

NON-REGULATION OF VIRTUAL CURRENCIES: THE CHINK IN THE ANTI-CORRUPTION ARMOUR

Submitted in partial fulfilment of the requirements of the Bachelor of Laws Degree,
Strathmore University Law School

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097000

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January 2021

Word count: 9,363 words

Contents

Declaration.....	iv
Abstract.....	v
List of cases	vi
List of Legal Instruments.....	vi
CHAPTER ONE: INTRODUCTION	1
I. BACKGROUND OF THE PROBLEM	1
II. STATEMENT OF THE PROBLEM.....	3
III. PURPOSE OF THE STUDY	5
IV. HYPOTHESIS.....	6
V. THEORETICAL FRAMEWORK.....	6
VI. RESEARCH METHODOLOGY	7
VII. RESEARCH QUESTIONS	7
VIII. JUSTIFICATION	7
IX. LIMITATIONS AND DELIMITATIONS	8
X. OBJECTIVES OF THE STUDY	8
XI. LITERATURE REVIEW	9
XII. CHAPTER SUMMARY.....	11
CHAPTER TWO: VIRTUAL CURRENCIES, BITCOIN AND MONEY LAUNDERING	12
a) Virtual Currencies.....	12
b) Bitcoin	12
c) How Bitcoin Transactions Occur	13
d) Hurdles to The Regulation of Cryptocurrencies.....	14
e) Money Laundering	15
CHAPTER THREE: LEGAL ANALYSIS	17
I. ANTI-CORRUPTION AND ANTI-MONEY LAUNDERING LAWS	17
a) The Constitution of Kenya 2010.....	17
b) Proceeds of Crime and Anti-Money Laundering Act	17
c) Central Bank of Kenya Act.....	19
d) The United Nations Convention Against Corruption	19
II. PLACE OF BITCOIN AND VIRTUAL CURRENCIES IN KENYA.....	20
CHAPTER FOUR: COMPARATIVE ANALYSIS	22
a) Switzerland	22
b) China.....	23
c) Canada	24

CHAPTER FIVE: FINDINGS, DISCUSSIONS, RECOMMENDATIONS AND CONCLUSION	26
I. FINDINGS	26
II. DISCUSSION.....	26
III. RECOMMENDATIONS.....	28
IV. CONCLUSION.....	29
BIBLIOGRAPHY	30

Declaration

I, KIMANI ANTHONY NDICHU, do hereby declare that this research is my original work and that to the best of my knowledge and belief, it has not been previously, in its entirety or in part, been submitted to any other university for a degree or diploma. Other works cited or referred to are accordingly acknowledged.

Signed:

Date:

This dissertation has been submitted for examination with my approval as University Supervisor.

Signed:

Supervisor's name:  Mahati Mutwa

Abstract

For a long time and with little success, Kenya has battled the vice that is corruption and misappropriation of public funds. Presently, with the emergence and continuous growth of digital currencies also known as virtual or cryptocurrencies, the scales are threatening to tip and not in any way to Kenya's favour. This paper demystifies virtual currencies in particular Bitcoin and attempts to identify ways in which loopholes in the law that might lead to the fight against corruption to be lost may be sealed. This project analyses the laws presently available locally to fight money laundering in comparison to other jurisdictions and the steps they have taken to try and stay ahead of the curve. In terms of methodology, this project is doctrinal in nature. There is reliance on statute, caselaw, books, journals, reports, newspapers, and internet resources which have been reviewed and analysed to provide the information used in the study.

The major finding in the paper is that most jurisdictions are opting to attempt to regulate cryptocurrencies in as far as the role it plays in money laundering is concerned. Another finding is that in all these states, regulation takes place at the exchange level where bitcoins are exchanged for regular fiat currency. The conclusion was then drawn that Kenya can do the same to capitalize on Bitcoin's promising influence and curb money laundering.

List of cases

Lipisha Consortium and another v Safaricom Limited (2015) eKLR

List of Legal Instruments

The Constitution of Kenya, 2010.

Central Bank of Kenya Act, 1984.

Proceeds of Crime and Anti-Money Laundering Act (No 9 of 2009).

The Ethics and Anti-Corruption Commission Act (No 22 of 2011).

United Nations Convention Against Corruption

CHAPTER ONE: INTRODUCTION

I. BACKGROUND OF THE PROBLEM

Since time immemorial, the Republic of Kenya has been plagued by the loss of public funds, property, and overall runaway corruption. First, the British came into the country and appropriated arable land which would come to be referred to as the White Highlands and, force the locals to move and settle in reserves that were dry and practically inhabitable.

After independence, it seems that the baton was passed on from the colonialists to the political elite as the latter went on an acquisition spree by grabbing large tracts of land for their gain and that of their cronies.¹ To add salt to injury, public entities and facilities became a cash cow for those in power as taxpayers' monies and goods allocated to them not-so-mysteriously found their way into the pockets of those appointed to deliver crucial services to citizens and to foster development. An example of this is the Emma Stores Scandal where Paul Ngei, a politician, permitted his wife to buy maize directly from farmers bypassing the Maize Marketing Board. She also refused to pay for the maize and wrote "return to sender" on payment demands.² This and other cases like it led to the collapse of many government entities such as the Kenya Creameries Cooperative which lacked the requisite funds to stay afloat.

This situation led to a tough economic period in the 1970s. This was caused partly by failed government investment in parastatals. For instance, after investing in over 300 enterprises, the government only received dividends amounting to 2.2M Pounds from only six parastatals.³ This led to the International Monetary Fund (IMF) and the World Bank, on whom the country was relying on financial aid at the time, to advise that the non-performing parastatals should be folded up and done away with.⁴ However, some projects, like the infamous Nyayo Pioneer Car Project, were instead turned into secret government projects.

¹ Klopp J.M, 'Pilfering the Public: The Problem of Land Grabbing in Contemporary Kenya' 47(1), *Africa Today*, 2000, 8.

² Maina W, 'Tales of State Capture: Goldenberg, Anglo-leasing and Eurobond' The Elephant, 5 September 2019 -<<https://www.theelephant.info/features/2019/09/05/tales-of-state-capture-goldenberg-anglo-leasing-and-eurobond/>> on 21 February 2020.

³ Republic of Kenya, *The Working Party on Government and Expenditure*, 1982, 41.

⁴ Mugo W, 'A team of experts from the University of Nairobi produced five Kenyan-made vehicles in 1990' The Standard, 19 February 2014- <<https://www.standardmedia.co.ke/article/2000105006/nyayo-pioneer-at-last-kenya-gets-a-car-to-call-its-own>> on 24 February 2020.

It is reported that this project cost the taxpayer Kshs 668,939,609 with none of the cars working.⁵

With the change in government in 2002, it seemed that the state would finally get a grip on the use of state funds to boost the already growing economy. After all, the Kibaki regime had been elected on the premise that it would not only provide the much-needed change from the totalitarian Moi regime but also because it promised to deliver universal primary education, economic growth, adoption of a new constitution, and the fight against corruption.⁶ Unfortunately, even though in the ten years the regime was in power it registered notable success in the first three goals, victory in the fight against corruption seemed to elude it. Case in point, the Anglo Leasing scandal which, combined with other similar scandals, robbed Kenyan taxpayers of a total of \$721 million in 2003⁷ dogged the regime.

The fight against corruption, as illustrated above, has been a losing battle. The 2010 Constitution, to bolster the fight, mandated Parliament to enact legislation to establish an independent ethics and anti-corruption commission.⁸ This led to the passing of the Ethics and Anti-Corruption Commission Act which establishes the Ethics and Anti-Corruption Commission.⁹ The duties of the commission include to “investigate and recommend to the Director of Public Prosecutions the prosecution of any acts of corruption, bribery or economic crimes or violation of codes of ethics or other matter prescribed under this Act, the Anti-Corruption and Economic Crimes Act or any other law enacted in accordance with Chapter Six of the Constitution”¹⁰ Furthermore, to retrieve monies stolen from public coffers, Parliament enacted the Proceeds of Crime and Anti-Money Laundering Act.¹¹

Despite all these efforts, the vice that is corruption seems to have the upper hand with Kenya reported to lose about \$6 Billion every year due to corruption, which is equivalent to a third

⁵ Mugo W, ‘A team of experts from the University of Nairobi produced five Kenyan-made vehicles in 1990’ The Standard, 19 February 2014- <<https://www.standardmedia.co.ke/article/2000105006/nyayo-pioneer-at-last-kenya-gets-a-car-to-call-its-own>> on 24 February 2020.

