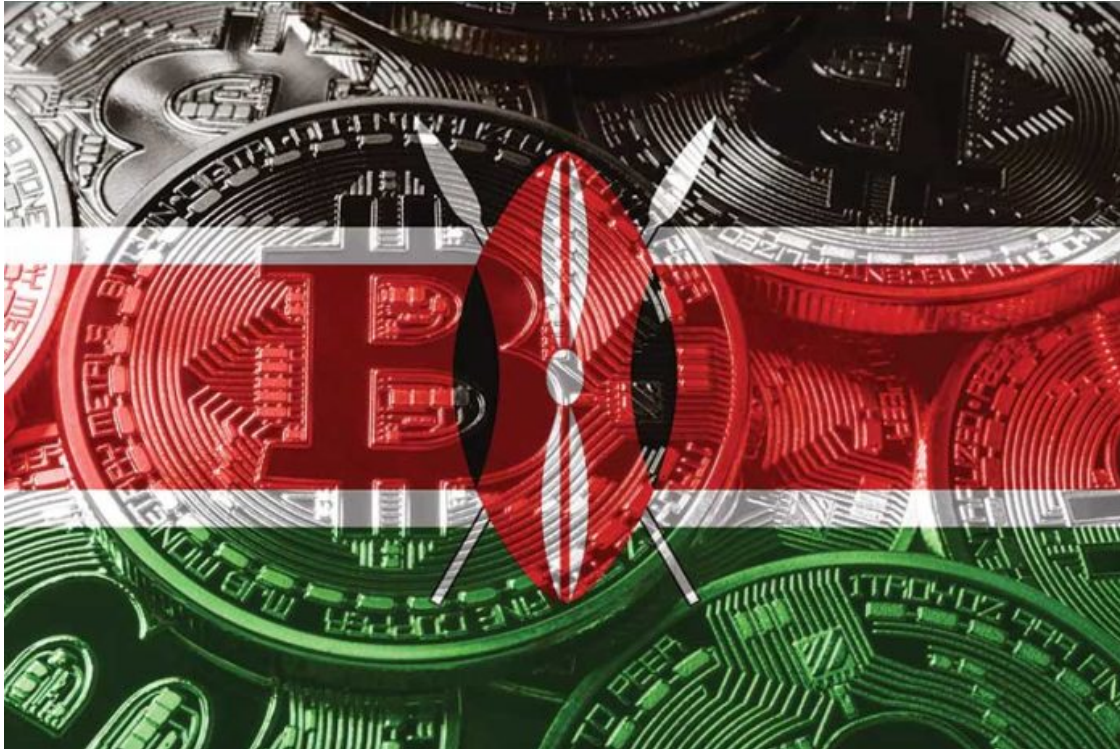


# The Nexus Between the Central Bank of Kenya and Private Providers of Cryptocurrencies

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By **Dorothy Muthoka**

**Cryptocurrencies ride on blockchain, a disruptive technology in the world. The Kenyan government has been lagging behind in recognising their growth and proliferation. Yet, it can utilise the power of its technological infrastructure to enhance the efficiency of these cryptocurrency payments. The innovation is becoming friendlier to law-enforcers than law-breakers.**

## Introduction

The current business environment and business operations are undergoing rapid changes due to digital transformation technologies. With the integration of the internet, blockchain, big data, artificial intelligence (AI), and related technologies, the changing dynamics of customer demands and the disturbances stemming from the COVID-19 pandemic have caused business operations to change<sup>1</sup>. During the month

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individual savings by ordinary Kenyan people rather than trading and speculation, showed that Kenya ranked fifth out of the 154 emerging countries chosen. Further, the report's worldwide adoption of cryptocurrencies had jumped to over 880 per cent, with the peer-to-peer platform driving cryptocurrency usage in emerging markets<sup>4</sup>. So the Kenyan government cannot ignore the acceleration of private providers of cryptocurrencies such as Cex.io, Paxful, Changelly, Kraken, Bitsquare<sup>1</sup>. Hence the need for this article to add to knowledge in the Kenyan financial market and analyse how these virtual currencies will change the landscape of money transfer in the future.

