True to their innovative spirit, over the past few years, many Kenyans have joined in on the cryptocurrency gold rush that seems to have swept across the world. This enthusiasm, however, is not shared by the Central Bank of Kenya (CBK), which issued the following stern warning:

‘This is to inform the public that virtual currencies such as Bitcoin are not legal tender in Kenya and therefore no protection exists in the event that the platform that exchanges or holds the virtual currency fails or goes out of business…. The public should therefore desist from transacting in Bitcoin and similar products.’

This warning falls short of making trading of virtual currencies illegal, as countries such as China, Bangladesh, Nepal, and Kyrgyzstan have done, but it does not legitimise it either. Notwithstanding this disapproval from the CBK, Kenyans have continued trading and holding cryptocurrencies and the country is now estimated to hold more than KES 163 billion worth of Bitcoin, equating to 2.3% of Kenya’s GDP.

Table 1 below shows Kenya’s Bitcoin holding in relation to GDP compared to other international markets.

The Kenyan courts have also had their say in relation to the legality of trading cryptocurrency in Lipisha Consortium Limited & another v Safaricom Limited [2015] eKLR (the Bitpesa Case). In this case, Safaricom suspended its M-PESA services to Lipisha Consortium and Bitpesa because Bitpesa was engaged in a money remittance business using Bitcoin without approval from the CBK. The court held that Safaricom was within its rights to have suspended its services to Lipisha and Bitpesa for operating a money remittance business without CBK approval. Further, the court would not

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1 CBK Warning on virtual currencies such as Bitcoin, December 2015.
2 Bitcoin government regulations around the world.
3 Citibank reports Kenya holds an estimated KES 163 billion worth of Bitcoin.
4 Source: Kenyan Wall Street - Kenya among the few countries in the world with highest per capita holding of Bitcoin
5 http://kenyalaw.org/caselaw/cases/view/117270/
force Safaricom to trade with Lipisha and Bitpesa, as Safaricom could be found to be in breach of anti-money laundering regulations by allowing Bitcoin trading and remittances through its M-PESA platform. This is due to the anonymity associated with Bitcoin trading, which is in contravention of know-your-client (KYC) requirements in remittances and money transfer regulations. This aspect of anonymity is explored further below.

As a result of this case, cryptocurrency trading centres in Kenya are no longer able to offer M-PESA till numbers thereby limiting the methods by which cryptocurrencies may be transferred between people wanting to trade.

In order to circumvent this hurdle, trading centres, such as Vietnam-based Remitano which recently entered the Kenyan market, now provide the M-PESA account details of a seller of Bitcoin on their platform, to which a purchaser must send the funds. Once the seller confirms they have received the funds, they will then authorise the transfer of the specified amount of Bitcoin to the purchaser. Alternatively, trading platforms will provide the bank account details for a purchaser to implement a bank-to-bank transfer. From a consumer protection perspective, this creates a significant risk of fraud.

In addition, Initial Coin Offerings (ICOs) are making an entrance into the Kenyan market. The Capital Markets Authority (CMA) has reportedly warned investors against participating in ICOs, which have not been approved by the CMA.

From a Kenyan legal perspective, the features of trading in cryptocurrencies which may be regulated include:

a) In relation to ICOs, by the CMA;

b) Remittances and money transfers, by the CBK; and

c) Capital gains tax and value added tax, by the Kenya Revenue Authority.

However, given the stance so far being taken against regulation of cryptocurrencies, Kenyan consumers have been left with little protection. In light of the report by Citibank on how much of the country’s GDP is contributed by cryptocurrencies such as Bitcoin, perhaps it is time for regulators such as the CBK to revisit the issue. Alternatively, cryptocurrencies should be the subject of an outright ban in Kenya as in countries such as China and Bangladesh. At least then there would be certainty of the status of cryptocurrencies in Kenya, rather than the half-hearted measure we have now with the regulators saying one thing but a significant section of the public choosing to trade in cryptocurrencies anyway.

The number of trades in Kenya is set to rise with the imminent opening of a UK-based blockchain financial institution, BlockBank, in Nairobi.

What are cryptocurrencies and how do they work?

The absence of regulation in most countries is partly the result of a lack of understanding on the part of governments and policymakers.

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6 [https://remitano.com/ke](https://remitano.com/ke)
8 [Business Daily - Kenyan group launches - Nurucoin](https://www.businessdailyafrica.com/kenyan-group-launches-nurucoin-icos/)
about what it is and how the technology behind it (blockchain technology) works. Unquestionably, cryptocurrencies, from a legal perspective, are a complex beast which may be classified under multiple identities.

