THE CRIMINAL CURRENCY CONUNDRUM: BALANCING INNOVATION AND REGULATION IN KENYA'S FIGHT AGAINST DIGITAL MONEY LAUNDERING

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

By

Angote Elvis Jemo

145753

Prepared under the supervision of

Mr Abungu Cecil

February 2025

Word Count (11,881)

Declaration

I, [**ANGOTE ELVIS JEMO**], 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: .....March 14 2025.....

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

Signed: .....  .....

[Supervisor's Name]

Date: .....March 14 2025.....

TABLE OF CONTENTS

TABLE OF CONTENTS

ACKNOWLEDGEMENTS

In the tapestry of this scholarly endeavor, I extend profound appreciation to my supervisor, **Mr. Abungu Cecil**, whose steadfast counsel, piercing insights, and erudite direction have been the crucible wherein this dissertation was forged. Their ceaseless encouragement and intellectual stewardship have sculpted my efforts, elevating them to heights I scarce dared envision. Likewise, I owe a deep debt of reverence to my father, **Justice Angote A. Oscar**, a beacon of sagacity and resolve, whose seasoned wisdom and unwavering moral compass in the juridical realm have illuminated my path, casting a radiant glow across the expanse of my academic odyssey.

Above all, I owe the deepest reverence and thanks to my Lord and Savior, **Jesus Christ**, the silent architect of every success, the wellspring of my strength, and the unfailing source of grace that carried me through this endeavour. Every word penned, every thought shaped, and every milestone reached stands as a testament to His unwavering presence. Ave **Christus Rex .**

ABSTRACT

As digital currencies transform the global financial landscape, their pseudonymity and decentralisation have created new opportunities for money laundering, presenting a significant challenge for Kenya's regulatory framework. This study examines whether Kenya should incorporate the Digital Currency Travel Rule into the Proceeds of Crime and Anti-Money Laundering Act (POCAMLA) to address this escalating threat. The objective is to uncover the allure of digital currencies, reveal their role in illicit finance, and propose a practical solution tailored to Kenya's unique context. The study is structured into five chapters. The first chapter delves into the appeal of digital currencies while acknowledging their potential for misuse. The second chapter examines the societal impact of money laundering and how digital currencies facilitate it through anonymity and mixing services. The third chapter analyses the Travel Rule, a Financial Action Task Force (FATF) initiative that mandates Virtual Asset Service Providers (VASPs) to share transactional data, evaluating its global effectiveness and Kenya-specific challenges such as regulatory gaps and technological limitations. The fourth chapter advocates for the integration of the Travel Rule into POCAMLA, anticipating improved oversight, deterrence, and trust in Kenya's financial system. The final chapter concludes with a call to action, recommending legislative and technological reforms.

Methodologically, this study employed a blend of doctrinal analysis alongside comparative and content analysis, utilising secondary sources such as journals, FATF reports, and Kenyan assessments. This approach enabled the construction of a robust argument, grounding the analysis in evidence while reasoning deductively from global trends to Kenya's specific needs. The findings indicate that Kenya's current framework is inadequate, but the Travel Rule presents a crucial opportunity that must be embraced to protect the economy and align with international standards.

LIST OF LEGAL INSTRUMENTS

Proceeds of Crime and Anti-Money Laundering Act (POCAMLA)

National Payments Systems Act (NPSA)

Capital Markets Act (CMA)

Central Bank of Kenya Act

Financial Action Task Force Recommendation 16

The Constitution of Kenya (2010)

LIST OF ABBREVIATIONS

AML - Anti-Money Laundering

BIS - Bank for International Settlements

BTC- Bitcoin

CBK - Central Bank of Kenya

CBDC - Central Bank Digital Currency

CMA - Capital Markets Act

DeFi - Decentralised Finance

FATF - Financial Action Task Force

IMF - International Monetary Fund

IRS - Internal Revenue Service

KYC - Know Your Customer

ML - Money Laundering

NPSA - National Payments Systems Act

P2P - Peer-to-Peer

PF - Proliferation Financing

POCAMLA - Proceeds of Crime and Anti-Money Laundering Act

RCT - Rational Choice Theory

TF - Terrorism Financing

UNODC - United Nations Office on Drugs and Crime

VA - Virtual Assets

VASPs - Virtual Asset Service Provider

Chapter 1: Introduction

1.1 Background

Amidst a global shift towards digital solutions, the financial sector has witnessed a significant transformation with the emergence of digital currencies.[1] The Internal Revenue Service (Hereinafter IRS) has described digital currencies[2] as follows, using the synonymous phrase "virtual currency."

"Virtual currency refers to a digital representation of value that serves as a medium of exchange, a measure of value, and a way to store wealth. Although it can operate similarly to conventional currency in certain contexts, it lacks status as legal tender in any jurisdiction."[3]

Digital currency emerges from coded protocols that regulate its issuance, mimicking a scarce resource. Fresh units arise via a process termed 'mining,' where participants use cryptography to validate transactions and record them in a decentralized digital ledger called the blockchain.[4]

This mechanism doubles as a reward structure, enticing individuals equipped with internet connectivity and suitable equipment to join in. Intriguingly, the ledger's reliability and safety depend on a network of miners who, though often wary of one another, are driven by economic incentives to uphold its integrity.[5]

Proponents of digital currencies highlight their economic advantages, including reduced transaction costs and immunity to inflation. These benefits, combined with low entry barriers and profit potential, contribute to their growing popularity and proliferation.[6] This efficiency makes digital currencies particularly attractive in regions with limited access to banking services. Additionally, digital currencies promote financial inclusion by allowing individuals without

[1] Auer R, Giulio C and Frost J 'Rise of the central bank digital currencies: drivers, approaches and technologies' Bank for International Settlements, BIS Working Papers No 880, 2020, 3 https://www.bis.org/publ/work880.pdf On 14 August 2024.
[2] By digital currency, this paper refers specifically to convertible digital currency.
[3] Glass J, 'What is a Digital Currency?' 57 *Columbia Law School* 3, 2017, 482.
[4] Turpin JB, 'Bitcoin: The Economic Case for A Global Virtual Currency Operating in An Unexplored Legal Framework', 21 *Indiana Journal of Global Legal Studies* 1, 2014, 335.
[5] Cvetkova I, 'Cryptocurrencies Legal Regulation' 5 *BRICS Law Journal* 2, 2018, 129.
[6] Halaburda H, 'Competition in the Cryptocurrency Market', Bank of Canada Working Paper 2014-33 , 2014, 3.

