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Crypto transfers to private wallets to now face identification checks

By Sugata Ghosh, ET Bureau   Last Updated: May 31, 2023, 12:19 AM IST

Synopsis
Crypto exchanges in India are planning to introduce a rule that will only allow a transfer of cryptocurrencies after the sender discloses the identity of the persons behind the private wallet receiving the cryptos. While there is a standard procedure to get to know the identity of buyers and sellers as part of the know-your-customer process, there is no way to know the identity of a private wallet owner. Transfers to private or unknown wallets have been a problem in the crypto ecosystem, leading to the new proposal to track transfers to private wallets and enhance security.

The no-questions-asked regime used by money launderers to freely move cryptocurrencies to 'private wallets' is about to end.

India's crypto exchanges are working on a rule under which platforms will allow a transfer only after the sender discloses the identity of the persons behind a private wallet which receives the cryptos.

In crypto trades the identities of buyers and sellers are typically known as long as they are clients of local exchanges which collect identification documents as part of the standard know-your-customer process.

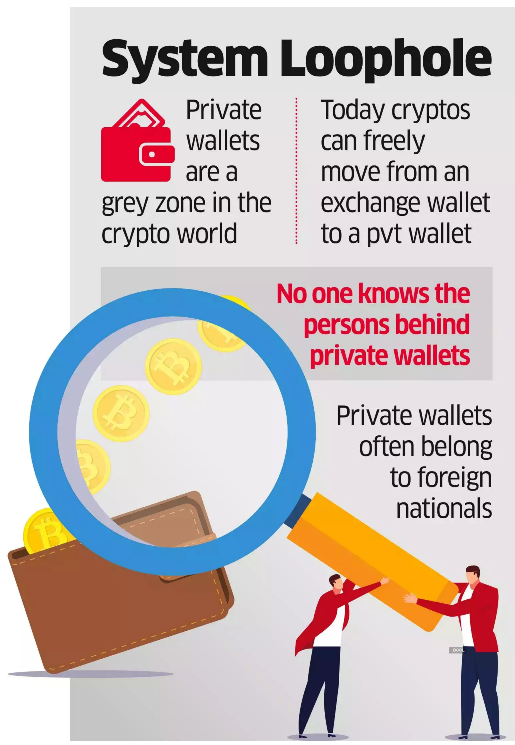
But there is neither a procedure to know the identity of a private wallet owner nor is there a regulation that restrains a person from shifting cryptos held in the wallet of an exchange in India to the private wallet of someone else who could well be a foreign national. This is likely to change to a great extent when the details of the recipient have to be revealed.

"What kind of ID, how would these be provided, and what could exchanges do to check the authenticity of the ID information are under discussion," a senior official of a large platform told ET.

Since the person who sends the cryptos would in all likelihood either know the details of the recipient or is in a position to obtain them, the proposed rule, even if a little onerous, could lend a degree of immunity to the platforms.

According to Jaideep Reddy, counsel, Trilegal, "Currently, platforms are the focus of investigation where users carry out suspicious withdrawals to external 'unhosted' wallet addresses. This also leads to their bank accounts being frozen, resulting in collateral damage to the platform and its other users." "Having clear guidelines for withdrawals to unhosted wallet addresses is in line with the approach in the Financial Intelligence Unit (FIU) guidelines to carry out enhanced due diligence for such transactions," he said.

Cyptos lying in the wallet of an exchange can move to the wallet of another domestic exchange, or to the private wallet of the holder, or to the private wallet of another person, or to the wallet of an overseas exchange. The last two kinds of transfers are tagged as 'high-risk' transactions. As part of generating 'suspicious transaction reports' (STR), with the platforms becoming 'reporting entities' under the Prevention of Money laundering Act (PMLA), certain parameters will be decided for the STRs. These could be the customer profile, value of the transaction, frequency etc.



Transfers to private wallets or unknown wallets have been a weak link in the crypto ecosystem. It came to the fore amid suspicion by law enforcement agencies that proceeds of crime from usurious lending on the back Chinese loan apps crossed borders in the form of cryptocurrencies. Bypassing banks, the money made through sharp practices and often illegal activities were transferred out of the country by using the proceeds to buy cryptos and then transferring the coins to private wallets of faceless, foreign entities. The proposed rule to track transfers to private wallets has assumed significance in this context.

"Such measures if it brings clarity in running the operations of the exchange will be good for the industry. The key is that the measures should not be too onerous or impossible to implement considering the technology involved in carrying out crypto trades," said Vyapak Desai, who heads international disputes practice at the law firm **Nishith Desai Associates**.

Some feel while the regulation under consideration may reduce risks it would not be fool-proof as linking a wallet address to the owner whose ID is furnished could remain a challenge.

There are other loose ends: the government, legal experts, and platforms are yet to arrive at an unambiguous stand on whether cross-border transfer of cryptos is a violation of the **Foreign Exchange Management Act** (FEMA).

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