Firstly, a cryptocurrency is a currency and, very rarely, legal tender.

This is one of the primary reasons that Satoshi Nakamoto created Bitcoin, the most famous cryptocurrency. It is also the aspect which drives most of the controversy and debate surrounding cryptocurrencies. Cryptocurrencies are digital or virtual currencies that secure payments by utilising cryptography. A key feature of cryptocurrencies is that it is not regulated by a single entity the way traditional legal tender (fiat currency) is.

Rather, the regulation of cryptocurrencies is through a decentralised method where any party participating in the process can verify the transactions that take place. The people who do this verification are called ‘miners’ and they verify cryptocurrency transactions by solving complex mathematical equations. So far as we are aware at the time of this article, no government has recognised Bitcoin as legal tender.

This raises the question of what is legal tender. Legal tender is ‘any official medium of payment recognised by law that can be used to extinguish a public or private debt, or meet a financial obligation. The national currency is legal tender in practically every country. A creditor is obligated to accept legal tender toward repayment of a debt. Legal tender can only be issued by the national body that is authorised to do so.’ In relation to this definition, section 22(1) of the Central Bank of Kenya Act provides:

‘The Bank shall have the sole right to issue notes and coins in Kenya and, subject to subsection (4), only those notes and coins shall be legal tender in Kenya… (emphasis ours).’

From the definitions above, in order for a currency to be legal tender, it must satisfy a two limb test: (i) a recipient must be obliged to accept the currency toward repayment of a debt and (ii) it must be issued by a national body, such as the CBK, that possesses the authority to do so. Generally speaking, cryptocurrencies fail both limbs of this test because (i) there is no obligation for creditors to accept cryptocurrencies as repayment of a debt and (ii) cryptocurrencies have not been issued by a national body. It is for these reasons that cryptocurrencies are generally not considered to be legal tender.

However, certain countries have announced that they are exploring the idea of creating their own cryptocurrency. Venezuela, for instance, announced that it would be creating its own petroleum-backed cryptocurrency, as a means of sidestepping economic sanctions on the country. If this does happen, the Venezuelan cryptocurrency may become legal tender if it fulfils the two tests above. Dubai, a pioneer in this field, has also announced it will launch its own government-backed cryptocurrency, as

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10 For a more detailed explanation on what Bitcoin is, please see [https://www.coindesk.com/information/what-is-bitcoin/](https://www.coindesk.com/information/what-is-bitcoin/)

11 For a more detailed explanation on how mining works, please see [https://www.coindesk.com/information/how-bitcoin-mining-works/](https://www.coindesk.com/information/how-bitcoin-mining-works/)

12 [Investopedia - Legal Tender](https://www.investopedia.com/terms/l/legal-tender.asp)

well as having granted the first cryptocurrency trading license in the Middle East.\textsuperscript{14}

Secondly, cryptocurrencies are assets. By this, we refer to the concept that the \textit{trade and ownership} of cryptocurrencies are legalised (while some countries have outlawed the trade and ownership of cryptocurrencies entirely, such as China).

Like any other asset then, cryptocurrencies’ value may change (at its highest in 2017, one Bitcoin was valued at just under USD 20,000), it may be traded, and it may be subjected to taxes and regulation as an asset (such as securities regulations). Examples of this are shown below:

\begin{itemize}
  \item[a)] IC\textsc{o}s are an unregulated, crowd sourcing method of raising capital for a new cryptocurrency venture. Investors pay the promoters in fiat currency, Bitcoin or Ethereum (another cryptocurrency) to develop the product in question, and in return, receive the equivalent value of the new cryptocurrency that is to be developed. In this sense, cryptocurrencies function as securities. While states such as China and South Korea have banned ICOs altogether, Switzerland has taken the opposite approach in its efforts to become the ‘crypto nation’.\textsuperscript{15}

  \item[b)] In the United States (US), the Commodity Futures Trading Commission (\textsc{cftc}) became the first US regulator to allow public trading of cryptocurrency derivatives and has designated cryptocurrencies as a commodity.\textsuperscript{17}

  \item[c)] In Australia, the Australian Taxation Office (\textsc{ato}) has stated, ‘\textquote{Transacting with bitcoin is akin to a barter arrangement, with similar tax consequences. Our view is that bitcoin is neither money nor a foreign currency, and the supply of bitcoin is not a financial supply for goods and services tax (\textsc{gst}) purposes. Bitcoin is, however, an asset for capital gains tax (\textsc{cgf}) purposes.}\textsuperscript{18}

  In this case, it is clear how the Australian government has not recognised Bitcoin as legal tender but does recognise it as an asset.