traditional bank accounts to participate in the global economy.[7] Cryptocurrencies are decentralised, which means they offer greater transparency and reduce the risk of government manipulation, giving users more control over their assets. Additionally, blockchain technology, which is the foundation of most digital currencies, provides a secure and unchangeable ledger that can reduce fraud and increase trust in financial transactions.[8]

Digital currencies pose significant risks despite their benefits, particularly in money laundering. Their anonymity and ease of transferring funds across borders make them attractive to criminals seeking to launder illicit proceeds.[9] Money laundering using digital currencies typically involves three stages: placement, layering, and integration. In the placement stage, illicit funds are converted into digital currency, often through unregulated exchanges. In the layering stage, these funds are transferred across multiple wallets and jurisdictions, making them difficult to trace. Finally, in the integration stage, the laundered funds are converted back into fiat currency or used to purchase goods and services, effectively "cleaning" the money. The lack of regulatory oversight in many jurisdictions exacerbates these risks.[10]

Financial institutions face the challenge of addressing the threat of money laundering on multiple fronts. It presents significant risks to the integrity of financial systems and the overall economy. It enables criminals to conceal the sources of illegal funds, making it possible for them to reintroduce this money into the legitimate financial system. This process distorts economic data, resulting in inaccurate assessments of economic performance and complicating governments' implementation of effective economic policies. Furthermore, the unchecked flow of illegal funds perpetuates criminal activities such as drug trafficking, terrorism, and corruption, leading to the destabilisation of communities and posing a threat to national security. The global nature of money laundering, often involving the movement of funds across multiple jurisdictions, makes it challenging to detect

[7] Dr Adgaonkar G, 'A Study on Advantages and Disadvantages of Digital Currency in India with Special Reference to Rupee' 3 *International Journal of Research Publication and Reviews* 11, 2022, 2094.
[8] Sharma R, Arabainda S, 'Using Crypto Currency and Associated Advantages and Disadvantages' 2 *International Journal of Economics & Finance Research & Applications* 2, 2018, 18-19.
[9] Bank of International Settlements, *The crypto ecosystem: key elements and risks,* 2023, 13.
[10] Prendi L, Borakaj D, Prendi K, 'The New Money Laundering Machine Through Cryptocurrency: Current and Future Public Governance Challenges' 5 *Corporate Law and Governance Review* 2, 2023, 86-87.

and prosecute offenders, especially in countries with weaker regulatory frameworks or limited resources.[11]

Central Banks worldwide are now considering the adoption of Central Bank Digital Currencies (Hereinafter CBDCs)[12] and regulation of the current digital currency.[13] Governments across various jurisdictions frequently issue warnings, mainly through central banks, to educate the public about the risks of investing in digital currencies. These notices emphasise the distinction between state-issued currencies and unregulated digital currencies, highlighting the high volatility and the lack of legal protection for investors. The warnings stress that those who invest in cryptocurrencies do so at their own risk, with no available legal recourse in case of losses.[14]

Numerous countries have not only highlighted the risks associated with cryptocurrencies but also emphasised their potential for illicit activities such as money laundering and terrorism financing.[15] Presently, in Kenya, the Central Bank of Kenya (Hereinafter CBK) has not exercised any regulatory powers on the use of digital currencies within its jurisdiction. However, the CBK issued several stringent public notices strongly advising against the use of digital currencies.[16] While these warnings have been firm, they have stopped short of imposing an outright ban on digital currency usage. Instead, the CBK's notices focus on disclaiming any liability for losses incurred by individuals who use digital currencies for transactions and emphasise that digital currencies are not recognised as legal tender.[17]

---

[11] Sanusib Z, Mohd N, Barnes P, 'Money Laundering Risk: From the Bankers' and Regulators' *Procedia Economics and Finance,* 2015, 7-13.

[12] Central Bank Digital Currencies (CBDC) in this paper shall be taken to mean "Digital currency issued by the Central Banks and intended to serve as a legal tender."

[13] Bank for International Settlements, *Central Bank digital currencies,* 12 March 2018, 3.

[14] Central Bank of Kenya, 'Public Notice Caution to the Public on Virtual Currencies Such as Bitcoin' December 2015,Https://Www.Centralbank.Go.Ke/Images/Docs/Media/Public_NoticOnVirtualCurrencies_Such_As_Bitcoin.Pdf On 15 August 2024.

[15] Kibwage C, 'Consumer protection in Kenya in the age of decentralised virtual currency' Published LL.M Thesis, Strathmore University, Nairobi, 2021, 25.

[16] Central Bank of Kenya, 'Public Notice Caution to the Public on Virtual Currencies Such as Bitcoin' December 2015,Https://Www.Centralbank.Go.Ke/Images/Docs/Media/Public_NoticOnVirtualCurrencies_Such_As_Bitcoin.Pdf On 15 August 2024.

[17] Central Bank of Kenya, 'Public Notice Caution to the Public on Virtual Currencies Such as Bitcoin' December 2015.

This regulatory vacuum has presented significant challenges for regulatory authorities, particularly in the field of anti-money laundering (AML).[18] To assess these challenges, Kenya conducted its first National Risk Assessment in 2023 on the risks of money laundering and terrorism financing associated with digital currency and their service providers. This assessment was based on the recommendation of the Financial Action Task Force (FATF).[19] The evaluation found that digital currency and their service providers in Kenya use anonymity-enhancing features, making transactions difficult to trace. The report found that this, along with the speed of transactions, increased and continues to increase the risk of these assets being used for money laundering and terrorism financing. [20]

The Governor of the Central Bank of Kenya underscored the vital role of cross-border regulations in safeguarding citizens as the cryptocurrency market evolves. He pointed out that the absence of specific laws against cryptocurrency trading has facilitated its use for illicit activities, underscoring the necessity of regulatory measures in this dynamic market.[21] Due to this regulatory gap and others, the Financial Action Task Force placed Kenya on its grey list, a significant setback for the country.[22]

1.2 Statement of Problem

This study will analyse whether Kenya should adopt a 'Digital Currency Travel Rule' in the Proceeds of Crime and Anti-Money Laundering Act to combat money laundering in digital currency.