⁶ Bachelard J.Y, The Anglo-Leasing scandal in Kenya: The politics of international and domestic pressure and counter-pressure, 37(124), *Review of African Political Economy*, 2010, 188.

⁷ Bachelard J.Y, The Anglo-Leasing scandal in Kenya: The politics of international and domestic pressure and counter-pressure, 189.

⁸ Article 79, *Constitution of Kenya*, 2010

⁹ Section 3(1), *The Ethics and Anti-Corruption Commission Act* (No 22 of 2011).

¹⁰ Section 11(d), *The Ethics and Anti-Corruption Commission Act* (No 22 of 2011).

¹¹ *Prevention of Crime and Anti-Money Laundering Act* (No 9 of 2009)

of its state budget.¹² Moreover, as late as 2020, Kenya has been ranked twenty-fourth globally among countries that register a high rate of illicit financial flows.¹³ In this regard, the judiciary has received most blame for its failure to convict and recover assets from persons brought to court on charges of corruption.¹⁴

While the above assertion may have some truth to it, it is important to note that this breed of criminals is smart, more often than not smarter than their victims in this case the government and by extension the taxpayer. The main way they are able to get away with their crimes is using money laundering. This process takes the illicit funds and through several stages turns them into clean untraceable funds that can be used by the criminals thus making their crime pay off. Presently, technological developments particularly in the financial sector are cropping up and threatening to make an already bad situation worse. Top of that list of developments is virtual currencies also known as cryptocurrencies. This paper opines that the present laws' ignorance of, coupled with the State's slow reaction to these technological advancements go a long way to aid looters of public resources, both present and future.

II. STATEMENT OF THE PROBLEM

Ideally, stolen and illegally acquired property should be returned to the rightful owner(s) after prosecution of the guilty parties by courts of law.¹⁵ With regards to stolen funds, the Prevention of Crime and Anti Money Laundering Act provides that the court, through State, as the prosecuting party in a case or on its own motion can grant an order for confiscation of all the proceeds from crime from a person convicted of a crime.¹⁶

Unfortunately, as it stands, very few corruption cases make it to court and when they do, convictions rarely occur, and the cases drag on for very long. As the cases continue, those who are accused of stealing the funds continue to profit from wealth acquired through corrupt means. While the judiciary blames it on gaps and lack of evidence on the part of the prosecution, members of the judiciary have been named by criminals as being accomplices

¹² Miriri D, 'Third of Kenyan budget lost to corruption: anti-graft chief' Reuters, 10 March 2016, - <<https://www.reuters.com/article/us-kenya-corruption/third-of-kenyan-budget-lost-to-corruption-anti-graft-chief-idUSKCN0WC1H8>> on 20 February 2020.

¹³ United Nations Conference on Trade and Development, '*Economic Development in Africa Report 2020; Tackling Illicit Financial Flows for Sustainable Development in Africa*' 2020.

¹⁴ Franceschi L, 'A history of state capture in Kenya: The Anglo Leasing scandal' Daily Nation, 29 November 2019-<<https://www.nation.co.ke/oped/blogs/dot9/franceschi/Audacity-of-greed-The-Anglo-Leasing-tragedy/2274464-5367190-xmjy6j/index.html>> on 20 February 2020.

¹⁵ Section 121(3), *Criminal Procedure Code*, 2015

¹⁶ Section 61, *Proceeds of Crime and Anti-Money Laundering Act* (No 9 of 2009).

to the criminals in their efforts to get the cases either dismissed or thrown out. This leads to many accused people walking free with stolen funds and wealth acquired through unscrupulous and illegal means.

Furthermore, illegally acquired assets are characteristically hidden in various ingenious ways. For instance, guilty parties have been found to have formed shell or phantom corporations to hold the money. This is because companies are independent legal entities hence, they separate the criminals from the money therefore making it harder to tie the two together. This was seen in the case of Samuel Gichuru, a former chairman of the Kenya Power and Lighting Company who formed Windward Trading Limited which was used to hide 500 million shillings in embezzled funds.¹⁷

Another example is the transferring of funds to offshore accounts located in tax havens, jurisdictions known for their low taxes and secrecy. This was the case in the Samuel Gichuru case who, together with Chris Okemo, stashed the 500 million shillings embezzled from the Kenya Power and Lighting Company in Jersey, a popular tax haven.

Third, the continued rise of the digital age brought with it a new form of currency known as cryptocurrencies or virtual currencies. These are currencies which act as real currencies but are unlike real currencies. The difference comes in that virtual currencies do not have legal tender status in any jurisdiction.¹⁸ Therefore, this differs from the electronic transfer of fiat currency for instance through PayPal and electronic wire transfers because there are no physical materials to intercept for proof of illicit activities.¹⁹ They exist in three forms, the first being physical meaning the virtual currency is represented on a physical medium, second is a centralized form where transfers occur through an intermediary and third is a decentralized form an example being Bitcoin.²⁰

While all three methods are ingenious due to their highly untraceable nature, with the first two, governments both locally and internationally have devised ways to track, seize and where applicable, repatriate stolen funds to their respective owners. In some instances,

¹⁷ Kahura D, ‘Follow the money: How to make dirty cash clean without Omo’ The Elephant, 6 April 2017 - <<https://www.theelephant.info/features/2017/04/06/follow-the-money-how-to-make-dirty-cash-clean-without-omo/>> on 7 December 2020.

¹⁸ Financial Crimes Enforcement Network, *Application of FINCEN'S Regulations to persons administering, exchanging, or using virtual currencies*, 2013, 1.

¹⁹ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’ 89(1), *Indiana Law Journal*, 2014, 443.

²⁰ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 443.

countries have cooperated to ensure the return of funds hidden in their jurisdiction as seen in the Framework for the Return of Assets from Corruption that was signed by Kenya and Switzerland to assist Kenya in recovering money stolen from state coffers and hidden in Switzerland.²¹ However, when it comes to cryptocurrencies, the lack of a regulatory framework would make it more difficult to track and recover the stolen assets therefore making both recovery and prosecution impossible.

Additionally, even though the law does provide for recovery of proceeds of illegal activities²², the lack of recognition and regulation of the use of cryptocurrencies provides a loophole in the law that may allow people guilty of corruption offences to profit from stolen funds. This paper seeks to analyse the law and propose solutions to fill the lacuna.

This is important because as it is now, Kenya is a leaking ship in terms of its financial management policies and the fiscal health of various public bodies. Corporations and entities that are meant to be helping the public access crucial services have become a cash cow for those placed in positions of power in these organizations and therefore leaving the public at risk of being unable to access services owed to them by virtue of being taxpayers.

Moreover, this paper comes at a time where virtual currencies are gaining in popularity both in legal and illegal activities and therefore, if left unchecked, could lead to widespread cases of money laundering by criminals which in turn will lead to financing of a plethora of illegal activities with the government left running around trying unsuccessfully to recover the assets.

III. PURPOSE OF THE STUDY

The purpose of this study is to establish the role cryptocurrencies play in the field of money laundering and whether the laws in place in any way address cryptocurrency. Thereafter, upon comparison with other jurisdictions that provide for regulation of cryptocurrencies in their laws, recommendations will be given on the best way forward in terms of getting the country up to speed with the developing technology legislation-wise.

²¹ Ombuor R, ‘Kenya signs deal to return stolen wealth from Switzerland’ VOA News, 10 July 2018 - <<https://www.voanews.com/africa/kenya-signs-deal-return-stolen-wealth-switzerland>> on 7 December 2020.

²² Section 61, *Proceeds of Crime and Anti-Money Laundering Act* (No 9 of 2009).

