Cryptocurrency Boom in Africa: What is Next for Kenya?

ARTICLE

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Introduction

The adoption of cryptocurrency globally has been on a gradual rise and in a little over a decade, the sector has ballooned and is estimated to be worth over USD 3 trillion . This momentum has not escaped Africa which has been reported widely as one of the fastest-growing and most promising continents for the adoption of cryptocurrencies.

According to a report published by Chainalysis, a US blockchain analysis firm, Africa's cryptocurrency market increased by 1,200% in the past year alone, bringing its total crypto assets to USD 105.6 billion. In the recent past, the continent has also witnessed significant growth in the ownership and trade rates of cryptocurrencies. Currently, apart from Bitcoin (the most widely used cryptocurrency globally), other cryptocurrencies such as Dash and Lisk are being traded in Kenya and other African countries including Botswana, Ghana, Nigeria, South Africa and Zimbabwe.

Additionally, according to recent data from the Absa Africa Financial Markets Index 2021, several African countries are currently looking at adopting digital currencies issued by central banks through secured systems, commonly known as Central Bank Digital Currency (CBDC). CBDC is a digital currency issued by the central bank and intended to serve as legal tender. Nigeria recently became the first African country to launch a digital currency backed by its central bank after the launch of the eNaira in October 2021 while Ghana continues to partner with German firm Giesecke+Devrient (G+D) to pilot the e-Cedi. Other countries such as Kenya, Morocco, Rwanda and South Africa are considering the feasibility of using digital currencies for retail purposes while Eswatini and Mauritius are exploring the possibility of using digital currencies for both retail and wholesale purposes.

Growth and Regulation of Cryptocurrency in Africa

As a continent with a vibrant fintech space that has already embraced revolutionary fintech technologies such as mobile money payment services, it is unsurprising that Africa is leading in the value of crypto-based remittances. Additionally, Africa has been consistently ranked as the most expensive region in the world for sending money but cryptocurrency platforms such Bitpesa, LocalBitcoin and Paxful have drastically reduced transaction fees in remittance costs by over 90%. Like many regulators globally, regulators in Africa have been faced with the daunting task of finding the appropriate instruments to regulate the risks emanating from the increased adoption of cryptocurrency. With increased trading in cryptocurrency, it is clear that cryptocurrencies cannot continue to operate in a vacuum.

African countries have adopted different crypto regulatory frameworks ranging from complete acceptance to total ban of cryptocurrency-related activity. According to a report published by the Law Library of Congress, by the end of 2021, 19 African countries had placed an implicit ban on cryptocurrencies prohibiting banks and other financial institutions from dealing in cryptocurrencies or offering services to people or businesses providing cryptocurrency services and banning cryptocurrency exchanges from operating in their economies. Other countries such as Algeria, Egypt, Morocco, and Tunisia mirrored the recent China approach and unilaterally banned cryptocurrencies in the economies making the use or trade of cryptocurrencies illegal.

On the other hand, South Africa has expedited its cryptocurrency regulations and is looking at unveiling its legal framework for cryptocurrency regulation in early 2022 following a series of cryptocurrency-related scams. According to Unathi Kamlana, the Financial Sector Conduct Authority (the FSCA) Commissioner, the FSCA sees cryptocurrency as assets rather than currencies. The cryptocurrency regulations to be tabled by the FSCA will establish rules on cryptocurrency trading, ensure investor protection and govern the interaction of the digital currency and the country's financial markets.

Blockchain Technology in Africa

One important technology that has gained a lot of popularity in Africa with the rise of cryptocurrencies is Blockchain. Blockchain can be defined in simple terms as a decentralised public ledger that allows all participants to keep track of and verify transactions without the need for centralised banks. Blockchain has been fundamental to cryptocurrency as it has provided a platform for the development of such technologies. However, apart from providing such a platform for cryptocurrency, Blockchain has been valuable in keeping track of transactions in different major industries without the need to rely on an intermediary.

In Africa, there is immense potential for the application of Blockchain for more efficient processes. For instance, certain characteristics of Blockchain such as the real-time feature, transparency and immutability can be useful in defeating corruption and transforming land administration and public procurement. These features are also ideally suited for improving the supply chain tracing and trade facilitation given that, unlike the current certification and labelling system, Blockchain cannot be manipulated. Blockchain technology can also be used to drive innovation and digitalisation in several sectors such as anti-money laundering tracking, real estate, insurance, elections, supply chains, digital identification, medical, agriculture and data sharing.