---

[18] Kimani N, 'Non-Regulation of Virtual Currencies: The Chink in The Anti-Corruption Armor' Unpublished Dissertation, Strathmore University Law School, Nairobi, 2021,26.

[19] The FATF Recommendations set out a comprehensive and consistent framework of measures which countries should implement to combat money laundering (ML), terrorist financing (TF), and the financing of proliferation of weapons of mass destruction (PF).

[20] The National Treasury and Economic Planning, *Virtual Assets (VA) and Virtual Assets Service Providers (VASPs) Money Laundering (ML) and Terrorism Financing (TF) National Risk Assessment Report,* 2023, XI-XII.

[21] Omulo C, 'Alert over crypto use in money laundering' The East African, 10 September 2023, https://www.theeastafrican.co.ke/tea/science-health/alert-over-crypto-use-in-money-laundering-4362574 On 15 August 2024.

[22] Dr Njiraini A, 'What will get Kenya off grey list' Business Daily, 30 April 2020, What will get Kenya off grey list - Business Daily (businessdailyafrica.com) On 15 August 2024.

1.3 Research Objectives

1) To examine digital currencies and analyse why they are attractive to users.

2) To assess the risks and societal effects of money laundering and to investigate how digital currencies enable money laundering.

3) To analyse the 'Digital Currency Travel Rule,' assess how it mitigates money laundering using digital currencies, and evaluate the potential challenges and benefits of implementing the rule in Kenya.

4) To propose that Kenya integrate a 'Digital Currency Travel Rule' into its Proceeds of Crime and Anti-Money Laundering Act and to discuss the expected positive impact on the country's ability to combat money laundering in the digital currency sector.

1.4 Research Questions

1) What are digital currencies, and why are they attractive to users?

2) a. What risks and effects do money laundering have in society?

b. How do digital currencies enable money laundering?

3) a. What is the 'Digital Currency Travel Rule,' and how does it work to mitigate money laundering using digital currencies?

b. What are the potential challenges and benefits of implementing the Digital Currency Travel Rule in Kenya?

4) Should Kenya integrate a 'Digital Currency Travel Rule' into its Proceeds of Crime and Anti-Money Laundering Act, and what would be the expected impact on the country's ability to combat money laundering in the digital currency sector?

1.5 Hypothesis

Kenya should adopt a 'Digital Currency Travel Rule' as part of its Proceeds of Crime and Anti-Money Laundering Act. This proposed solution offers hope for a more secure financial landscape and could greatly strengthen the nation's efforts to combat money laundering in the digital currency sector.

1.6 Justification

This study is crucial for the rapidly growing digital currency sector as it addresses a significant gap in Kenya's Anti-Money Laundering (AML) framework. By evaluating whether Kenya should integrate a 'Digital Currency Travel Rule' into its Proceeds of Crime and Anti-Money Laundering Act. This research will provide valuable insights that can enhance the country's efforts to combat money laundering. The research will offer valuable insights for policymakers, financial institutions, and regulatory bodies, sparking a necessary conversation on the future of digital currency regulation in Kenya.[23] Law enforcement agencies will be better equipped to trace and prosecute money laundering activities involving digital currencies, thus significantly strengthening Kenya's overall financial integrity.

1.7 Theoretical Framework

The study is premised on the Public Interest Theory of Regulation and Rational Choice Theory in criminology.

1.7.1 Public Interest Theory of Regulation

As developed by A.C. Pigou,[24] this theory posits that regulating enterprises and various economic factors promotes public interest. It argues that government interventions are necessary to correct market failures, ensure fairness, and safeguard public welfare. This theory operates on the premise that private interests may dominate in the absence of regulation, leading to outcomes that are detrimental to society.[25] Under this theory, regulations are seen as instruments to align private sector activities with societal goals, ensuring that economic activities contribute positively to the public good rather than undermining it.[26]

---

[23] Kenya's Financial Intelligence Unit was established under Section 21 of the Proceeds of Crime and Anti-Money Laundering Act to combat money laundering, terrorism financing, and proliferation financing.

[24] Hantke-Domas M, 'The Public Interest Theory of Regulation: Non-Existence or Misinterpretation?' 15 *European Journal of Law and Economics* 2003, 165.

[25] Posner R, 'Theories of Economic Regulation' *5 The Bell Journal of Economics and Management Science* 2, 1974, 336.

[26] Marshel S, 'The Regulation of Virtual Currencies in Kenya' Published LLM Thesis, University of Nairobi, Nairobi, 2019, 7.

In the modern regulatory landscape, the Public Interest Theory continues to guide policy decisions across various domains. Environmental regulation, financial oversight, and public health policies are often justified on the grounds of promoting public welfare. [27]

The absence of effective regulation represents a significant market failure in the context of digital currencies.[28] Due to their decentralised and often anonymous nature, digital currencies are exploited for money laundering, undermining the financial system's integrity and posing risks to public welfare. The theory is in line with the suggestion that the Kenyan government has a responsibility to intervene by implementing a 'Digital Currency Travel Rule' to correct this failure to protect the public from the adverse effects of money laundering.

According to Buchanan, regulations are tools through which governments ensure that private sector actions align with the broader goals of societal welfare.[29] This perspective underscores the importance of government and regulatory bodies in safeguarding the public interest. Kenyan institutions like the Central Bank of Kenya and the Financial Reporting Centre have the crucial task of implementing regulations to prevent the misuse of digital currencies for illegal activities. By presenting these institutions as central figures in advancing the common good, the study will investigate how incorporating the Travel Rule fits their duty to uphold the integrity of Kenya's financial system.

However, the criticism of government regulation has existed for as long as government regulation itself. These critiques are often convincing and continue to be relevant today. Although confidence in public regulatory institutions is at risk of being dismissed as idealistic and uninformed in the modern administrative state, it's essential to strike a balance between regulatory measures and maintaining a free and fair market.[30] This study aims to investigate how implementing the Travel Rule can support the innovation of digital currency within a secure and regulated framework without hindering advancements in the digital currency sector.

[27] Hantke-Domas M, 'The Public Interest Theory of Regulation: Non-Existence or Misinterpretation?' 16.
[28] Hantke-Domas M, 'The Public Interest Theory of Regulation: Non-Existence or Misinterpretation?' 15.
[29] Buchanan J, *A Theorist of Political Economy and Social Philosophy,* Palgrave Macmillan, 2018, 11.
[30] Croley S, 'Public Interest Regulation' 50 *Florida State University Law Review* 3, 2000, 7.