IV. HYPOTHESIS

The research is based on the presumption that criminals who engage in corruption and misappropriation of funds in Kenya are driven by a favourable risk-reward factor where the reward outweighs the risk. This is because even though laws on anti-money laundering and stolen asset recovery are present in Kenya, they have gaping loopholes which may deter their application. This would enable criminals to still be able to gain from illegal activities even if by bad luck they are prosecuted. This presumption is made in comparison to other jurisdictions which have shown better results in asset recovery presumably from staying ahead of the curve and as a result, having better laws and laid-down procedure. This paper assumes that upon the application of some recommendations drawn from the laws of these jurisdictions, the laws will be strengthened and therefore deter people from committing these crimes.

V. THEORETICAL FRAMEWORK

The theoretical basis of this paper is the rational choice theory of criminology. This theory, which is extracted from the expected utility model in economics²³ assumes that offenders freely and actively choose to commit crimes and that the decision is made in response to the immediate circumstances and the immediate situation in which the offense is contemplated. If the situation maximizes the payoff and minimizes the cost, then that is the way to go.²⁴ The motivation to commit the crime is dependent on a calculation of costs and rewards.²⁵

This theory advocates for the formation of measures directly related to preventing the crime rather than focusing on factors in the offender's environment that would cause them to commit the crime.²⁶

With virtual currencies, the transaction costs are lower than those of the fiat currency since it is highly unregulated thus giving criminals incentive to break the law.²⁷ Additionally, as it is now, the cost of committing corruption offences that is jail time is considered small

²³ Heineke JM, *Economic models of criminal behaviour*, 2nd ed, North-Holland Publishing Company, New York, 1978, 1.

²⁴ Akers R.L, Rational choice, deterrence, and social learning theory in criminology: The path not taken, 81(3), *Journal of Criminal Law and Criminology*, 1990, 654.

²⁵ Bennet T, 'Situational crime prevention from the offender's perspective' in Heal K, and Laycock G, *Situational Crime Prevention: From theory into practice*, Her Majesty's Stationery Office, London, 1986, 15.

²⁶ Jeffery C.R, *Crime prevention through environmental design*, Sage Publications, California, 1971, 22.

²⁷ Bååth D, and Zellhorn F, 'How to combat money laundering in Bitcoin?' An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.' Published Thesis, Linköpings Universitet, Sweden, 2016, 8.

compared to the rewards which include wealth and power seeing as the chances of serving jail terms is very minimal and the chances of having the wealth confiscated even less. Therefore, strong, functional, and airtight laws on stolen asset recovery that ensure that any form of wealth related to proceeds of corruption is confiscated would provide the much-needed deterrence factor in the theft of public funds in that the cost/benefit analysis would turn out to disfavour a potential criminal thus reduce the rates of theft.

VI. RESEARCH METHODOLOGY

The research will use a doctrinal methodology. This will involve the use of relevant primary and secondary sources which include statute, case law, books, journals, newspapers, and internet sources. These will be reviewed and analysed to provide information on the study.

VII. RESEARCH QUESTIONS

- 1) What are cryptocurrencies and bitcoin and how do they work?
- 2) What is money laundering and how does it relate to Bitcoin?
- 3) What are the laws in place regarding stolen asset recovery?
- 4) What are other jurisdictions doing differently?
- 5) What should be done in Kenya to improve the situation?

VIII. JUSTIFICATION

The rationale of this research is the realization that the country is haemorrhaging money in struggling to provide its citizens with services, a problem caused by greedy, unscrupulous individuals who milk various organizations dry. Moreover, the developments in the digital space, specifically in the financial sector has brought about novel ways in which those who steal these funds could hide them and profit off the stolen funds. This research aims to provide a solution to this problem by bolstering the law on anti-money laundering and the recovery of stolen funds to ensure that people are dissuaded from stealing public funds.

The information this study will add includes the methods used by other countries which have registered success in the field of regulation of cryptocurrencies and the impact the recovery of assets will have not only in the affected entities but also on the economy and in terms of the country's global standing.

The information gathered in this research could prove to be of good use not only locally, but internationally by governments and various international organizations and bodies that have suffered the brunt of theft and misappropriation of funds.

From the study outcomes it could be implied that the legislature and the responsible state organs have their work cut out for them to ensure that the law responds to the changing times in the digital space. This is because the loopholes in the law that will be identified in this paper have the potential to cause the country to lose more than it is already losing to corruption.

IX. LIMITATIONS AND DELIMITATIONS

a) Limitations

The major shortcoming of this study would be that the realm of stolen asset recovery and in particular how it deals with virtual currencies is not a widely researched field locally thus heavy reliance will be on international publications. Moreover, the study is limited to the law in question and not to the prosecution and their building of a case.

b) Delimitations

This research will be restricted to corruption and public theft cases and not venture into the wider area of proceeds from all illegal activities. This is because the problem that the paper wishes to address is that of missing public funds and how to have them returned and at the same time deter those who would think of plan to steal from public coffers.

X. OBJECTIVES OF THE STUDY

The aim of this study is to investigate the application of asset recovery measures by current laws and assess their effectiveness where cryptocurrencies are concerned.

To achieve this, this paper will first briefly define cryptocurrencies and Bitcoin and how transactions are carried out. Following that the author will then highlight the reasons cryptocurrencies are hard to regulate followed by a brief definition of money laundering and how it works. Then, the relationship between Bitcoin and money laundering will be explained.

Afterwards, the laws currently in place addressing the recovery of illegally acquired assets will be analysed. Then the paper will investigate the place of virtual currencies in the Kenyan legal system.

Thereupon, the paper will examine the laws in jurisdictions that have recognized virtual currencies as modes of payment and financial transactions in relation to legal activities.

Lastly, the paper will give recommendations on what may need to be done to make the process of recovery of illegally acquired assets more efficient and up to date.

XI. LITERATURE REVIEW

There have been various perspectives on the role of law in stolen asset recovery and the effect of adequate recovery mechanisms on both the economy and the rate of financial crimes. The role of courts in ensuring adequate enforcement of these laws has also been extensively reviewed in multiple publications. What is similar in almost all publications is the belief that the situation can be salvaged but only if the responsible bodies are willing to step up and work.

Kimberly Ann Elliott²⁸ compares Kenya and Uganda in an effort to try and narrow down factors which would allow corruption to thrive. She specifically points to illiteracy which she says allows for the literate bureaucrats to exploit their constituents as was the case in post-colonial Kenya. Furthermore, inadequate management controls and lack of proper monitoring facilities play a big role in allowing for corrupt individuals to have a field day.

Kempe Ronald Hope Sr.²⁹ in a subsequent paper addresses corruption in Kenya post-2010 arguing that corruption has grown to become endemic, transforming institutions that were designed to benefit the public to get-rich-quick schemes for public officials and corrupt private agencies. In his opinion, this is largely aided by the existing governance institutions which lack both the will and capacity to combat corruption. He identifies factors such as centralised power and the absence of strong, democratic institutions as the main causes of corruption and analyses its effects on the economy and international standing of the country.

David Scher³⁰ addresses repatriation of stolen wealth in Africa while focusing on Kenya and Nigeria. He posits that repatriation of wealth is not easy even for countries as it is plagued by numerous hurdles, biggest of them being that those who steal have a lot of influence and power. Furthermore, most of this wealth is hidden in foreign jurisdictions thus navigating of the “international legal labyrinth” becomes an uphill task especially for developing countries. However, with the current wave of international cooperation on the fight against

²⁸ Elliott K.A, ‘The Problem of Corruption: A tale of two countries’ 18(524), *Northwestern Journal of International Law and Business*, 1998.

²⁹ Hope K.R, ‘Kenya’s corruption problem: Causes and Consequences’ 52, *Commonwealth and Comparative Politics*, 4, 2014.

³⁰ Scher D, ‘Repatriating Africa’s looted billions’ 14, *African Security Review*, 4, 2005.

corruption, the process has become more streamlined making recovery of stolen assets almost a reality.

