ Sand Dollar, available at: <https://www.sanddollar.bs/>
eNaira, available at: <https://www.enaira.gov.ng/>, and Bank of Jamaica, "Jamaica's Central Bank Digital Currency (CBDC) – JAM DEX, available at: <https://boj.org.jm/corefunctions/currency/cbdc/> (last visited on December 29, 2022).

²² Central Bank Digital Currency (CBDC) pilot launched by RBI in retail segment has components based on blockchain technology, available at: [https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1882883#:~:text=The%20Minister%20stated%20in%20response,the%20paper%20currency%20and%20coins.\(last](https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1882883#:~:text=The%20Minister%20stated%20in%20response,the%20paper%20currency%20and%20coins.(last) visited on December 29, 2022).

some certain entities only. Account based CBDC is possible only with opening of accounts by public in Central bank.

In India, Reserve Bank of India is the authority of issue of money. It is regulated by Reserve Bank of India Act of 1934. Various provisions of the act such as section 24 about denomination, section 25 about form of banknote and section 26(1) about legal tender status are providing statutory powers to Reserve bank of India. The power to issue CBDC is provided by the Finance act of 2022 through which Reserve Bank of India act of 1934 was amended. This amendment added digital form of bank note also to the meaning of 'bank note'. So Section 22 of Reserve Bank of India act, 1934 makes the RBI the authority to issue digital bank note. And Section 22 A is inserted to make some provisions applicable for physical bank note but not applicable to digital bank note. As the amendments of Reserve bank of India act shall replicate in legislation, separate amendment to criminal law protection from counterfeits, legal tender status such monetary law are not necessary.

Consumer Protection and Grievance Handling

CBDC is a digital currency. This digital nature provides positive results such as more access to and availability of choices of services and products with much speed and convenience at low cost. At the same time digital nature of CBDC may also increase chances of digital fraud, data breaches, lack of privacy and digital security risk incidents. The consumers of CBDC are at higher risk. So, the consumer protection is very much alarming. Major risks of CBDC consumers are; privacy risk: CBDC can provide privacy only to an extent. Digital nature of CBDC makes anonymity imperative. Security and technology risks: Security risks of consumers are depends on the using technology audits implementation. CBDC has more complex technology and it may be beyond the knowledge of common consumers. As the technology can indirectly affect consumer risk it is necessary to neutralize with appropriate standards of audit and technology. Accountability Risk: In case of losses in CBDC transactions that are accountable to consumer is primary question as of now. Increase in rate of digital literacy of consumer can resist cyber attacks and maintain security. Deficiency in intermediary services and disruption in technical support are the main expecting problems.

SUGGESTIONS

1. As CBDC is a tool for cross-border payment, balanced standard for interoperability, data protection, localisation, dispute resolution and settlement finality are to be considered.

2. Subjectivity of CBDC to Foreign Exchange Management Act of 1999 might be considered. “Banks and any other service providers” will be participated in CBDC according to RBI concept notes. But ‘service Providers’ are not defined. It is imperative whether the entities which are already regulated by Reserve bank of India or new entities or both are service providers. As per the answer CBDC may be subjected to Banking Regulation Act of 1949 and Payment and Settlement Systems Act of 2007.
3. To technical services or any other services new players should be entertained only with clear legal framework. For example, in Nigeria merchants should provide e-Naira as one of the options of transitions in businesses in the country.
4. CBDC intermediaries should be regulated with adequate legal framework focuses on eligibility, licensing, cost, fee, norms, specifications of wallet, privacy and security, dispute resolution, governance of data and risk management policies.
5. As the intermediaries are accessed to information of consumers to great extent feasibilities of IT Act, 2000 & the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 should be considered.
6. Applicability of Prevention of Money Laundering Act of 2002 and Know-Your-Customer (KYC) framework are immense.
7. RBI should be empowered to take actions against intermediaries to ensure security of CBDC²³.

CONCLUSION

21st century shows unprecedented changes regarding forms of money. As the unregulated digital currencies like Bitcoins and Ethereum attracts the world because they are beyond the authority of state and utmost privacy is provided to customers. But CBDCs were introduced with the backing of central bank to provide legal protection in addition to cost-effective transaction. India's CBDC pilot launch is a result of research on successful CBDCs of many other countries. But there are gaps among the designs of different CBDC. So it is important to understand the legal implications of the same according to design of CBDC in our country. Consideration of above mentioned suggestions shall make the legal framework regarding CBDC of India more effective and efficient to the financial stability of country as well as consumer security.

²³Examining the Policy and Legal Consideration of a Digital Rupee, *available at:* <https://vidhilegalpolicy.in/blog/examining-the-policy-and-legal-consideration-of-a-digital-rupee/> (last visited on December 29, 2022).