The Public Interest Theory emphasises the importance of minimising risks that could adversely affect the public.[31] Therefore, this study will use the Public Interest Theory to assert that enforcing the 'Digital Currency Travel Rule' is essential in mitigating the dangers linked to digital currencies in relation to money laundering. The rule will act as a safeguard that ultimately benefits society by bolstering the security of financial transactions.

1.7.2 Rational choice theory of criminology

Rational Choice Theory, as articulated by Ronald V. Clarke and Marcus Felson, emphasises that criminal behaviour results from individuals making calculated decisions. According to this theory, offenders consider the potential rewards of a crime against the risks of detection and punishment. Clarke and Felson argue that crime is not an impulsive act but a deliberate choice made after assessing various factors.[32] Therefore, the theory asserts that if the benefits of crime are high and the costs are low, crime will occur. However, if the benefits of crime are lower than the costs, crime will not occur. An implication of this theory, then, is that if the costs of crime are made to be high, would-be rational offenders will be restrained or deterred from committing it.[33]

This perspective aligns with the utilitarian philosophy of Jeremy Bentham and Cesare Beccaria, who believed that individuals seek to maximise pleasure and minimise pain. [34] Beccaria emphasised that the certainty, swiftness, and severity of punishment are crucial deterrents to criminal behaviour.[35] Clarke and Cornish expanded on this by introducing the concept of "choice structures," which categorise crimes based on the decision-making processes involved.[36]

In the context of digital currencies, Rational Choice Theory (Hereinafter RCT) provides a useful framework for analysing the motivations and decision-making processes of individuals involved

---

[31] Michael Hantke-Domas, 'The Public Interest Theory of Regulation: Non-Existence or Misinterpretation?' 15 *European Journal of Law and Economics,* 2003, 165.

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

[33] Paternoster R, Bachman R, 'Explaining criminals and crime: essays in contemporary criminological theory' Oxford University Press, 2001,1.

[34] Cullen F, Wilcox P, *Encyclopaedia of Criminological Theory,* SAGE Publications, Inc Teller Road, Thousand Oaks California, 2010, 4-6.

[35] Harcourt B, 'Beccaria's on Crimes and Punishments: A Mirror on the History of the Foundations of Modern Criminal Law' *Oxford University Press*, 2014,39-40.

[36] Cornish D, Clarke R, 'Understanding Crime Displacement: An Application of Rational Choice Theory' 25 *Criminology* 4,1987, 933-948.

in money laundering. Thanks to their anonymity, ease of transfer, and absence of centralised control, digital currencies offer distinct advantages for those seeking to launder money. These characteristics make digital currencies especially appealing for illicit activities, enabling wrongdoers to move large amounts of money across borders with minimal oversight and detection.

According to RCT, individuals engaged in money laundering using digital currencies are rational actors. The anonymity and decentralized nature of digital currencies significantly reduce perceived risks, making them an attractive option for concealing the origins of unlawfully obtained funds, especially in weak regulatory environments.

Integrating a 'Digital Currency Travel Rule' into Kenya's Proceeds of Crime and Anti-Money Laundering Act can be thoroughly analysed using the RCT framework. By implementing rigorous regulatory measures, the Travel Rule endeavours to change the cost-benefit analysis for potential wrongdoers. This is so, as it mandates sharing information about the sender and receiver of digital currency transactions among financial institutions, thus diminishing the anonymity that currently makes digital currencies attractive for money laundering.

Therefore, by examining how offenders weigh the costs and benefits of using digital currencies for money laundering, the study will assess whether the proposed rule can effectively increase the perceived risks and reduce the attractiveness of such activities. The theory will guide the analysis of current regulatory gaps and the development of recommendations to enhance Kenya's ability to combat money laundering in the digital currency sector.

1.8 Literature Review

1.8.1 On the Risks of Digital Currencies in Money Laundering

The advent of digital currencies has introduced notable obstacles and weaknesses in combating money laundering.[37] If you were to ask the general public what money laundering is, most might guess that it involves the drying, washing, or dry cleaning of currency notes. While this is

[37] Li Wenyang, 'Challenges and Response Strategies of Digital Currency to Traditional Monetary Policy' 4 *Frontiers in Sustainable Development* 3, 2024, 119-128.

somewhat correct, the layman may not be aware of the scale of this industry, which the IMF reports to have a turnover of approximately $1.5 trillion, making it the world's third-largest industry. [38]

Scholars like Ajay Kumar explain money laundering as a method where substantial sums of illicit funds, derived from activities such as drug trafficking, terrorism, or major crimes, are disguised to seem lawfully earned. Essentially, it transforms tainted proceeds into apparently clean assets.[39] This takes one back to cleaning the vast piles of cash. If done successfully, it allows the criminals to maintain control over their proceeds and ultimately provide a legitimate cover for their source of income. Money laundering plays a fundamental role in facilitating the ambitions of the drug trafficker, the terrorist, the organised criminal, the insider dealer, the tax evader, as well as the many others who need to avoid the kind of attention from the authorities that sudden wealth brings from illegal activities.[40]

We can decipher that money laundering is a sophisticated crime that is not taken very seriously at first glance by anyone in society. As compared to street crimes, it is a modern digital crime. At times, people refer to it as a victimless crime, but the reality is that it is not a crime against a particular individual but against nations, economies, governments, the rule of law, and the world at large.[41]

So where does digital currency come into this, and why are they appealing? Recently, money launderers have increasingly turned to this new technology to conceal the origins of illegally obtained proceeds. First, we need to address why it appeals to offenders who partake in this crime using it. Jay B. Sykes and Nicole Vanatko described digital currencies as digital representations of value that, like ordinary currency, function as media of exchange, units of account, and stores of value. However, unlike ordinary currencies, digital currencies are not legal tender, meaning they cannot be used to pay taxes, and creditors need not accept them as payments for debt.[42]

---

[38] Ajay V, 'Money Laundering: Concept, Significance and its Impact' 4 *European Journal of Business and Management* 2, 2012, 113.
[39] Ajay V, 'Money Laundering: Concept, Significance and its Impact' 4 *European Journal of Business and Management* 2, 2012, 113.
[40] Ajay V, 'Money Laundering: Concept, Significance and its Impact,' 2012, 113.
[41] Gjoni M, 'Money Laundering Effects' UBT International Conference, University of Business and Technology in Kosovo, 7 November 2015, 15-16.
[42] Congressional Research Service, *Virtual Currencies and Money Laundering: Legal Background, Enforcement Actions, and Legislative Proposals,* 3 April 2019,1-2.