The Australian government, through the Australian Transaction Reports and Analysis Centre, examined digital currencies for use in criminal activities, specifically money laundering. In the report stemming from this study³¹, it was concluded that digital currencies fall outside conventional anti-money laundering legislation thus providing digital currency exchanges with the platform to enable criminals to serially convert their digital currencies to other digital currencies before reintroduction as fiat currency.³² The reported also noted that this has some drawbacks the major ones being the limited size of digital currency markets and the limited rate of acceptance of payment.³³

Danton Bryans, in his paper ‘Bitcoin and Money Laundering,’³⁴ states that while regulating bitcoin brings with it a raft of challenges, virtual currencies are best dealt with by regulating the Bitcoin currency exchange. These are the points or businesses that deal with the changing of Bitcoin to fiat currency and vice versa. By licencing and consequently allowing for the use of Bitcoin in the market, the process of averting money laundering becomes easier. This is because, exchanges gain credibility through user confidence and volume.³⁵ Therefore, if the exchange has few users then it would be unable to process huge transactions without raising red flags. Furthermore, since it will be operating as a currency exchange, it will be easier to govern it through the present laws on currency exchange currently used by various forms of fiat currencies.³⁶

While David Scher is correct in positing that international cooperation has led to the streamlining of the process of asset recovery, the use of Bitcoin and other virtual currencies throw a spanner in the works. The author posits that while the knee-jerk reaction would be to make new laws governing the use of Bitcoin and extend its application to money laundering offences, the best cause of action would be to amend the present laws on anti-money laundering and stolen asset recovery to provide for the recovery of virtual currencies so as to future-proof the law in preparation of the advancements in the financial sector.

³¹ Australian Transactions Reports and Analysis Centre, *Typologies and case studies reports*, 2012.

³² Australian Transactions Reports and Analysis Centre, *Typologies and case studies reports*, 2012, 19.

³³ Australian Transactions Reports and Analysis Centre, *Typologies and case studies reports*, 2012, 17.

³⁴ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’ 89(1), *Indiana Law Journal*, 2014.

³⁵ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 471.

³⁶ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 471.

XII. CHAPTER SUMMARY

This paper shall be divided into five chapters addressing various aspects of the topic.

The first chapter will introduce the topic and give a background of the problem and what the paper intends to address. It will go further and briefly discuss the details of the paper.

Chapter two will then tackle the issue of cryptocurrencies, Bitcoin and money laundering. It will first demystify cryptocurrencies beginning with a brief definition of virtual currencies and Bitcoin followed by how transactions involving cryptocurrencies are carried out. Then it will highlight the challenges to the regulation of Bitcoin. Following this, a brief definition of money laundering and how it occurs will be provided and afterwards, the relationship between Bitcoin and money laundering will be provided.

Subsequently, Chapter Three will contain an analysis of the concerned laws. This analysis will be of the laws concerning anti-money laundering in place locally. This will be done through identifying the various laws in place and their aims with regard to fighting corruption and recovering illegally acquired assets. Lastly, the place of cryptocurrencies in the Kenyan context will be discussed.

Chapter Four will examine various jurisdictions and how they regard cryptocurrency as a mode of transaction. In this chapter, the various jurisdictions will be identified and their requisite laws addressing recovery of illegally acquired assets held in virtual currencies analysed. Moreover, the chapter will also contain a review of the results achieved in these jurisdictions.

The fifth and last chapter will contain the findings and recommendations. Drawing on the findings in the third and fourth chapters, this chapter will focus on what exactly needs to be done to seal the loopholes in the law therefore improving the rate of asset recovery presently and in the future and to dissuade others from committing corruption offences. In addition, this chapter will put forward recommendations on what exactly should be changed or even added onto the present laws.

CHAPTER TWO: VIRTUAL CURRENCIES, BITCOIN AND MONEY LAUNDERING

a) Virtual Currencies

To begin with, virtual currencies are defined as a digital representation of value that can be digitally traded and that functions either as a medium of exchange, a unit of account and/or a store of value but does not have legal tender status in any jurisdiction.³⁷ Many countries and individuals have taken to use them as a store of value that approximates a speculative asset rather than a unit of money.³⁸

The lack of a legal tender does not the effect of rendering the currency invalid but when it is received by a creditor, it is a valid and legal form of payment. Therefore, the conclusion can be drawn that while virtual currencies are not issued by any jurisdiction it fulfils the functions of a currency by agreement within the community of users of the currency.³⁹ There are various types of virtual currencies the primary one being Bitcoin. Most of the other currencies take their shape and form in one way or another from Bitcoin thus they are referred to as ‘Altcoins.’⁴⁰ These include ‘Namecoin’ and ‘Ethereum.’⁴¹

b) Bitcoin

Bitcoin is defined as a decentralized, pseudonymous, peer-to-peer network.⁴² It was founded in 2009 by one Satoshi Nakamoto after the Great Recession in 2008.⁴³ The currency was aimed to be a peer-to-peer network that would “generate a system for electronic transactions

³⁷ Financial Action Task Force, *Virtual Currencies Key Definitions and Potential AML/CFT Risks*, June 2014, 4.

³⁸ Lastra RM and Allen JG, Virtual currencies in the ecosystem: Challenges ahead, European Parliament Policy Department for Economic Scientific and Quality of Life Policies, 2018.

³⁹ Financial Action Task Force, ‘*Virtual Currencies Key Definitions and Potential AML/CFT Risks*’ June 2014, 4.

⁴⁰ Lastra RM and Allen JG, Virtual currencies in the ecosystem: Challenges ahead, European Parliament Policy Department for Economic Scientific and Quality of Life Policies, 2018.

⁴¹ Bradbury D, ‘What are Altcoins?’ The Balance, 30 August 2020 - <<https://www.thebalance.com/altcoins-a-basic-guide-391206>> on 7 December 2020.

⁴² Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 443.

⁴³ Bååth D, and Zellhorn F, ‘How to combat money laundering in Bitcoin; An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.’ Published Thesis, Linköpings Universitet, Sweden, 2016, 8.

without relying on trust.”⁴⁴ This meant that it would not be under the control of any government agency but instead be controlled by rigorous mathematical equations.⁴⁵

The pseudo-anonymity trait is achieved by creating “enough obfuscation to provide users with plausible deniability.”⁴⁶ This is done using an alphanumeric string that represents the source and/or the destination of a bitcoin transaction, therefore, identifying only a user and not any identifiable information leaving any third party in the dark as to who are the parties to the transaction.⁴⁷

Bitcoin is popular for one main reason; it lowers transaction costs. This is a term used collectively to refer to any factor that obstructs, prevents, or makes transactions between two parties more costly.⁴⁸ Thanks to being largely electronic in nature and lacking regulation, Bitcoin and other virtual currencies have gained favour with a lot of users for being cheaper to transact with compared to fiat currencies. This is evident with the ever-rising market capitalization value of Bitcoin which went from \$1 Billion in 2013 to \$350 Billion in 2020.⁴⁹

c) How Bitcoin Transactions Occur

There are three ways through which Bitcoins can be obtained. First, Bitcoins can be obtained in exchange for fiat currency through the use of private channels or traders. Secondly, bitcoin can be acquired as payment for goods and services and lastly Bitcoins can be “mined.” Mining is a process where Bitcoin users maintain the blockchain ledger to ensure double spending does not occur and in return they are awarded Bitcoins.

For a Bitcoin transaction to occur, one needs to have a bitcoin wallet. This is a piece of software that exists in the form of a computer program or a downloadable application that connects the user to the Bitcoin network.⁵⁰ The transaction begins with the prospective

⁴⁴ Nakamoto S, Bitcoin: A peer-to-peer electronic cash system, 2008, 8.

⁴⁵ Bååth D, and Zellhorn F, ‘How to combat money laundering in Bitcoin: An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.’ Published Thesis, Linköpings Universitet, Sweden, 2016, 8.

⁴⁶ Peck ME, The Cryptoarnachists’ answer to cash, IEEE Spectrum, June 2012, 50.

⁴⁷ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 443.

⁴⁸ Bååth D, and Zellhorn F, ‘How to combat money laundering in Bitcoin?’ An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.’ Published Thesis, Linköpings Universitet, Sweden, 2016, 8.

⁴⁹ Best RD, Bitcoin Market Capitalization as of December 13, 2020, Statista, 14 December 2020, - <<https://www.statista.com/statistics/377382/bitcoin-market-capitalization/#:~:text=Bitcoin%20market%20capitalization%20as%20of%20December%2013%2C%202020,0&text=In%20December%202020%2C%20the%20Bitcoin%20than%20350%20billion%20U.S.%20dollars.>> on 22 December 2020.

