

The GLOCEPS

— Daily Influential Brief —

Research and Analysis in Development Pillar

Cryptocurrency and the urgent need for financial policy regulation in Kenya

Michael Owuor

As the Central Bank and Capital Markets Authority adjust to the reality of escalating use of cryptocurrencies in Kenya, concerns abound on the present state of appropriate regulations on the same. Our Research Fellow for Development, Michael Owuor, explores the urgent need for policy regulations in tandem with global and regional trends.

Dr. K.O. Asembo, Editor-in-Chief



Photo credit: CoinGeek

Introduction

The rising popularity of cryptocurrencies in the global financial architecture has drawn the attention of financial regulators. Though the advent of digital currencies has been marked by divergence of opinions among policymakers and financial experts, there is a growing convergence that the colossal nature of cryptocurrency operations and transactions will highly affect the economy and related undertakings. It is estimated that digital currency ownership in Kenya is valued at 5% of the 2021/22 national budget or 50% of the Standard Gauge Railway (SGR) project. Likewise,

nation-states like El Salvador and Japan have accepted digital currencies either as legal tender or legal means of payment. This trend marks the increasing appreciation and recognition of digital currencies and regulation among major economies like the United States and the European Union. Domestic regulators and those in sub-Saharan Africa cannot afford to remain ambivalent as the associated benefits or risks affect their economy regardless of their actions. This paper explores the dynamics of cryptocurrencies and the need for policy regulation.





The context

A growing concern about the vast holdings and transactions undertaken in digital currencies prompted a response by Kenya's financial regulatory authority. In December 2015, the Central Bank of Kenya issued a public warning on digital currencies. The caution was premised on three key points. First, transactions in cryptocurrencies are largely untraceable, anonymous and prone to money laundering and terrorism financing. Secondly, cryptocurrencies trading platforms are largely unregulated, and lastly, virtual currencies are speculative in nature, exposing users to losses.

Despite the warning points around the burgeoning technology, its popularity and usage has continued unabated. By 2016, digital currency

holdings by Kenyans was estimated at KES 163 billion, equivalent to 2.3% of annual GDP. Daily cryptocurrency transactions are valued at \$1.5 million, with more service points and individuals making and receiving payments. Dedicated automated teller machines and third party-enabled cryptocurrency payment platforms like Paypal are emerging as popular options for cryptocurrency users to purchase, transfer, convert and withdraw them as cash. These realities threaten the undertaking of regulatory obligation such as the collection of tax revenues by the exchequer. Against the backdrop of improved adoption, the recognition and regulation of cryptocurrencies is fundamental to the nation's economic health and security.



Photo credit: CodeAddis.com

Central Bank of Kenya Governor, Dr. Patrick Njoroge





Global and local dynamics of cryptocurrencies

The formal advent of cryptocurrencies in 2009 was greeted with universal skepticism. Most economies viewed it as an incipient threat. India, South Korea and China either banned or ordered a crackdown on the trading of digital currencies. The United Kingdom expressed concerns on its vulnerability to criminal activities. The United States signaled the need for greater regulatory scrutiny. Similarly, social media firms like Facebook banned cryptocurrency adverts on their platforms.

Resonant of Kenya, her positions were informed by the current legal and regulatory frameworks on legal tenders and financial securities. Digital currencies failed to meet the classification of

being regarded as legal tender because they placed no obligation for creditors to accept them for repayment of debt. Additionally, they are not issued by a national body.

However, due to an emerging trust-based system among its users, digital currencies have circumvented some of the constraints. This has allowed the rising communities of digital currency to employ them as a trading currency and investable assets. Moreover, their volatility has proved as premium attraction to speculators who have grown their accumulated holdings of digital currencies. As illustrated below in Figure 1, Kenyans are ranked among the popular holders and users of digital currency.

	Nationality	Holders of digital currency	Holders as a percentage of national populations
1.	Ukraine	5,565,881	12.73%
2.	Russia	17,379,175	11.91%
3.	Venezuela	2,941,502	10.34%
4.	Kenya	4,580,760	8.52%
5.	USA	27,491,810	8.31%
6.	South Africa	4,215,944	7.11%
7.	Nigeria	13,016,341	6.31%
8.	Colombia	3,122,449	6.14%
9.	Vietnam	5,961,684	6.12%
10.	Thailand	3,629,713	5.20%





The ease in the adoption of digital currency by the Kenyan populace can be attributed to their risk-taking nature and prevalence of financial technologies (FinTech). The Kenyan FinTech environment is vibrant with innovations around mobile money and electronic transactions in financial securities. These platforms provide an interface for the payment and receipt of finances necessary for transacting in digital currencies.

Even without formal recognition and legal backing in the local space, the global opportunities and vibrancy of digital currencies drives these undertakings. Thus, a rising number of government agencies are taking a leading and proactive step in regulating digital currency and enabling embryonic technology. Countries within the European Union (EU) have initiated laws to encourage its growth. The EU and members' central banks are developing renewed appreciation of blockchain technology and cryptocurrencies. These are viewed as startups with great potential. As such, new regulations mandated increased transparency and sharing of information between markets and institutions.