Jerry Brito and Andrea Castillo, proponents of digital currencies, argued in 2016 that digital currencies offer cheaper and faster transactions than traditional bank-centric payment networks, provide inflation-resistant alternatives to fiat currencies, and involve promising new technologies like blockchain. However, other commentators such as Joshua Fruth argued that the anonymity offered by certain decentralised digital currencies, that is, digital currencies not issued or maintained by a central organisation, makes them an attractive vehicle for money laundering.[43]

The Financial Action Task Force (FATF) has highlighted how digital currencies' anonymity, paired with minimal user identification and verification, heightens risks to anti-money laundering (AML) efforts.[44] Likewise, researchers like Arvind Narayanan and Joseph Bonneau have emphasized that the pseudonymous and decentralized traits of these currencies significantly enable money laundering (Narayanan et al., 2016).[45] Similarly, the absence of a centralized authority overseeing digital currency transactions complicates oversight. Ndichu has argued that this lack of a unified governing body creates ongoing difficulties for regulators used to managing centralized financial entities with stringent reporting and compliance obligations.[46]

This sentiment is echoed by the FATF report, which points out that traditional regulatory frameworks struggle to monitor and prevent money laundering using digital currencies due to their decentralised and global nature.[47]

While numerous policymakers and scholars raise concerns about the potential dangers of digital currencies, others contend that these concerns are exaggerated. In their report titled "National Security Implications of Virtual Currency," Joshua Baron and Angela O'Mahony of the RAND Corporation argue that digital currencies do carry some risks, but they do not necessarily give rise to significant criminal activity or systemic threats. They assert that the supposed anonymity of digital currencies, often cited as a facilitator of illicit behaviour, is not as absolute as commonly

---

[43] Fruth J,' Crypto-cleansing:' strategies to fight digital currency money laundering and sanctions evasion' Reuters, 13 February 2018 https://www.reuters.com/article/business/crypto-cleansing-strategies-to-fight-digital-currency-money-laundering-and-sa-idUSKCN1FX290/ On 18 August 2024.

[44] Financial Action Task Force, *Virtual Currencies Key Definitions and Potential AML/CFT Risks,* 2014, 9.

[45] Narayanan A, Bonneau J, Felten E, Miller A, Goldfeder S, *Bitcoin and Cryptocurrency Technologies* Princeton University Press, New Jersey, 2016, 168.

[46] Ndichu A, 'Non-Regulation of Virtual Currencies: The Chink In The Anti-Corruption Armour' Unpublished LL.B dissertation, Strathmore University Law School, Nairobi, 2021, 5.

[47] Financial Action Task Force, *Virtual Currencies Key Definitions and Potential AML/CFT Risks,* 2014,9

believed. They suggest that with advancements in blockchain analytics and a more structured regulatory environment, digital currencies are becoming less appealing to criminals, as transactions can now be traced and scrutinised more effectively compared to traditional cash-based systems.[48]

Similarly, in his paper "Is Bitcoin a Real Currency? An Economic Appraisal," David Yermack suggests that the speculative nature of digital currencies such as Bitcoin may limit their attractiveness for illicit activities. He argues that the volatility and uncertainty associated with digital currencies make them less reliable for criminals seeking stability for money laundering or financing illegal operations. Yermack emphasises that the excitement surrounding digital currencies often overlooks their practical limitations as tools for illicit activities.[49]

1.8.2 On the Digital Currency Travel Rule

Ever since Bitcoin was created, digital regulation has been unclear or non-existent. However, in June 2019, the FATF officially amended one of its 40 recommendations to include crypto asset service providers in the regulation.[50] The Digital Currency Travel Rule, advocated by the FATF, aims to address these challenges by requiring financial institutions and digital asset service providers (VASPs) to collect and share specific information on the originators and beneficiaries of digital currency transactions. Chaehyeon Lee and Changhoon Kang argue that implementing the Travel Rule is crucial for maintaining transparency in digital currency transactions.[51] They emphasise that without such regulatory measures, criminals would easily exploit the anonymity associated with digital currencies to launder money and finance terrorism.[52]

However, applying the Travel Rule in the context of developing countries, such as Kenya, presents unique challenges. Rhoda Adura Adeleye and Onyeka Franca Asuzunote note that while developed nations have embraced the Travel Rule differently, many developing countries struggle

[48] Baron J, O'Mahony A, Manheim D, Dion-Schwarz C, 'National Security Implications of Virtual Currency' RAND Corporation, Santa Monica, 2015, 33-57.
[49] Yermack D, 'Is Bitcoin a Real Currency? An Economic Appraisal' *Handbook of Digital Currency,* 1ed, 2015, 31-43.
[50] Crypto.com Macro Report, *FATF Travel Rule,* 2020, 5.
[51] Lee C, Kang C, Choi W, Cha M, K. Hong, 'Code: Blockchain-Based Travel Rule Compliance System,' *IEEE International Conference on Blockchain*, Espoo, Finland, 2022, 222-229.
[52] Lee C, Kang C, Choi W, Cha M, K. Hong, 'Code: Blockchain-Based Travel Rule Compliance System,' 222-229.

with its implementation due to limited regulatory infrastructure and resources.[53] In Kenya, the absence of the Travel Rule in the current AML framework creates a significant gap in the country's ability to regulate digital currencies effectively.

While the literature offers valuable insights into the general advantages and challenges of the Travel Rule, there is a notable gap in research focusing specifically on Kenya's regulatory environment. This study seeks to fill this gap by providing a detailed analysis of how Kenya can effectively integrate the Digital Currency Travel Rule into its existing AML framework, considering the country's specific regulatory challenges and opportunities.

1.8.3 Contribution

Despite the extensive discussion of risks associated with digital currencies, there is a noticeable gap in the literature regarding Kenya's specific challenges in regulating these currencies to prevent money laundering. Much of the existing research tends to generalise the issues across developing countries, overlooking Kenya's unique challenges, such as limited resources for enforcement, lack of technical expertise, and a weaker regulatory framework. There remains a critical gap in understanding how specific regulatory measures, such as the 'Digital Currency Travel Rule,' could address these challenges in Kenya. This study aims to fill this gap by analysing whether Kenya should adopt the 'Digital Currency Travel Rule' within its Proceeds of Crime and Anti-Money Laundering Act. By examining the potential impact of this rule on Kenya's ability to combat money laundering in the digital currency sector, the study will provide valuable insights for Kenyan policymakers and regulatory bodies.