⁵⁰ Kaplanov NM, ‘Nerdy money: Bitcoin, the private digital currency, and the case against its regulation, 25(1), *Loyola Consumer Law Review*, 2012, 116.

sender specifying a certain number of bitcoins to be transferred to another user. The prospective recipient's bitcoin wallet then generates a unique code consisting of alphabetic and numeric characters that represent a sort of account to which the bitcoins will be sent to. The sender then puts the bitcoins in this account and confirms the payment by using a private key. The recipient then is able to withdraw the funds using a separate private key.⁵¹ It is important to note that while the transactions are hidden behind a sequence of numbers and letters, every transaction can be seen by anyone on the network thus explaining why Bitcoin is a pseudonymous rather than an anonymous network.⁵² In order for transactions to be valid and to avoid double spending, they must be logged on a shared public ledger known as the blockchain.⁵³ Double spending is the phenomenon where the same digital currency is used in two separate transactions and is the reason why earlier attempts at virtual currencies failed.⁵⁴ This ledger is maintained by thousands of home computers rather than by a central server in the mining process described earlier.

d) Hurdles to The Regulation of Cryptocurrencies

I. Non-regulation

While this may seem repetitive, it makes sense to look at it from a global point of view. Globally, regulators have shown hesitation or flatly refused to regulate virtual currencies because of the risks attached to the currency. A major risk cited by many regulators is that the value of cryptocurrencies is dictated by the laws of supply and demand and there is no backing by tangible assets. This makes them very volatile so much so that normal financial regulations would not be sufficient.

II. Anonymity.

The fact that transactions using Bitcoin and virtual currencies provide the users with anonymity makes it easy for people wishing to engage in illegal activities such as money laundering to do it behind the protection of a screenname. Moreover, the use of Bitcoin addresses makes it difficult to track the injection, layering and re-entry of funds since the

⁵¹ Bååth D, and Zellhorn F, 'How to combat money laundering in Bitcoin; An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.' Published Thesis, Linköpings Universitet, Sweden, 2016, 9.

⁵² Nian LP and Chuen DL, 'Introduction to Bitcoin' in Chuen DL (ed), Handbook of Digital Currency, 1st ed, Elsevier Inc, London, 2015, 22.

⁵³ Kaplanov NM, 'Nerdy money: Bitcoin, the private digital currency, and the case against its regulation, 116.

⁵⁴ Nian LP and Chuen DL, 'Introduction to Bitcoin', 15.

addresses to do not directly lead to the identification of a person.⁵⁵ This presents a hurdle to regulators because the inability to be able to identify a user translates to either criminals getting away or, as shown in the Emma Kariuki case, innocent parties being prosecuted.

III. Use of Blockchain technology

As explained above, the shared public ledger that is the blockchain is not housed in one central server but rather in many home computers. These computers are responsible for maintaining the blockchain and by extension the entire Bitcoin cryptocurrency. Moreover, with every transaction, the Bitcoin network automatically scales the difficulty for completing blocks for miners thus in order to stop the network from functioning one would need to disable every single miner on the network thus making the system impossible to interrupt.⁵⁶

IV. Quick and cheaper transactions

the fact that Bitcoin and other virtual currencies assure users of quick transactions and lowered transaction costs due to the absence of a middleman gives criminals the platform to move money faster, cheaper and, thanks to the obfuscation created by funnelling the funds through multiple addresses, more discreetly than ever before.

e) Money Laundering

Money laundering is defined as the concealment of the origins of illegally obtained money.⁵⁷ This is typically done through transfers involving foreign banks or legitimate businesses. Money laundering has three stages: placement, layering and integration.

Placement is the physical insertion of “dirty money” into the financial system.⁵⁸ It involves the physical movement of currency to a place or into a form that is less suspicious to the authorities and convenient to the criminal and introducing them to the banking system or the retail economy through multiple deposits, escrow accounts or even direct deposits with the help of crooked bank employees.

Layering can be defined as the stacking of illegal funds. This involves the creation of complex financial transactions such as wire transfers and multiple financial dealings with

⁵⁵ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 447.

⁵⁶ Bryans D, ‘Bitcoin and money laundering: Mining for an effective solution’, 447.

⁵⁷ Merriam Webster Dictionary, 11th ed.

⁵⁸ Schneider F and Windischbauer U, ‘Money Laundering: Some facts’ Economics of Security Working Paper Number 25, 2010, 6 - < file:///C:/Users/Anthony%20Ndichu/Downloads/diw_econsec0025.pdf> on 14 December 2020.

the aim of concealing the origin of the money.⁵⁹ An example of how this is done is through over and under-invoicing international transactions, charging fictitious goods and services or through back-to-back loans.⁶⁰

Finally, integration involves the introduction of the now “clean money” into the economy through legitimate transactions such as purchasing of specific stocks deposits, direct investments into real estate companies and so on.⁶¹

Where virtual currencies are concerned, the absence of a third-party in transactions makes it harder to monitor the transactions. This is because the go-to strategy in anti-money laundering is to monitor the third party thus making it difficult for criminals to transact without scrutiny.⁶² Moreover, since transactions involving virtual currencies are online, making face-to-face contact is out of the question thus making identification harder.

Furthermore, Bitcoin’s pseudonymous nature makes it hard for to trace the individual behind the transaction even though the transactions themselves are logged on the Blockchain. Additionally, unlike cash for which one has to deposit a certain maximum to avoid raising suspicion, Bitcoins in the value of millions can be stored on a single USB drive and transacted all over the world in a manner of minutes.⁶³ All these factors put together make Bitcoins a more preferable way to launder money for criminals.

⁵⁹ Schneider F and Windischbauer U, ‘Money Laundering: Some facts’, 6.

⁶⁰ Schneider F and Windischbauer U, ‘Money Laundering: Some facts’, 8.

⁶¹ Schneider F and Windischbauer U, ‘Money Laundering: Some facts’, 8.

⁶² Bååth D, and Zellhorn F, ‘How to combat money laundering in Bitcoin; An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.’ Published Thesis, Linköpings Universitet, Sweden, 2016, 9.

⁶³ Bååth D, and Zellhorn F, ‘How to combat money laundering in Bitcoin; An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.’ Published Thesis, Linköpings Universitet, Sweden, 2016, 9.

CHAPTER THREE: LEGAL ANALYSIS

I. ANTI-CORRUPTION AND ANTI-MONEY LAUNDERING LAWS

a) The Constitution of Kenya 2010

The Constitution of Kenya, in line with its aim of being a transformative constitution, provides for measures to curb corruption and financial crimes. This is done through several provisions the principal one being Article 10 which lists integrity, transparency, and accountability as some of the national values and principles of governance.⁶⁴

Furthermore, under Chapter Six, the Constitution restricts state officers from maintaining a bank account outside Kenya except in accordance with an Act of Parliament.⁶⁵

b) Proceeds of Crime and Anti-Money Laundering Act

Secondly, there is the Proceeds of Crime and Anti-Money Laundering Act which was enacted in 2009. This Act aims to provide for the offence of money laundering and to introduce measures for combating the offence, to provide for the identification, tracing, freezing, seizure, and confiscation of the proceeds of crime, and for connected purposes.⁶⁶

The Act defines property as “all monetary instruments and all other real or personal property of every description, including things in action or other incorporeal or heritable property, whether situated in Kenya or elsewhere, whether tangible or intangible and includes an interest in any such property and any such legal documents or instruments evidencing title to or interest in such property.”⁶⁷ Additionally, realizable property is defined as; (a) property laundered, (b) proceeds from or instrumentalities used in, or intended to be used in money laundering or predicate offences, (c) property that is the proceeds of, or used, or intended or allocated for use in, the financing of any offence and (d) property of corresponding value. Therefore, under criminal forfeiture, the property realizable is any property held by the defendant or any property held by another person, to whom the defendant directly or indirectly made a gift.⁶⁸

To help fulfil its objectives, the Act also provides for the formation of the Financial Reporting Centre.⁶⁹ This Centre is a body corporate with perpetual succession whose

⁶⁴ Article 10(2)(c), *The Constitution of Kenya*, 2010.

⁶⁵ Article 76(2)(a), *The Constitution of Kenya*, 2010.

