

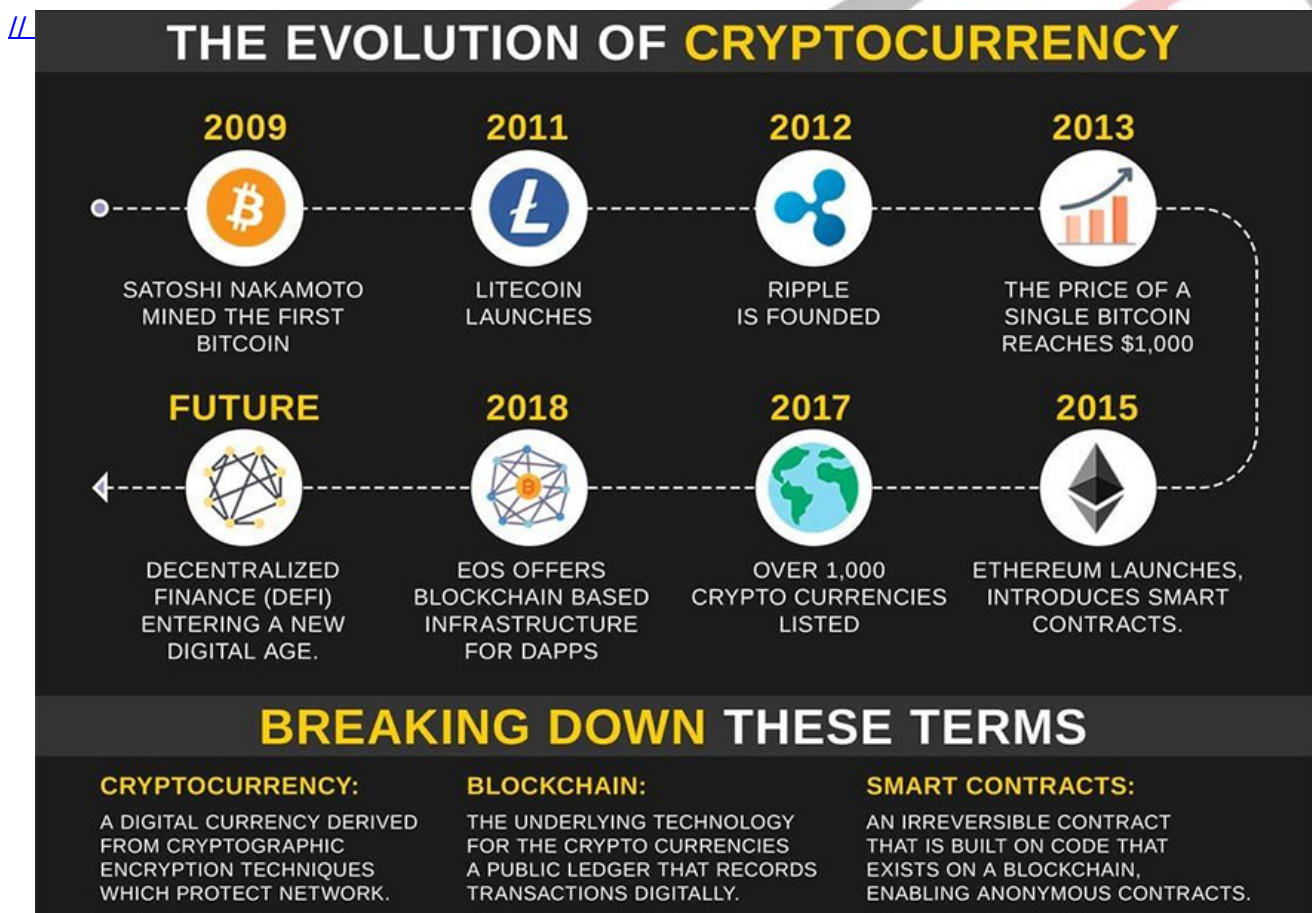


# Crypto Finance

## Why in News

The development of [Bitcoin](#) and other [Cryptocurrencies](#) in a decade has changed the definition of money and generated a parallel universe of **Alternative Financial Services (AFS)**.

- The development has allowed **crypto businesses to move into traditional banking territory**.
- AFS is a term often used to describe the array of **financial services offered by providers that operate outside** of federally insured banks and thrifts.



## Key Points

- **Alternative Services Offered by Crypto:**
  - **About:** Most notably, **lending** and **borrowing**.
  - **Advantages over Banks:** Investors can **earn interest on their holdings of digital currencies** - often a lot more than they could on cash deposits in a bank - **or borrow with crypto as collateral** to back a loan.

- **Reason:** By law, **banks are required to have reserves** to ensure that even if some loans go bad, customers can still withdraw funds, whereas **crypto banks do not have the same reserve** requirements and the institutions they lend to can take risky activities.
  - **Risks:** Deposits are **not guaranteed** by the central bank's backed **Deposit Insurance Corp.** Cyberattacks, extreme market conditions, or other operational or technical difficulties could lead to a temporary or permanent halt on withdrawals or transfers.
- **Stablecoin:**
  - They are **cryptocurrencies pegged to stable assets**, commonly the dollar. They are meant **to provide the steady value of government-issued money** in digital form for blockchain transactions, but they are **issued by private entities**.
    - Crypto is very volatile, making it less practical for transactions like payments or loans. **That's where stablecoins come in.**
  - Stablecoin issuers are supposed to hold and monitor reserves as government institutions do. But there is **no guarantee they actually hold the one-to-one dollar backing they claim.**
- **Central Bank Digital Currency:**
  - It is the virtual format of a **fiat currency** (issued by the government and regulated by a central authority such as a central bank) for a particular nation or region.
  - Central bankers are examining the **potential for issuance of a government-issued cryptocurrency.** That would theoretically offer the convenience of crypto with the reliability of money controlled by a central bank.
  - Many countries, including the **US and India, are considering developing a central bank digital currency.**
- **Decentralized Finance:**
  - Decentralized finance, or DeFi, loosely describes an **alternative finance ecosystem where consumers transfer, trade, borrow and lend cryptocurrency**, theoretically independently of traditional financial institutions and the regulatory structures.
  - The DeFi movement aims to **"disintermediate" finance**, using computer code to **eliminate the need for trust and middlemen** from transactions.
  - DeFi platforms are **structured to become independent from their developers and backers over time** and to ultimately be governed by a community of users.
- **Benefits of Crypto Finance:**
  - **Financial Inclusion:**
    - Innovators argue that crypto fosters financial inclusion. Consumers can earn unusually high returns on their holdings, unlike at banks.
  - **Quick and Cheap Transactions:**
    - Crypto finance gives people **long excluded by traditional institutions the opportunity to engage in transactions quickly, cheaply** and without judgment.
    - As crypto **backs their loans, the services generally require no credit checks**, although some take customer identity information for tax reporting and anti-fraud purposes.
    - On a DeFi protocol, **users' personal identities are generally not shared**, since they are judged solely by the value of their crypto.

## Way Forward

- New technology demands a new approach; **novel risks can be addressed without necessarily restricting innovation.**

- For example, instead of mandating that DeFi protocols **maintain the reserves of a bank and collect customer information, officials might create new kinds of requirements** devised for the technology and products, like code audits and risk parameters.
- Questions of identity, which are crucial to **fighting financial fraud, need to be addressed.** Instead of starting with specifics — collecting the identity of individuals — law enforcers could take the broad view.
- Using [artificial intelligence](#) and data analysis to monitor suspicious activity and working back to track identity.

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