Legality and Regulation of Cryptocurrencies in Kenya

Cryptocurrencies in Kenya remain unregulated and developments in the crypto-asset regulation remain limited to regulator-issued notices cautioning the public on the risks associated with the use of virtual currencies. In December 2015, for instance, the Central Bank of Kenya (the CBK) stated that virtual currencies are not legal tender and warned Kenyans about the use and volatility of Bitcoin and similar products. The notice went on to remind Kenyans that no protection exists if the platform that exchanges or holds the virtual currency fails or goes out of business. In 2018, the CBK issued a circular to Kenyan banks warning them against dealing with cryptocurrencies or dealing with entities transacting in cryptocurrencies. Our review of the treatment of cryptocurrency in Kenya from a legal perspective as of 2019 can be accessed here.

Another major development has been the first-ever crypto learning centre in Kenya which was launched by the World Food Programme in collaboration with Corsali, a machine learning company and Celo, a Blockchain firm. The project is aimed at providing Kenyan youth with skills that will enable them to earn a living using cryptocurrency and e-wallets.

Kenya has also seen the launch of the Blockchain Association of Kenya, a non-profit organization that has been promoting the adoption of blockchain and cryptocurrency technology in Kenya and East Africa.

The Capital Markets Authority (the CMA) on the other hand has been more overt in its approach towards cryptocurrencies with warnings against participation in initial coin offerings or coin exchanges. Despite the lack of regulation of cryptocurrency, the CMA has taken the position that cryptocurrencies are "securities" and therefore fall within the regulation of the CMA. For this reason, the CMA has sought to regulate initial coin offerings and coin exchanges.

Kenyan courts provided support to the CMA's regulatory mandate in relation to initial coin offerings and exchanges in the case of Wiseman Talent Ventures v Capital Markets Authority [2019] eKLR (the Kenicoin Case) . In the Kenicoin Case, the CMA had issued a strongly worded statement (available here) cautioning the public against participating in any initial coin offering or trading in any coin exchange offered by Wiseman Talent Ventures (Kenicoin).

The CMA's contention justifying its actions was that cryptocurrencies met the definition of securities under the "Howey Test" established in the well-known American case of Securities Exchange Commission (SEC) vs W.J Howey Co.328 US 293 (1946). Following the assertion that cryptocurrencies are securities, the CMA then maintained that it had oversight authority under section 11 (3) (r) of the Capital Markets Authority Act to "regulate and oversee the issue and subsequent trading, both in primary and secondary markets, of capital market instruments".

Kenicoin disputed the CMA's authority in relation to cryptocurrencies and submitted that the CMA's regulatory actions against its activities amounted to an abuse of power. In its decision, the Court held that while there is no law regulating digital currencies, exchanges and related activities in Kenya, that absence does not ouster jurisdiction of the general regime of law under the Capital Markets Act and the application of the "Howey Test" in defining securities.

The Court specifically stated, "The balance of convenience tilts in favour of Investor/Consumer protection through, inquiry, investigation and regulation of cryptocurrency/Kenicoin as security under Capital Market Authority, the defendant whose mandate is to regulate capital markets and securities".

The Court ruled that the investing public ought to be protected until an appropriate legal framework is established to regulate initial coin offerings in Kenya.

Despite the warnings from the CMA and the CBK, there has been a meteoric rise in the adoption of cryptocurrency in Kenya. In 2021, for the second year in a row, Kenya was ranked by Chainalysis as the world's leader in peer-to-peer trading volumes. Bitcoin trading volumes in Kenya also surged in 2021.

In its Q 1, 2021 Capital Markets Soundness Report, the CMA, while recognising the increased crypto-related activity in Kenya, highlighted the need to adopt a more encompassing approach to crypto assets which integration could allow the use of the CMA regulatory sandbox to test various forms of crypto assets for future oversight. The CMA also stated that it was ready to engage the CBK to form a common stance.

Exposure of Investors in an Unregulated Cryptocurrency Market

The continued growth and popularity of cryptocurrency means more people are investing in the sector and there is, therefore, a need for regulation to ensure adequate protection of investors. The lack of regulation has left investors unprotected and exposed to crypto-related crimes.

Cryptocurrency has not been without challenges and has experienced headwinds over the last few years. Two years in a row, for instance, South Africa has been in the news for possibly the biggest crypto scams. In 2020, Mirror Trading International, a South African company, swindled hundreds of thousands of victims of Bitcoin worth USD 588 million. In April 2021, South Africa once again fell victim to crypto-related fraud after the founders of Africrypt disappeared with USD 3.6 billion worth of Bitcoin after informing the investors that the company had been hacked.