⁶⁶ *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁶⁷ Section 2, *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁶⁸ Section 57(1), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁶⁹ Section 21, *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

principal objective is to assist in the identification of the proceeds of crime and the combating of money laundering and the financing of terrorism.⁷⁰ It carries out this function by making information collected by it available to investigating and supervisory agencies, exchanging information with similar bodies in other countries regarding money laundering activities and related offences and ensure compliance with international standards and best practice in anti-laundering measures.⁷¹

Furthermore, the Act also provides for the formation of the Asset Recovery Agency.⁷² This agency is tasked with implementing the provisions of parts VII to XII of the Proceeds of Crime and Anti-Money Laundering Act. These parts address criminal forfeiture, civil forfeiture, preservation and forfeiture of property, production orders and other information gathering orders, the criminal assets recovery fund and international assistance in investigations and proceedings. The Attorney General appoints the Agency Director⁷³, who in turn appoints members of staff.⁷⁴ As part of its funding, the agency is entitled to a percentage of the total proceeds recovered or realized from property seized or forfeited to the government.⁷⁵

On criminal forfeiture, the Act provides that the proceedings on application of a confiscation or restraint order are civil and therefore, the rules of evidence applicable in civil proceedings shall apply to proceedings on application for a confiscation order or a restraint order.⁷⁶ Upon conviction of the defendant of an offence, the court, on application of the Attorney General, the Agency Director or its own motion, inquire into any benefit which the defendant may have derived from that offence, any other offence that the defendant has been convicted of at the same trial and any criminal activity that the court finds to be sufficiently related to that offence.⁷⁷ If the court finds that the defendant benefitted, it shall make an order for the defendant to pay the government any amount it considers appropriate. The court can also make any other orders to ensure the effectiveness and fairness of the order.

⁷⁰ Section 23(1), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷¹ Section 23(2), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷² Section 53, *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷³ Section 53(2), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷⁴ Section 53(4), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷⁵ Section 54A(2)(b), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷⁶ Section 56, *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

⁷⁷ Section 61(1), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

It is evident from the analysis above that Bitcoin is not addressed with regard to the hiding and the recovery of assets acquired illegally and therefore provides a loophole for criminals, present and future, to use it to hide, launder and reintroduce to the economy these assets.

c) Central Bank of Kenya Act

The Central Bank of Kenya Act is an Act of Parliament that establishes the Central Bank of Kenya, provides for its operations, establishes the currency of Kenya and addresses connected matters.⁷⁸ The Act gives the Central Bank of Kenya the sole authority to issue notes and coins in Kenya and only those notes and coins shall be legal tender.⁷⁹ This means that until the Central Bank recognizes a unit of currency as legal tender, it cannot be recognized as one.

d) The United Nations Convention Against Corruption

The United Nations Convention Against Corruption which was ratified by Kenya on 9th December 2003 states in its Preamble that one of the reasons the Convention was drafted was the “concern about the links between corruption and other forms of crime, in particular organized crime and economic crime, including money laundering.”⁸⁰

The Convention, in an effort to tackle money laundering, requires signing states to “institute a comprehensive regulatory and supervisory regime for banks and non-financial institutions, including natural and legal persons that provide formal or informal services for the transmission of money or value and, where appropriate, other bodies susceptible to money laundering.”⁸¹ The aim of this provision is to both deter and detect cases of money laundering.

The States are also to ensure that authorities dedicated to combating money laundering are empowered to cooperate and exchange information at the national and international level within conditions prescribed by domestic law. This has been made possible in Kenya by Section 23 of the Proceeds of Crime and Anti-Money Laundering Act which establishes the Financial Reporting Centre that has the powers to share evidence and results of investigations with other countries.⁸²

⁷⁸ *The Central Bank of Kenya Act* (1984).

⁷⁹ Section 22, *The Central Bank of Kenya Act* (1984).

⁸⁰ Preamble, *United Nations Convention Against Corruption*, 31 October 2003, UNTS 2349.

⁸¹ Article 14(1)(a), *The United Nations Convention Against Corruption*.

⁸² Section 23(2), *Proceeds of Crime and Anti-Money Laundering Act*, 2009.

Article 14(2) of the Convention states that Parties shall consider implementing feasible measures to “detect and monitor the movement of cash and other appropriate negotiable instruments across their borders.” This has to be done without impeding the flow of legitimate capital. The author argues that the failure to address Bitcoin and other virtual currencies in the law places Kenya in a position where it is in violation of this provision of the Convention.

II. PLACE OF BITCOIN AND VIRTUAL CURRENCIES IN KENYA

For years after its launch, the place of Bitcoin in the county was largely unknown, with the regulatory authorities choosing to remain silent on the matter. Even though there was no form of recognition or otherwise, Bitcoin gained popularity in the Kenyan market with several individuals and businesses transacting in Bitcoin. This went on until December 2015 when the Central Bank of Kenya, the main regulator finally issued a statement informing Kenyans that Bitcoin and other virtual currencies were neither legal tender nor regulated in Kenya and therefore, “the public should desist from transacting in Bitcoin and similar products.⁸³ The regulator cited three reasons against the use of Bitcoin. First was that transactions in virtual currencies were untraceable and largely anonymous making them susceptible to use by criminals in money laundering and financing of terrorism. Secondly, the global non-regulation of virtual currencies presented a risk to consumers who could lose their money without any legal redress if the system collapsed and lastly that since there was no backing of assets and the value of cryptocurrencies is speculative in nature, the value of virtual currencies was prone to high volatility thus exposing users to potential losses.⁸⁴

The courts have also had their say on whether or not virtual currencies are legal in Kenya. In the case of *Lipisha Consortium and another v Safaricom Limited*,⁸⁵ the courts held that the Respondent company was within its rights to suspend and refuse to offer services to the First Petitioner. The facts were that Lipisha Consortium had handed Mpesa services to a third party that is Bitpesa Limited who were engaging in Bitcoin exchanges using the Respondent’s mobile money services thus threatening the Respondent’s licence granted by the Central Bank of Kenya. This is because the 2nd Petitioner was carrying out a money remittance business which required a licence from the Central Bank of Kenya. However, the

⁸³ Central Bank of Kenya, ‘Caution to the public on virtual currencies such as bitcoin’ December 2015, 2.

⁸⁴ Central Bank of Kenya, ‘Caution to the public on virtual currencies such as bitcoin’ December 2015, 2.

⁸⁵ *Lipisha Consortium and another v Safaricom Limited* (2015) eKLR.

exchange involved Bitcoin was and still is neither recognized as legal tender nor currency thus the business could not be licenced.

This, however, has not stopped Kenyans from transacting in bitcoin case in point being a man from Nakuru who paid for his bride price, and several businesses that have reported accepting bitcoin as a mode of payment.⁸⁶ Furthermore, it is reported that Kenya holds an estimated 163 Billion Shillings worth of Bitcoin, which is equal to about 2.3% of her GDP, making the country to have the fifth highest Bitcoin holding per capita.⁸⁷

This popularity of the use of bitcoin in legitimate transactions can be said to be the proverbial smoke to the fire that is illegal transactions that are money laundering and the hiding of stolen assets. Already, certain individuals are using the pseudonymity granted by Bitcoin to commit crimes, a great example being a case where three peer-to-peer traders were charged with conspiracy to commit a felony after receiving amounts totalling to Kshs 10.2 million that was stolen from a local bank and mobile money service in a cryptocurrency transaction.⁸⁸ The three who were charged could not identify the Bitcoin buyer who only went by the screenname “BADASS20.” However, the stolen money was traced back to the traders’ accounts and therefore leaving them with questions to answer. This is just but a tip of the iceberg to what could go on if issues regarding the use of virtual currencies are left unaddressed.

⁸⁶ Russon MA, ‘Crypto-currencies gaining popularity in Kenya’ BBC News, 22 February 2019 - <https://www.bbc.com/news/business-47307575> on 12 December 2020.

⁸⁷ Mbogo A, ‘Kenyans are among the highest Bitcoin holders per capita according to Citi Report.’ BitcoinAfrica.io, 14 January 2018 - <<https://bitcoinafrica.io/2018/01/14/kenyans-are-among-highest-bitcoin-holders-per-capita/>> on 7 December 2020.