  \item[d)] On 21 February 2018, the US Securities Exchange Commission (\textsc{sec}) and the US Department of Justice (\textsc{doj}) filed complaints against BitFunder, a bitcoin-denominated exchange and its founder (‘\textsc{bitfunder’}). The SEC’s civil complaint alleges that BitFunder operated as an unregistered online securities exchange for virtual ‘\textit{shares}’ of currency-related
\end{itemize}

\textsuperscript{14} LinkedIn Pulse - Gold trading company launches world’s first cold storage
\textsuperscript{15} FT - "Cryptonation" Switzerland issues guidelines to support market
\textsuperscript{16} FINMA publishes ICO guidelines
\textsuperscript{17} US Commodity Futures Trading Commission Press Release 1 December 2017
\textsuperscript{18} Tax treatment of cryptocurrencies in Australia
enterprises (e.g., virtual currency mining operations) (the ‘virtual assets’). The SEC and DOJ termed BitFunder as an exchange of virtual assets. This gives credence to the opinion that cryptocurrencies can be recognised as assets and not necessarily as legal tender.

e) It is worth noting that some nations in the European Union such as Germany, Sweden and Finland regulate and tax cryptocurrencies such as Bitcoin as a commodity. Moreover, the German Federal Financial Supervisory Authority (BaFin) has stated that virtual currencies are not legal tender and therefore are neither currencies nor foreign notes or coins. BaFin has stated that virtual currencies also do not usually qualify as e-money within the meaning of the German Payment Services Supervision Act.

Risks of cryptocurrency

The risks commonly associated with cryptocurrency may be summarised as follows:

a) **Unregulated** – to a large extent across the globe, most regulators have either refused to regulate the industry or are considering regulations. This has the added risk of a lack of stability of the price. Because the price of cryptocurrencies is driven by supply and demand (rather than being backed by tangible assets) and there is no financial regulator behind it, cryptocurrency prices are highly volatile and without the normal protections a financial regulator could provide. This also means investment mechanisms such as ICOs may not be subject to the strict levels of scrutiny as conventional securities.

b) **Anonymous** – one of the biggest threats perceived by regulators is that cryptocurrency transactions are completely anonymous. While there is a huge opportunity presented by cryptocurrencies to transfer ‘money’ cheaply and quickly, there is a significant risk for nefarious characters to take advantage of the system, notably for money laundering and terrorist financing objectives. The question then is how will regulators oversee this in a manner that promotes the financial inclusive capabilities of cryptocurrency, while also preserving national security interests?

c) **Hacking** – because of the high price of cryptocurrencies, places where cryptocurrencies are hoarded, such as exchange platforms, become prime targets for hackers. The most recent example of this is the Coincheck hacking in Japan, which resulted in over USD 532 million worth of its holdings being stolen. This following on the heels of the Mt Gox collapse four years ago which led to that bitcoin exchange house filing for bankruptcy has left Japanese regulators working on what more can be done to protect investors. The Coincheck scandal clearly shows that regulation on its own is insufficient to protect the public.

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19 More than a Token Risk - ICO Trading Platforms and Promoters in SEC Crosshairs
20 FT - European court ruling bolsters bitcoin
21 Clifford Chance - ICO regulations
22 Cambridge University - Could cryptocurrency help the bottom billion?
Forbes - Virtual currencies could spread financial inclusion one mobile phone at a time
23 Japan Times - Cryptocurrency exchange Coincheck loses 58 billion hacking attack
d) *Bubble* – a popular argument among cryptocurrency sceptics, supported by the economist who predicted the 2008 financial crisis, is that cryptocurrencies are currently in the middle of a massive bubble that is destined to crash. This is based on the fact that there is no underlying asset upon which the value of the cryptocurrencies is pegged.

With this backdrop and given that many developed countries such as India have condemned cryptocurrencies as potentially financing illegal activities, and Korea stating that it was planning a crackdown on trading in the digital currency and preparing a ban on opening anonymous cryptocurrency accounts, we do not expect Kenya to be introducing regulations that will protect consumers from trading in cryptocurrencies anytime soon.

**Article by Sonal Sejpal and Geunhak Shin**

*Should you have any questions regarding cryptocurrencies from a Kenyan law perspective or are interested in discussing the content of this article in more detail, please contact Sonal Sejpal.*

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