## Evidence from Around the Globe

**As cryptocurrency has become a more significant factor in the global investment landscape, countries have taken different approaches to regulating the asset class.**

The world is experiencing the greatest appreciation of cryptocurrency in history, and it is becoming clear that this will not be going away anytime soon. Africa is no exception, and Kenya is one of the three largest Bitcoin markets on the continent, alongside giants like Nigeria and South Africa<sup>5</sup>. Moreover, Nigeria recently became the first African country to introduce a digital currency<sup>6</sup>. It joins the Bahamas and the Eastern Caribbean Central

Bank in being among the first jurisdictions in the world to roll out national digital currencies<sup>7</sup>. As cryptocurrency has become a more significant factor in the global investment landscape, countries have taken different approaches to regulating the asset class<sup>8</sup>. Japan has recognised the cryptocurrency Bitcoin fiat money as having the same function as money. The Canadian Securities Administrators and the Investment Industry Regulatory Organization of Canada have clarified that crypto trading platforms and dealers in the country must register with provincial regulators, and crypto investment firms, as money service businesses, are required to register with the Financial Transactions and Reports Analysis Centre of Canada<sup>9</sup>. In 2017, Australia's government declared that cryptocurrencies were legal and specifically stated that Bitcoin (and cryptocurrencies that shared its characteristics) should be treated as property and subject to capital gains tax. However, the United Kingdom, Singapore, South Korea, and India have not yet offered cryptocurrencies as legal tender but have introduced cryptocurrency-specific requirements relating to "Know Your Customer".

## Kenyan Regulatory Framework

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Exchange (NSE), launched the derivative market known as the NEXT, which facilitates the trading of futures contracts. The NEXT is regulated by the Capital Market Authority (CMA), which admitted a fintech company to its regulatory sandbox to test its Cashlet application. This application is a digital, mobile-based unit trust investment application, and if the CMA can go to that extent, then the CBK should also accelerate the way they are doing business. This is because anytime that cryptocurrencies or other virtual currencies are mentioned, many people often think of negative connotations, because of previous challenges they have experienced. For example, some people have exploited these currencies for unlawful purposes<sup>10</sup>. But for the entrepreneurs, engineers, venture capitalists and bankers who are pouring their time, energy, and money into cryptocurrency and crypto-asset-related businesses, the use of decentralised technology continues to grow, thrive, and drive innovation. So, contrary to the popular reaction of prohibiting it, this technology is becoming friendlier to law-enforcers than it is to law-breakers<sup>11</sup>.

## The Way Forward for Kenya's Landscape

Since the Kenyan payment landscape is categorised in terms of value (wholesale payment system) and volume (retail payment system), the blockchain technology that cryptocurrencies use will enhance high volumes of cross-border trading with East Uganda, Tanzania, and Rwanda. The Kenyan government should be involved in projects that experiment with ways to establish a proper regulatory framework for cryptocurrency as a legal tender, rather than denying the fact that Kenyans are involved in that trading. A well-thought-of blockchain platform will help improve efficiency in government, even in matters such as the level of technological infrastructure, tax collection, election registration, security and personal data, and remedies for aggrieved parties during the engagement. Cryptocurrency is not like ordinary shares or real-estate investments that promise to give a steady return of profits; there are levels of risk in terms of high volatility. So, a tax levy should be encouraged to take care of such volatility, since the mode of payment would also be digital<sup>12</sup>. In addition, fears of cryptocurrencies being used in the financial crime of insider trading on the financial market, such as the NSE, would be negligible.