⁸⁸ Kenyan Wall Street, Bitcoin case at Milimani Law Courts sets precedence, Kenyan Wall Street, 30 June 2020 - <[https://kenyanwallstreet.com/bitcoin-case-kenyas-milimani-law-courts-sets-precedence/#:~:text=November%202028%2C%202017%20Three%20peer,bank%20and%20mobile%20money%20operator,](https://kenyanwallstreet.com/bitcoin-case-kenyas-milimani-law-courts-sets-precedence/#:~:text=November%202028%2C%202017%20Three%20peer,bank%20and%20mobile%20money%20operator,>)> on 9 December 2020.

CHAPTER FOUR: COMPARATIVE ANALYSIS

While virtual currencies are more or less a new phenomenal in the financial sector, its novelty and the challenges that come with it are not experienced by Kenya alone. Its decentralized nature has brought similar obstacles across the board in how best to efficiently deal with it. In this section, an analysis is carried out on several jurisdictions that have made an effort to grab the bull by the horns and made an effort to regulate cryptocurrencies with regard to taxation and anti-money laundering efforts. These jurisdictions are Switzerland, Canada, China, and the United States of America.

a) Switzerland

For a long time in the financial sector, Switzerland was a tax haven due to its secrecy when it came to financial transactions. The use of numbered Swiss bank accounts was almost if not as efficient as Swiss army knives, true to the precision the Swiss are famous for. While this goes against the points this paper tries to put across, an advantage that comes from it is that to maintain this position in the global financial markets, the Swiss legislature has had to be adaptive in coming up with laws that keep up with changes in technology.

Its legal relationship with Bitcoin and cryptocurrencies can be traced back to 2014 when the government published a report detailing the economic significance, legal treatment, and risks of virtual currencies.⁸⁹ At that point in time, the opinion of the Federal Council of the report drew the conclusion that the economic value of virtual currencies as a means of payment was “fairly insignificant” and that it would remain that way for some time.⁹⁰

However, the opinion of the Council has changed over the course of time. It now recognizes the potential and advantages that the new developments in the financial sector, in particular Bitcoins and the blockchain technology, has to offer. To promote the growth and development in this sector, the regulation barriers for Fintech firms were reduced by amending the banking laws.⁹¹ However, it still warns of the risks involved in money laundering, terrorist financing and investor protection.⁹²

⁸⁹ Switzerland Federal Council, *Federal Council Report on Virtual Currencies in Response to the Schwaab and Weibel Postulates*, 2014.

⁹⁰ Switzerland Federal Council, *Federal Council Report on Virtual Currencies in Response to the Schwaab and Weibel Postulates*, 2014, 3.

⁹¹ Gesley J, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 66.

⁹² Gesley J, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 66.

In addition to the regulation changes, the Swiss government announced that it would set up a working group on blockchain and Initial Coin Offerings. This working group in conjunction with government agencies and involving interested businesses will “study the legal framework for financial sector-specific use of blockchain technology with a particular focus on ICOs.”⁹³

Acknowledging the potentials and risks of Bitcoin and virtual currencies means that even as efforts are made to take advantage of the positives, the negatives are also prevented. In Switzerland, this is done via the regulation of “financial intermediaries.”⁹⁴ These are defined as “natural or legal currencies who accept or hold deposit assets for third parties or who assist in the investment or transfer of such assets for transactional basis.” What this means for anti-money laundering efforts is that, as per the 2014 report, trading of virtual currencies falls under Anti-money laundering legislations thus a duty of due diligence lies with those trading. These obligations include verifying the identity of the contracting party and the beneficial owner.⁹⁵

For taxation purposes, Switzerland considers virtual currencies to fall into two categories: wealth tax and income tax. Cryptocurrencies are held to be on the same boat as foreign currencies⁹⁶ therefore citizens in the different cantons or Swiss States are obligated to remit taxes in both classes charged at a rate set by the tax authorities on 31st December of every year. In 2017, the rate of Bitcoins was CHF 13,784.38.⁹⁷ This figure is only meant to act as a recommendation to the Canton authorities as the taxes differ from state to state.

b) China

Looking to the East, China, a leading economy in the region does not recognize cryptocurrencies as legal tender nor does it provide for their regulation in its laws.⁹⁸ In 2013, Bitcoin was defined as a virtual commodity and citizens could trade in it and other virtual

⁹³ Gesley J, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 66.

⁹⁴ Gesley J, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 66.

⁹⁵ Geldwäschereigesetz [GwG] [Anti-Money Laundering Act] [AMLA], Oct. 10, 1997, SR 955.0, art. 2, para. 1, let. a, art 3.

⁹⁶ Gesley J, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 66.

⁹⁷ Gesley J, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 70.

⁹⁸ Zhang L, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 30.

commodities albeit with a warning from the government about the risks involved. This changed in the following years as the government instituted regulatory measures to clamp down on the trade of cryptocurrencies. These included the ban on Initial Coin Offerings, a sort of IPO for virtual currencies, restriction and eventual stifling to extinction of trading platforms. Furthermore, banks, other financial institutions and insurance companies were banned from offering cryptocurrency services.

While China cited concerns over financial risk and investor protection as being the reasons behind her crackdown on virtual currencies and their use in transactions that should in no way be taken to mean that the state is against cryptocurrencies in general. This is because, in October 2017, the People's Bank of China had reportedly completed trial runs on the algorithm needed for a digital currency supply.⁹⁹ This was confirmed in a 2018 interview with the then Governor of the People's Bank of China, Zhou Xiaochuan who stated that the country had been developing its own digital currency for the previous three years and had even gone as far as to set up an Institute of Digital Money in the Bank.¹⁰⁰ Allegedly, this new digital currency would resolve the challenges brought about by digital currencies primarily by being a digital version of the fiat currency backed by the Central Bank.¹⁰¹ Basically, it would be able to attain legal status as it would be the same as the Japanese Yuan.

c) Canada.

Canada, much like Kenya, does not recognize cryptocurrencies as legal tender. The Canadian Revenue Authority instead classifies Bitcoin and other virtual currencies as commodities.¹⁰² However, unlike Kenya, it expressly allows for the use of cryptocurrencies. According to the Financial Consumer Agency of Canada, one can buy goods and services from businesses that accept cryptocurrencies as a mode of payment.¹⁰³ The Canadian Revenue Authority

⁹⁹ Zhang L, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 33.

¹⁰⁰ Zhang L, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 32.

¹⁰¹ Zhang L, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 33.

¹⁰² Gowling LWG, 'Canadian Taxation of Cryptocurrency ... so far' Lexology, 14 November 2017, - <<https://www.lexology.com/library/detail.aspx?g=6283077e-9d32-4531-81a5-56355fa54f47>> on 17 December 2020.

¹⁰³ Digital Currency, FINANCIAL CONSUMER AGENCY OF CANADA, <https://www.canada.ca/en/financial-consumeragency/services/payment/digital-currency.html>

considers these transactions as barter trades.¹⁰⁴ One may also buy and sell digital currency on cryptocurrency exchanges, a platform similar to the stock market.

For taxation purposes, the Financial Consumer Agency states that tax rules apply to all transactions, including those conducted using digital currencies.¹⁰⁵ Consequently, virtual currencies are governed by the Income Tax Act.¹⁰⁶ Correspondingly, as a Canadian is filing their taxes, they must report their gains and losses from selling or buying digital currencies as they could be taxable income as capital for the taxpayer.¹⁰⁷

To curb money laundering through Bitcoin and other virtual currencies, amendments were made to the Canadian Proceeds of Crime (Money Laundering) and Terrorist Financing Act in 2014.¹⁰⁸ The effect of this amendment was to treat virtual currencies as money-service centres for the purpose of anti-money laundering. Therefore, entities dealing with Bitcoin and other cryptocurrencies are required to register with the Financial Transactions and Report Analysis Centre of Canada and comply with other standards such as maintaining records and reporting suspicious transactions.¹⁰⁹ Banks are also barred from opening and/or maintaining accounts with companies dealing with virtual currencies unless the entity is registered with the Financial Transactions and Report Analysis Centre.¹¹⁰

Finally, in a report compiled by the Library of Congress,¹¹¹ out of fourteen countries studied, only two had placed a ban on cryptocurrencies with the rest either considering or already regulating. China, one of the countries that has banned the use of cryptocurrencies, was, at the time of publishing the report and at the time of writing this paper, in the process of developing its own cryptocurrency.