1.9 Methodology

This study will use various sources based on primary and secondary sources to reach its conclusion.

Chapter 2 will rely upon content analysis. This chapter will review literature, focusing on secondary sources such as journal articles, working papers, and reports that explain digital currencies' concept, technological underpinnings, and appeal to various users. This chapter will

[53] Adeleye R, Asuzu O, Bello G, Oyeyemi P, Kehinde F, 'Digital currency adoption in Africa: A critical review and global comparison' 21 *World Journal of Advanced Research and Reviews* 2, 2024, 130-139.

utilise inductive reasoning, where observations from secondary sources will guide the formulation of broader conclusions regarding the attractiveness of digital currencies.

Chapter 3 will combine doctrinal and content analysis to review literature on how digital currencies facilitate money laundering, focusing on secondary sources such as journal articles, reports, and case studies. The chapter will analyse relevant jurisprudence of statutes, case laws, and international frameworks addressing money laundering to assess the risks and societal impacts. Deductive reasoning will be employed, starting with the general principles of money laundering and narrowing down to specific cases where digital currencies have been utilised for illicit activities. This reasoning will help build a logical connection between money laundering risks and the role of digital currencies.

Chapter 4 will employ a trio of comparative, legal, and content analyses. It will analyse the implementation of the Digital Currency Travel Rule in other jurisdictions, focusing on countries with similar legal systems or economic conditions to Kenya. Content analysis will also be used to review the existing literature on the Travel Rule, including international guidelines, reports, and case studies. Legal analysis will be applied to assess Kenya's current legal framework and identify gaps that the Travel Rule would address. This chapter will also utilise deductive reasoning, starting with a general understanding of the Travel Rule and narrowing it down to its potential application in Kenya.

Chapter 5 will synthesise findings from Chapters 2, 3, and 4 using deductive reasoning to answer the main research question. Building on the insights gained from the previous chapters, this chapter will assess the feasibility and potential impact of integrating the Digital Currency Travel Rule into Kenya's Proceeds of Crime and Anti-Money Laundering Act. In this chapter, legal analysis will be key to assessing how integrating the Travel Rule could strengthen Kenya's legal framework against money laundering. Additionally, comparative analysis will help draw lessons from other jurisdictions that have effectively implemented the Travel Rule. This will ensure that both local and international experiences inform Kenya's approach.

1.10 Chapter Breakdown

Chapter 1 serves as the study's introduction, outlining the problem statement, research objectives, conceptual framework, and study justification, laying the groundwork for subsequent chapters.

Chapter 2 will delve into the concept of digital currencies and their appeal to a wide range of users. This section will provide an in-depth exploration of digital currencies' technical and economic features, examining the factors that make them attractive to individuals, businesses, and even criminal elements.

Chapter 3 will assess the risks and societal impacts of money laundering, particularly focusing on the facilitation of digital currencies in such activities. It will explore the broader effects of money laundering on society, including economic instability and crime proliferation. Additionally, the chapter will examine the specific role of digital currencies in enabling money laundering.

Chapter 4 will conduct an analysis of the Digital Currency Travel Rule, delving into its function in combating money laundering using digital currencies. This chapter aims to offer a thorough comprehension of the rule, including its operational methods and usage in various jurisdictions. Additionally, it will assess the potential challenges and advantages associated with implementing the Travel Rule in Kenya by drawing on international instances and Kenya's existing legal framework to illuminate possible obstacles and prospects.

In Chapter 5, the research will address the main question: whether Kenya should integrate the Digital Currency Travel Rule into its Proceeds of Crime and Anti-Money Laundering Act. Building on insights from the previous chapters, this chapter will assess the potential impact of such integration on Kenya’s ability to combat money laundering in the digital currency sector. The chapter will use deductive reasoning and legal analysis to propose recommendations, considering both the benefits and potential challenges of this legal reform.

Chapter 2: Understanding Digital Currencies and Their Appeal to Users

2.1 Introduction

Digital currencies have revolutionised global financial systems by introducing decentralised, cryptographically secure, and technologically advanced methods of exchange. Unlike traditional currencies, these digital forms operate independently of central banks and financial institutions, utilising blockchain technology[54] to facilitate transactions. This chapter delves into the fundamental nature of digital currencies, their historical evolution, and the factors contributing to their increasing popularity.

Understanding digital currencies is essential for this study, as their unique features—such as pseudonymity, borderless transactions, and minimal regulation—offer opportunities for financial inclusion while also posing significant regulatory challenges. This discussion lays the groundwork for analysing how digital currencies can be misused for illicit financial activities, particularly money laundering, and whether Kenya should implement regulatory measures like the Digital Currency Travel Rule.

2.2 Understanding Digital Currencies

2.2.1 Definitions and Characteristics

Despite their growing prominence, digital currencies lack a universally accepted definition. Generally, digital currencies are internet-based mediums of exchange that differ from national fiat currencies, enabling peer-to-peer transactions without intermediaries.[55] Unlike traditional online payment systems like PayPal or Apple Pay, which facilitate transactions in fiat currency, digital currencies operate as independent units of value. That is to mean PayPal and Apple Pay do not operate as separate systems for valuing currency; instead, they benefit from transacting in national

[54] Blockchain is a decentralized, distributed ledger technology that securely records transactions across multiple computers in a tamper-resistant and transparent manner.
[55] Black's Law Dictionary, 10 ed.

currencies.[56] This principle also applies to credit card transactions, whether conducted in person or online.[57]

One of the earliest definitions of digital currencies, proposed by Arvind Narayanan and Joseph Bonneau et al.,[58] describes digital currency as "an internet-based medium of exchange distinct from physical forms of currency" with the potential to operate independently of state-controlled financial systems.[59] Other authors have further refined this definition to encompass specific features, such as decentralisation and cryptographic security.