**Cryptocurrency is not like ordinary shares or real-estate investments that promise to give a steady return of profits; there are levels of risk in terms**

The government of Kenya should also be aware of the human patterns and values surrounding money (whether traditional or digital) due to their preconceptions. The introduction of a new kind of private money in a modern society will be met with resistance. For example, when the M-PESA product, a Kenyan mobile money transfer

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country have embraced the product, due to the efficiency and effectiveness of this way of transferring money. The majority of MPESA agents and shops were also introduced as well as bank agents emerged as satellite banks to assist people in transaction and system growth. The same would be expected with the introduction of cryptocurrencies. People who had no access to banks or bank products quickly adopted the online services as a substitute for electronic government money and bank services. This is because the majority of Kenyans live in areas where internet coverage is low. The government could use the massive power of its technological infrastructure to enhance the efficiency of these cryptocurrency payments by using offline when there is no internet coverage. This will also reduce the cost of transactions, as well as the cost of travel, as consumers do not have to travel to locations where banks are available. Therefore, virtual currency transfers will be embraced and eradicate traditional cash transfers. Hence, the proper regulation of cryptocurrencies will increase the efficiency, accuracy, and speed of transactions.

## Recommendations

Some ways in which the Kenyan government could embrace cryptocurrencies while forming a regulatory framework would be:

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1. Having an underlying asset, with the value of cryptocurrencies traded in exchange platforms. The NSE could list the most popular cryptocurrencies, just like they did with the derivative market (NEXT). This is because not all investors are risk averse, some are high risk takers who would wish to benefit from their volatilities. Then the NSE would offer a central and convenient platform for such investors.
2. The CBK and other financial institutions/private providers should collaborate in creating regulations to maintain a certain sense of order and a system to keep the public informed regarding cryptocurrencies. Since cryptocurrency transactions are normally anonymous, a measure that other countries have advocated for is the concept of "Know Your Customer/Client", which can deter the threats of money laundering, the funding of terrorism, and tax evasion.
3. The regulators of transactions will oversee cryptocurrency transactions that will allow for financial inclusion and also preserve the CBK "fears". The CBK could think of a Central Bank Digital Currency (CBDC) issued and regulated by them. The World Economic Forum has discussed several reasons for launching the a CBDC: It promotes and facilitates financial inclusion, enable direct welfare disbursements to citizens, facilitate diaspora remittances, reduce the cost of processing cash, improve the availability and usability of Central Bank money, increase revenue and tax collection, support a resilient payment system, improve the efficiency of cross-border payments<sup>14</sup>.
4. According to Njogu<sup>2</sup> continuous monitoring of the size and growth of cryptocurrencies will be prudent to ensure that their material risks are identified as well as their transmission channels to financial stability risk. If the case of M-PESA concept was accepted by the Regulators and ordinary Kenyans, then that could shed light on the monitoring of cryptocurrencies in Kenya.



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General view shows the Central Bank of Kenya headquarters building along Haile Selassie Avenue in Nairobi, Kenya November 28, 2018. REUTERS/Njeri Mwangi

## Conclusion

The future of cryptocurrencies is expected to include increased financial innovation in the fintech space and an increased willingness by regulators to engage with private providers to seek an appropriate solution to create a win-win strategy. Although the use and regulation of these technologies has started a discussion with the public in Kenya, there is hope for it to be taken to the next level, as most countries have raised awareness of its positive impact and its value preservation. In the end, the problem remains that, even with the regulations and foreseen future for cryptocurrencies, there is still an issue concerning how much room there is for private providers to thrive, while the regulators can take this opportunity to govern before it is too late. Cryptocurrencies are revolutionary technologies which will have a very positive financial and economic impact on the future for Kenya and other countries around the world.

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## About the Author



**Dorothy Muthoka** has a wealth of experience in accounting, having worked in the Finance Department for ten years. Further, she has been able to rise through the academics ranks from Graduate Assistant to a Senior Lecturer, conducting research and mentoring students in areas of Accounting or Finance.

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