¹⁰⁴ Gowling LWG, ‘Canadian Taxation of Cryptocurrency … so far’ Lexology, 14 November 2017, - <<https://www.lexology.com/library/detail.aspx?g=6283077e-9d32-4531-81a5-56355fa54f47>> on 17 December 2020.

¹⁰⁵ *Digital Currency*, FINANCIAL CONSUMER AGENCY OF CANADA, <https://www.canada.ca/en/financial-consumeragency/services/payment/digital-currency.html>

¹⁰⁶ Ahmad T, The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018, 25.

¹⁰⁷ What You Should Know About Digital Currency, Canada Revenue Agency, - <<https://www.canada.ca/en/revenueagency/news/newsroom/fact-sheets/fact-sheets-2015/what-you-should-know-about-digital-currency.html>> on 17 December 2020.

¹⁰⁸ Bill C-31, *An Act to Implement Certain Provisions of the Budget Tabled in Parliament*, (2014).

¹⁰⁹ Section 255, *Bill C-31, An Act to Implement Certain Provisions of the Budget Tabled in Parliament*, (2014).

¹¹⁰ Section 258, *Bill C-31, An Act to Implement Certain Provisions of the Budget Tabled in Parliament*, (2014).

¹¹¹ The Law Library of Congress, Global Research Centre, *Regulation of Cryptocurrency in selected jurisdictions*, 2018.

CHAPTER FIVE: FINDINGS, DISCUSSIONS, RECOMMENDATIONS AND CONCLUSION.

I. FINDINGS

There have been several findings stemming from the analysis carried out in the preceding sections. First, that the laws locally, while attempting to extensively provide for matters corruption and anti-money laundering, fail to provide for virtual currencies which are quickly gaining popularity in the country, not to mention globally, thus providing a loophole for those who might wish to launder money to do so unabated.

Secondly, most countries that are considered forward thinking when it comes to matters finance and anti-money laundering are either in the process of or already enacting legislation on virtual currencies by regulating Bitcoin exchanges and Initial Coin Offerings. These are key points in the chain of Bitcoin transactions since they are the points in which regulatory agencies can stop the laundering of money. If not legislating, some jurisdictions are banning them altogether.

II. DISCUSSION

From the analysis carried out in the preceding chapters and the findings drawn from it, it is evident that Kenya's failure to provide for some form of regulation regarding Bitcoin and virtual currencies in general puts the country at risk of suffering the brunt of corruption even more than it is currently. This is in line with Kempe Ronald Hope Sr's argument that institutions lacking the will and capacity to combat corruption is a major cause of the continued cases of corruption and loss of funds.¹¹²

Additionally, seeing as most corruption offences regarding the public sector are perpetrated by individuals in positions of power, Kimberly Ann Elliot's argument is validated. While illiteracy does not apply *stricto sensu*, Bitcoin and indeed virtual currencies being largely a novel concept to many translated to the number of those who know and understand the inner workings being few. This allows those in a position of knowledge and with dishonourable intentions to take advantage of the loopholes in the law and benefit much to the detriment of the Kenyan people.

¹¹² Hope K.R, 'Kenya's corruption problem: Causes and Consequences' 52(4), *Commonwealth and Comparative Politics*.

As far as the rational choice theory goes, all these factors, when combined, tip the risk-reward scale in favour of criminals and would-be criminals. The reason behind this is that the immediate situation as it stands is that Bitcoins exist, are traded, and are not regulated in the country. Furthermore, they are practically untraceable and if Kenyans keep paying taxes, there is money in the government and so if someone is to steal and launder the money using Bitcoins, chances of getting caught are close to nil.

As observed in the findings, it is evident that jurisdictions are opting to either legislate and attempt to provide for solutions to the challenges virtual currencies present to the standard laws or ban them altogether. At this point in time, the two options are available to Kenya.

If the country decides to go for the latter, it will mean cracking down on an already promising financial sector tax-wise thus risking people's sources of income now and the country's global standing if the technology takes off in the future. This would also mean devoting a lot of resources to ensuring that no one in the country transacts using Bitcoin, something that we as a country lack the infrastructure to do. While China can be said to have done the same thing and the trend now being to look to the East for inspiration, it is important to remember that China is in the process of developing its own cryptocurrency which would propel it to the top in global financial standings. Therefore, an outright ban would not be a favourable move, a sentiment supported by the European Parliament in a report after an extensive study on cryptocurrencies stated that "Policy makers and regulators should not ignore VCs, nor should they attempt to ban them. Both extreme approaches are incorrect."¹¹³ Moreover, the increased growth in technology such the availability of Virtual Private Networks would enable people to still trade in virtual currencies even if an outright ban were issued. Instead, the authors of the earlier mentioned report argue that virtual currencies should be treated as any other financial instrument proportionally to their market importance, complexity, and associated risks.¹¹⁴

According to Bååth and Zellhorn, a potential money launderer looking to use Bitcoin to launder money would typically have to go through five entities that is the sender of the illegally acquired funds, the recipient of the illegally acquired funds, Bitcoin miners, the

¹¹³ Dabrowski M, Janikowski L, *Virtual currencies and central banks' monetary policy: Challenges ahead*, European Parliament, 2018, 26.

¹¹⁴ Dabrowski M, Janikowski L, *Virtual currencies and central banks' monetary policy: Challenges ahead*, European Parliament, 2018, 26.

Bitcoin development team and the Bitcoin traders who will change the Bitcoin to fiat currency.¹¹⁵

III. RECOMMENDATIONS

With the above discussion in mind, the author's recommendation would be that Kenya take the former option and attempt to provide for the regulation of virtual currencies through legislation. For Kenya and indeed other countries to stand a chance of being able to stop the illicit activities that may stem from the usage of cryptocurrencies, some form of attitude adjustment is in order. Scholars have opined that government agencies and policymakers must ensure that "enforcement agencies have the resources and legal support to create uniformed regulatory bodies, policies and enforcement protocols to properly equip them in the fight against illegal activities."¹¹⁶ These laws therefore will need to strike a balance between upholding the right to privacy of the users and the government's responsibility to stop and protect citizens from illegal activities. The way to do this, according to Danton Bryans, is to focus on each transaction entity to determine which entity, upon regulation would impart the highest transaction costs for money launderers without bearing unreasonably high transaction costs for the regulator and the regulated.¹¹⁷

Going through the chain in Bitcoin transactions, the best group to focus regulation on would be the Bitcoin traders who change the Bitcoin to fiat currencies. This is because the anonymous and decentralized nature of Bitcoin would make it impossible to regulate the other four entities. However, since the traders typically exchange Bitcoin for fiat currencies, they would technically be considered a money remittance business. Therefore, when it comes to regulation locally, they could be regulated more or less in the same way as foreign exchange businesses under Section 33A, 33B and 33C of the Central Bank Act. Regulation would go a long way in ensuring that the government has the ability to increase the transactional cost for criminals at the least cost to the government since Bitcoin traders are an important part in the money laundering process.¹¹⁸

¹¹⁵ Bååth D, and Zellhorn F, 'How to combat money laundering in Bitcoin?' An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.' Published Thesis, Linköpings Universitet, Sweden, 2016, 12.

¹¹⁶ Morton DT, 'The future of Cryptocurrency: An unregulated instrument in and increasingly regulated global economy' 16(1) *Loyola University Chicago Law Review*, 2020, 131.

¹¹⁷ Bryans D, 'Bitcoin and money laundering: Mining for an effective solution', 443.

¹¹⁸ Bååth D, and Zellhorn F, 'How to combat money laundering in Bitcoin?' An institutional and game theoretic approach to anti-money laundering prevention measures aimed at Bitcoin.' Published Thesis, Linköpings Universitet, Sweden, 2016, 12.

IV. CONCLUSION

In conclusion, regulation of cryptocurrencies combined with other efforts already in place would give the government a better chance at fighting corruption thus finally having one up on the vice that has held this country back from achieving her full potential.

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