Likewise, Switzerland has adopted a proactive approach to digital currencies. This is considered key in positioning the country as a crypto-state. Laws have been enacted to determine their viability as securities and thus taxation. There has been a growth in cryptocurrencies usage in country's public infrastructure such as paying for transportation and municipal fees. These trends are similar with those witnessed in Germany, Sweden and Finland which tax and regulate digital currencies. The states of New York, Arizona, Maine, Nevada, Vermont have enacted legislation with similar interests. These policy undertakings are done concurrently with public cautions about the risky and speculative nature of digital currency trading and susceptibility to fraud.

Japan has broken a new frontier. Digital currencies have earned recognition as a legal means of payment though still not her traditional trading currency. El Salvador have promulgated legislation recognizing one of the cryptocurrencies, bitcoin, as legal tender alongside the US dollar. Panama and Brazil are considering



Photo credit: Verdict





Photo credit: Espaco Bunker

similar pursuits. Equally, Australia privately recognizes cryptocurrencies as “money”. This approach has enabled the country’s authorities to tax those who trade in cryptocurrencies while developing a responsive regulatory framework for the nascent initial coin offering (ICO) sector.

These trends contrast with the ambivalence among domestic policymakers in Kenya. Task-forces have been formed by the Central Bank and the Capital Markets authority to study various aspects of cryptocurrencies. However, the notion that they are unapproved, unregulated and highly speculative investment options is deeply engrained. Banks have been warned not to open or transact accounts in digital currencies. Though digital currencies are generally disregarded as legal tenders, there is a growing universality of their recognition as financial securities in the same vein as bonds, shares and

other intangible publicly traded assets. In the Kenyan context, their regulation will be better served under the Capital Markets Act rather than the Central Bank of Kenya Act. In the Kenya marketplace, the emerging opportunities are being recognized and pursued by corporate entities.

A UK based blockchain firm, BlockBank, has set up an office in Nairobi to exploit the country’s digital market. BlockBank bought a stake in Kenya’s Spire Bank with the aim of advancing mutual FinTech partnerships and facilitating international crypto banking associations. Though BlockBank would be unable to obtain a banking license under the currently regulated regime, it is plausible to exploit regulatory loopholes to operate an alternative payment system for cryptocurrencies. This is because the purview of the Central Bank of Kenya is limited to the





banking system. Similarly, the International Business Machines Corp are using a mobile blockchain platform, which powers digital currency, to address the challenge of access financing in the informal sector. This is illustrative of the opportunities due to the adaptable nature of blockchain technology to solve other pertinent monetary concerns. Globally, corporate entities are debunking legitimacy questions by accepting payments made using cryptocurrencies. Visa, MasterCard, Bank of America, JP Morgan, Coca-Cola, Amazon, PayPal, Tesla, and Microsoft allow these forms of payment. Moreover, China, Dubai and Venezuela have launched government-backed cryptocurrencies. The above developments illustrate that digital currencies are here to stay. It is anticipated that

cryptocurrencies will continue to affect the financial markets including those in foreign exchange as more forex brokers engage in digital currencies trading.

Equally, the currencies are becoming increasingly popular in transferring money between financial institutions at faster and less costly ways compared to older money transfer technologies. This undercuts revenue collection by banks and government through the fees and taxes. In a sector that thrives in strategic positioning and action, disinterests may be traded off against future economic gains. Policymakers will be required to appreciate this reality, then plan and act prudently.



Photo credit: Twitter





Prospects

The trends point towards a colossal volume of global economic transactions and financial securities being engrained with digital currencies. While a significant number of governments and regulators have adopted a waiting game with regards to recognizing and regulating cryptocurrencies, an increasing population of states are allowing, promoting and regulating this technology. The usage of blockchain technologies is on the rise. Disinterest or inactions are both consequential. Initial coin offers (ICOs) are likely to become popular financial security options and fundamental means of raising public and private sector capital. It is incumbent upon policymakers, regulators and legislators to understand and act appropriately with the fast-paced development in digital currencies. While the \$1 trillion digital currency industry is deemed to pose a threat to the centralized role of government in monetary and financial regulation, its rapid adoption and popularity will have a great impact regardless. Immediacy in understanding the potential of digital currencies and regulating them present viable opportunities to bridge the existent knowledge gap, mitigate consequences and advance economic benefits.



Photo credit: Finance Monthly

Mr Michael Owuor is GLOCEPS Research Fellow for Development Pillar. He has over ten years' experience in running multidisciplinary development programs and research with international public benefit organizations, universities and government agencies for policy action. His research priorities include business strategies, economic development and political economy. He holds Bachelor's degree in Business Management; a Master of Business Administration and MSc in Health Systems Management.





The GLOCEPS, Daily Influential Brief brings to policy makers precise incisive analyses of policy issues and events locally, regionally and globally. The priority is on topics that have a bearing on Kenya and beyond and are themed on defence and security; diplomacy and foreign policy; public policy, ethics and governance; strategic interests and transnational crimes; and development. We invite contributions from experts with policy opinions centred on any of the five pillars. Give us your thoughts and feedback through info@gloceps.org



**THE GLOBAL CENTRE FOR POLICY AND STRATEGY
(GLOCEPS)**

Research | Knowledge | Influence

Off Kiambu Road, Nairobi Kenya
P.O. Box 27023-00100, Nairobi.
Telephone: 011 2401331
Mobile: +254 700 279635
Email: info@gloceps.org
Web: <https://www.gloceps.org>