Nakamoto, the creator of Bitcoin, described it as a "peer-to-peer electronic cash system," highlighting its decentralised nature.[60] Scholars such as Antonopoulos define digital currencies as a payment system that operates without a central authority, using a peer-to-peer network. He also emphasizes that they promote financial independence by eliminating dependence on central banks.[61]

In his insightful paper, Harwick begins by describing digital currency as a manifestation of a new monetary system. He argues that digital currency has the potential to make the traditional financial system, which relies on a central bank to regulate the issuance and circulation of currency obsolete.[62] However, I believe a significant challenge remains: digital currency may struggle to maintain purchasing power stability, economic efficiency, and long-term economic growth, all of which are essential for providing the financial intermediation needed to replace the current system. This is because, without stable purchasing power and effective financial intermediation, digital

[56] Avaliani A, 'Successful e-business systems - PayPal' Unpublished Paper, International University in Germany, 2004,1-2.
[57] Carolan C, *The ABCs of credit card finance: Essential facts for students*, Centre for Student Credit Card Education, Inc., Burlingame, 2010,1-3.
[58] Et al includes Edward Felten, Andrew Miller and Steven Goldfeder.
[59] Arvind N, Bonneau J, Felten E, Miller A, Goldfeder S*,* Bitcoin and Cryptocurrency Technologies: A Comprehensive Introduction, *Princeton University Press,* New Jersey, 2016, 5-51.
[60] Satoshi N, A Peer-to-Peer Electronic Cash System, 1-11, 2009, https://www.ussc.gov/sites/default/files/pdf/training/annual-national-training seminar/2018/Emerging_ Tec h_Bitcoin_Crypto.pdf Accessed on 27 October 2024.
[61] Antonopoulos A*, Mastering Bitcoin,* O'Reilly Media, Sebastopol, 2014, 1-3.
[62] Harwick C, 'Cryptocurrency and the Problem of Intermediation', 20 *The Independent Review* 4, 2016, 569- 588.

currencies may find it challenging to sustain widespread economic activity, investment, and growth comparable to traditional financial systems.[63]

A significant distinction between digital currencies and traditional payment systems lies in the role of blockchain technology. Blockchain acts as a decentralised ledger, recording transactions securely, transparently, and immutably. Digital currencies depend on cryptographic security to ensure transaction integrity and prevent counterfeiting. Their key features include:

- **Decentralisation:** Transactions occur without a central authority, reducing the risks of government control and inflation.
- **Cryptographic Security**: Encryption techniques ensure transaction authenticity and protect user privacy.
- **Portability and Durability**: Digital currencies exist in electronic form, making them easy to store and transfer globally.
- **Divisibility:** Unlike physical cash, digital currencies can be divided into smaller units, enhancing transaction flexibility.[64]

The diversity in definitions underscores a wide range of perspectives: while some researchers highlight the role of digital currencies in promoting financial autonomy, others concentrate on their ability to facilitate faster and more cost-effective transactions. Each definition adds to a comprehensive understanding, with Nakamoto introducing the fundamental mechanism and others elaborating on functional and security aspects. Nonetheless, common themes such as decentralisation, security, and independence from traditional banking systems are often mentioned.

2.2.2 Origin and Historical Development of Digital Currencies

Tracing the development of digital currencies requires examining technological innovations and economic thinking shifts. The concept of digital currencies dates back to the 1980s when David

[63] Ogun R, 'Digital currencies: Emerging trends, challenges and the future of the monetary system' *60 Central Bank of Nigeria Economic and Financial Review* 4, 2022, 128-129.
[64] Samora M, 'The Regulation of Virtual Currencies in Kenya', Published LLM Thesis, University of Nairobi, Nairobi, 2019, 17-30.

Chaum[65] developed ECash, an early cryptographic payment system based on blind signatures to ensure transaction anonymity.[66] While ECash failed to gain widespread adoption, it laid the groundwork for future developments in digital finance.[67] ECash's failure influenced subsequent innovations, which introduced decentralisation as a solution to the trust and scalability challenges faced by centralised digital currencies.[68]

The modern era of digital currencies began in 2009 with the release of Bitcoin by Nakamoto.[69] Bitcoin introduced a decentralised ledger system, solving the double-spending problem and eliminating reliance on financial intermediaries. Its success spurred further innovation, leading to the emergence of Ethereum in 2015, which expanded digital currency functionality through smart contracts; self-executing agreements embedded in blockchain networks. This step opened the market more for others to start creating and using digital currency. This evolution exemplified how digital currencies have adapted to diverse economic and technological needs, adding new layers of functionality.[70]

The rise of Bitcoin and Ethereum inspired the development of thousands of digital currencies, each with unique use cases. This is due to the fact that blockchain facilitates trust in digital currencies without a centralised authority, a shift that has fueled the growth of various cryptocurrencies, each with unique features and functionalities.[71]

Furthermore, central banks worldwide have also shown increasing interest in issuing their digital currencies, commonly referred to as Central Bank Digital Currencies (Hereinafter CBDCs).

---

[65] David Chaum is a cryptographer and pioneer in digital currency, known for inventing eCash and laying the foundation for modern blockchain and privacy-preserving technologies.

[66] D'Andrea V, 'History and evolution of the main cryptocurrencies' Luis University, 2018, 21-22, https: // tesi. Luiss.it/23488/1/680091_D%27ANDREA_VINCENZO_History%20and%20evolution%20of%20the%20main%20 cryptocurrencies.pdf On 31 October 2024.

[67] Song J, Yanqiu C, Yuxuan L, Qizhi S, 'Cryptocurrencies' Past, Present and Future', 2022, 1402-1403 <file:///C:/ Users/User/Down loads/125983674.pdf On 31 October 2024.

[68] Arvind N, Bonneau J, Felten E, Miller A, Goldfeder S, Bitcoin and Cryptocurrency Technologies: A Comprehensive Introduction, *Princeton University Press,* New Jersey, 2016,10-12.

[69] Satoshi Nakamoto is a pseudonym for an unknown creator that is believed to be from Japan

[70] Farnaghi M, Mansourian A, 'Blockchain, an enabling technology for transparent and accountable decentralized public participatory GIS' 2020, 3, file:///C:/Users/User/Downloads/Blockchain_an_enabling___ technology_for_transparent_.pdf On 2 November 2024.

[71] Gans j, Catalini C, 'Some Simple Economics of the Blockchain', National Bureau of Economic Research, Working Paper 22952, 2019, 5-40, https://www.nber.org/system/files/working_papers/w22952/w22952.pdf On 1 November 2024.

