KAPLAN&STRATTON NEWSLETTER

THE CAPITAL MARKETS (AMENDMENT) BILL, 2023

This newsletter aims to inform you of the recent presentation of the Capital Markets (Amendment) Bill ("**the Bill**") legislative proposal to the National Assembly in Kenya and provide you with an update on its contents. The proposal, if approved, will be published in the Kenya Gazette as a bill with the objective of amending the Capital Markets Act Cap 485A to include digital currency in the definition of securities, thereby bringing digital currency under the purview of the Act.

The proposed bill is designed to ensure effective oversight of the rapidly growing digital currency market, which is currently unregulated by existing laws. The bill aims to connect Kenyans to global markets while providing a secure and transparent environment for digital currency transactions and reduce risks for citizens participating in this field and promoting an equitable and decentralized financial system.

As of June 2023, there are more than 22,900 cryptocurrencies in existence globally but not all of them are active or valuable. Despite warnings from regulators such as the Central Bank of Kenya (**CBK**) about the high risk associated with cryptocurrency in the event of the failure or closure of cryptocurrency and exchange platforms, it is estimated that over 4.5 million people in Kenya, representing 8.5% of the country's population, currently own cryptocurrencies. This makes Kenya the African country with the highest percentage of its population owning cryptocurrencies.

Late last year, the CBK announced that the Joint Financial Sector Regulators Forum (JFSRF) had agreed to consider the Treasury Cabinet Secretary's recommendation to establish a working group to advise on the creation of a comprehensive oversight framework for activities and players involved with crypto assets in Kenya. This is a shift in regulatory approach as compared to the preceding year when CBK warned financial institutions against dealing in cryptocurrencies due to concerns about money laundering and fraud.

However, the status and completion timeline of the JFSRF process are unclear. The current bill is a private member's bill and not the result of the JFSRF process whose status and completion timeline are unclear. It is uncertain whether the National Assembly will approve this current legislative proposal, and, if it is, whether the outcome of the JFSRF efforts will be incorporated into it upon completion.

After the Central Bank of Kenya (CBK) published the Discussion Paper on Central Bank Digital Currency (CBDC): Comments from the Public in June 2023, the Bill continues to be the prevailing proposed regulation for active digital currency. The report gathered views from the public regarding the potential applicability of a CBDC in Kenya and concluded that implementing a CBDC in Kenya may not be a significant priority in the short to medium term.

While we await further developments, we analyze the current proposed amendments to the Act with the following provisions being particularly noteworthy:

a) Defining digital currencies

The Bill proposes definitions for terms related to digital currencies. It defines "block chain" as a system of recording information in a shared digital register which is duplicated and distributed across the whole network of computer systems within the business network. "Cryptocurrency" is defined as a form of digital currency in which transactions are verified and records maintained by a decentralized system. The proposed bill suggests an amendment to the definition of securities under the Act by including digital currencies.

The Bill defines digital currencies as digital representations of value that lack the legal status of currency or money and are not issued or guaranteed by a central bank or public authority. Further, they have controllable electronic records and are accepted by natural or legal persons as a means of exchange, payment, investment, transfer, storage, or electronic trading, based on agreement or actual price.

b) Regulations on the trade of digital currencies

The proposed bill makes it mandatory for individuals who plan to introduce a new cryptocurrency product to obtain a license from the Capital Markets Authority (CMA). To obtain this license, the following criteria must be met: i) the cryptocurrency product must have been subjected to a product development period of not less than two (2) years; and ii) the product must have been subject to a product test on a customer base of not less than ten thousand (10,000) customers.

c) Responsibilities of persons trading in digital currencies and taxation

Under the bill, persons who trade in digital currencies shall be required to keep a record of digital currency transactions, including purchases and sales, and pay taxes on any gains made from transactions in digital currencies. When digital currency is held for up to twelve months, income tax laws apply. When the holding period exceeds twelve months, capital gains tax laws apply. To facilitate taxation, individuals who possess or transact in digital currency must provide the Kenya Revenue Authority with relevant information, which includes: the amount of virtual currency in Kenya Shillings, type of virtual currency, acquisition and sale dates, transaction proceeds, associated costs and any resulting gains or losses.