Other parts of the world have also witnessed similar patterns of increased crypto-related frauds. Amidst these fraud cases, English courts have shown their willingness to flexibly use different legal tools to assist investors who have fallen victims to such fraud. For instance, in the Fetch AI Limited, Fetch AI Foundation PTE v Persons Unknown, Binance Holdings and Binance Markets case, the High Court in London ordered Binance to identify those who had carried out the hack and freeze their accounts.

The decision by the English court to order the disclosure of the identity of the hackers is a positive development in the fight against cryptocurrency fraud as the anonymity of the hackers is a major hindrance to the location and recovery of cryptocurrencies obtained illegally.

Lessons and Way Forward for Cryptocurrencies in Kenya and Africa

While the CBK had remained mum after its notice in 2018, in an exciting turn of events, the CBK on 11 February 2022 issued a lengthy discussion paper that assesses the applicability of Central Bank Digital Currency (the CBDC) in Kenya's retail space and cross-border payments (the Discussion Paper). The CBK has invited comments from the public on the Discussion Paper and this is a first step in initiating dialogue on the potential opportunities and risks of adopting the CBDC in Kenya.

The Discussion Paper cites numerous opportunities for a CBDC rollout such as financial stability, enhanced cross-border payments, consumer protection and promotion of innovation. It also takes note of the significant potential risks associated with the issuance of CBDC such as disintermediating banks, financial exclusion and risks related to cybersecurity and money laundering.

Although the CBK has stepped up its efforts in exploring the possibility of issuing a CBDC, we note that it continues to steer clear of cryptocurrencies. Given the increased adoption of cryptocurrency and the profound impact this could have on the Kenyan financial system and the risk exposure for unsuspecting investors, it is also critical for the CBK to consider the best way to navigate the complex legal issues and policy issues posed by the burgeoning cryptocurrency space.

While other regulators such as the CMA have broadly interpreted their powers and responsibilities to capture the regulation of cryptocurrency activities, different regulators need to collaborate and create an effective legal framework.

Additionally, it is also important that regulators examine the existing laws and determine whether such laws are appropriate to tackle issues such as anonymity which enables criminals and terrorists to carry out money laundering and conduct illicit business activities.

African regulators can rely on the different guidelines issued by international bodies to understand variables that are key to establishing a fit for purpose legal framework. According to the International Monetary Fund, the cryptocurrency regulatory framework should have three core elements:

a. regulation of crypto-asset service providers: the regulatory framework should regulate and licence crypto-asset service providers that deliver critical functions storage, transfer, settlement and custody of reserves and assets.

b. the regulatory framework should be tailored to the main use of the crypto assets: the regulatory framework should categorise crypto assets based on their underlying function and determine the best-suited regulator to regulate such products. For example, cryptocurrency products for investment should have similar requirements to those imposed on securities brokers and dealers while crypto products for payment should be overseen by regulators that oversee payment services.

c. relevant authorities should provide regulated financial institutions concerning their exposure to and engagement with crypto: where, for example, a regulated institution is providing custodial services in relation to crypto assets, the regulatory framework should clarify the requirements needed for such a function to address any risks that may arise from such a function.

In addition, such a legal framework should at a minimum also:

1. acknowledge the existence and ubiquity of cryptocurrencies - rather than start on the premise of Kenyans not owning them;

2. recognise the fluidity of the sector given the pace at which the technology is being used to rapidly innovate and offer more products and services e.g., Decentralised Autonomous Organisations;

3. provide mechanisms of protecting consumers and investors;

4. promote transparency in the sector to enable consumers and

investors to know what they are investing in or buying ;

5. balance the need to foster responsible innovation and the need to achieve regulatory objectives such as fighting money laundering; and

6. providing strong technological and organisational safeguards to ensure secure networks and applications for cryptocurrencies.

Conclusion

While the existing regulatory landscape for cryptocurrencies differs across jurisdictions, there are significant lessons that Kenyan regulators and other African regulators can learn from jurisdictions such as Japan, the United Kingdom and Switzerland which have adopted well-designed regulations that have continued to encourage cryptocurrency innovations.

In addition, once South Africa has adopted cryptocurrency regulations in 2022 as expected, we could see an increased willingness among African regulators to adopt comprehensive crypto regulations.

Key contact

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