d) Register of digital currencies

The proposed bill requires the use of a centralized electronic register to track digital currency transactions, but it may be more practical for the CMA to consider utilizing block chain technology instead. Block chain technology, which underpins many digital currencies, has the capability to process and securely store a vast amount of transactions in a decentralized manner. This approach could offer greater efficiency and security, making it a more feasible option for tracking and monitoring digital currency transactions.

What the proposed bill means for you

The proposed bill will impact various stakeholders including the creators of digital currencies, businesses, market enablers and the Kenyan public.

Before this legislative proposal, there were no specific requirements for launching a digital currency in Kenya. The new requirements introduced by the bill could potentially serve as a hurdle for creators of digital currencies, particularly those that have been operating in an informal environment without regulation. However, the new regulations could also bring legitimacy and stability to the industry, which could in turn attract more investment to the sector. In Kenya, there are indeed several cryptocurrency exchanges and startups that have emerged in recent years, as well as blockchain-based startups operating in various sectors such as finance, healthcare and agriculture.

The requirement for centralized registration of all digital currency transactions under the new bill has the potential to reduce the likelihood of duplicated transactions and prevent fraud. This also potentially increases the level of trust and safety for consumers and investors in the cryptocurrency market in Kenya.

Whether digital currencies should be treated as securities or commodities is a subject of ongoing debate in the financial industry. The bill recognizes cryptocurrencies as legitimate forms of investment and regulates them as securities, thereby creating opportunities for the Kenyan public to invest in digital currencies. The recognition of digital currencies as securities may have several benefits for investors such as increased legitimacy, access to institutional investors and improved transparency in the industry. However, regulation as securities may also come with several potential disadvantages such as increased regulation and compliance costs, reduced flexibility and innovation and potential loss of anonymity. Regardless of the approach used, regulation of digital currencies should strike a balance between protecting investors, fostering innovation, and facilitating access to capital while also addressing potential risks including fraud and market manipulation, which are addressed by regulating digital currencies as securities.

For businesses, increased recognition of cryptocurrencies as a payment alternative would allow consumers to pay them directly without a need to switch to a legal currency. This would enable them to avoid taxation on any potential increase in value, thus increasing profits.

The regulation of digital currencies can have a mixed impact on the economy, with both positive and bad results, even while the bill's goals are to reduce risk in transactions involving digital currencies and promote transparency and stability in the industry. There are many market-based incentives for environmental sustainability, equitable public access to the financial sector, financial and economic stability, increased participation in the global economy, and the creation of external financial networks that reduce the need for legal tender, among other positive effects. Increased demand on electrical supply, greenhouse gas emissions, noise and other forms of pollution, fraud and other financial crimes, and financial insecurity are some of the negative repercussions.

Overall, the bill has the potential to bolster and support Kenya’s economy and financial sector. Considering the capacity of the bill to have both positive and negative side effects, it is important to ensure transparency and accountability within the Authority’s regulatory measures to prevent all forms of corruption or unethical practices.

Conclusion

Creation of law to regulate digital currency in Kenya is crucial in ensuring that all stakeholders are protected from the pitfalls of an unregulated finance sector while allowing them to enjoy the benefits of equitable and secure access to digital currencies. The proposals in the bill present various improvements and much-needed regulatory mechanisms to ensure consumer protection and economic stability. However, the bill is lacking in essential provisions related to the regulation of cryptocurrency companies and exchanges and it would be important to consider provisions to address these issues before the bill is enacted.

As this legislative proposal moves through the legislative process, it will be important to stay abreast of any developments and changes. In the meantime, it is prudent to consider the potential impact of these changes on your investments and industry and consider how you can adapt and take advantage of any new opportunities that may arise. We will continue to monitor the progress of the bill and will keep you updated on any further developments.

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