CBDCs represent an evolution in monetary policy, enabling governments to provide digital alternatives to cash that are both stable and integrated into the existing financial system. The rapid development of CBDCs reflects a broader trend of convergence between traditional finance and digital currencies, as central banks seek to harness the benefits of digital currency technology without the volatility associated with cryptocurrencies like Bitcoin.[72]

The historical development of digital currencies illustrates a continuous evolution driven by technological advancements and shifts in economic thought. Beginning with David Chaum's pioneering cryptographic innovations, digital currencies have transitioned from theoretical concepts to practical financial instruments with the emergence of Bitcoin and Ethereum. In summary, digital currencies represent a diverse and rapidly evolving field, with numerous authors contributing definitions, historical analyses, and evaluations of early motivations and subsequent achievements. By synthesising these perspectives, it becomes evident that digital currencies were created with ideals of decentralisation, security, and economic independence at their core

In my view, while digital currencies have undoubtedly transformed financial systems, their long-term success hinges on addressing scalability, stability, and regulatory challenges. As this landscape continues to evolve, striking a balance between innovation and financial security will be essential for their sustained growth and integration into the global economy

2.3 Why Digital Currencies Are Attractive

Digital currencies have attracted global interest because of their potential benefits as well as the risks they pose. On one hand, they offer opportunities for financial innovation, inclusion, and efficiency, which appeal to legal entities and institutions. On the other hand, they also create pathways for illicit activities such as money laundering and tax evasion, presenting challenges for regulatory bodies.

[72] Bordo M, Levin A, 'Central Bank Digital Currency And The Future Of Monetary Policy' National Bureau Of Economic Research, Working Paper 23711, 2017,2-15, https://www.nber.org/system /files/working_papers /w23711/w23711.pdf On 5 November 2024.

2.3.1 Financial Inclusion

A significant advantage of digital currencies is financial inclusion, facilitated by their decentralised nature, which allows individuals and institutions to bypass traditional financial intermediaries, thereby lowering costs and expanding accessibility.[73]

The currencies can serve underbanked populations by providing financial services to those without access to conventional banking.[74] These features support the broader financial inclusion agenda, particularly relevant in developing economies where banking infrastructure may be limited. Additionally, they facilitate cross-border trade and remittances by reducing transaction costs and processing times.[75] Unlike conventional financial systems, where transfers may take several days to clear, blockchain transactions are nearly instantaneous. Due to these unique features, digital currencies offer a cost-effective way to transfer funds across borders, especially for migrant workers sending money back home.

This feature is driving policymakers to focus on improving cross-border payment systems and to consider issuing Central Bank Digital Currencies (CBDCs). By reducing fees and processing times, digital currencies facilitate the flow of funds between individuals and families across countries, which is particularly valuable in regions with underdeveloped banking infrastructure.[76] In addition to that, this efficiency makes digital currencies an attractive alternative for businesses engaged in global commerce.[77]

Smart contracts, introduced by Buterin through Ethereum, add another layer of appeal by automating contractual obligations. This automation reduces the need for intermediaries in legal agreements, thereby lowering legal costs and increasing transaction speed. The self-executing nature of smart contracts presents potential applications for businesses and legal professionals,

[73] Samora M, 'The Regulation of Virtual Currencies in Kenya', Published LLM Thesis, University of Nairobi, Nairobi, 2019, 61.
[74] Odeyo E, 'Exploring Financial Inclusion in Kenya Through Cryptocurrencies: A Case for a Regulatory Framework' Published LL. B Dissertation, Strathmore University, Nairobi, 2021, 42-56.
[75] Button S, 'Cryptocurrency and Blockchains in Emerging Economies', 20 *SQP* 3, 2018, 42-44.
[76] Banerjee B, 'Digital Currencies and Cross-Border Policy Cooperation and Coordination' 2 *Research and Information System for Developing Countries* 1, 2020, 23-34.
[77] Sydow A, Sanwar B, Chad C, 'Leveraging Blockchain's Potential–The Paradox of Centrally Legitimate, Decentralized Solutions to Institutional Challenges in Kenya' 14 *Journal of Business Venturing Insights*,2020, 1.

particularly in areas such as escrow services and real estate.[78] They can simplify compliance processes and enhance the enforceability of agreements.

2.3.2 Privacy and Pseudonymity

One of the most contentious aspects of digital currencies is the privacy they offer. Cryptocurrencies like Bitcoin enable pseudonymous transactions, allowing users to conceal their identities while still securing their transactions on a public ledger. This feature is particularly advantageous for individuals in authoritarian regimes or those seeking protection from financial surveillance, such as political activists. In these scenarios, digital currencies provide a level of financial autonomy and privacy that is difficult to achieve within traditional financial systems.[79]

However, the same privacy mechanisms that appeal to law-abiding users also create opportunities for illicit activities. The pseudonymity inherent in digital currencies poses significant challenges for regulators attempting to trace the origins and destinations of funds, making it difficult to distinguish between legal and illegal transactions. This ability to conduct transactions without regulatory oversight has led to digital currencies being labelled as a preferred medium for criminal enterprises, with findings indicating that approximately one-quarter of Bitcoin users are involved in illegal activities.[80]

2.3.3 Limited Regulation and Arbitrage Opportunities

The broad appeal of digital currencies is significantly driven by their ease of access and minimal regulatory barriers. Unlike traditional currencies, which typically require banking services or other regulated financial institutions, digital currencies can be easily acquired and transferred through online exchanges or peer-to-peer networks with few restrictions.[81]

---

[78] Buterin V, 'A Next Generation Smart Contract & Decentralized Application Platform' 1, https:// blockchain lab.com/pdf/Ethereum_white_papera_next_generation_smart_contract_and_decentralized_application_platform-vitalik-buterin.pdf On 12 November 2024.

[79] Böhme R, Christin N, Edelman B, Moore T, 'Bitcoin: Economics, Technology, and Governance' 29 *Journal of Economic Perspectives* 2, 2015, 219-230.

[80] Foley S, Karlsen J, & Putniņš T, 'Sex, Drugs, and Bitcoin: How Much Illegal Activity Is Financed Through Cryptocurrencies?', *Review of Financial Studies,* 2018, 1-5.

[81] Banerjee B, 'Digital Currencies and Cross-Border Policy Cooperation and Coordination' 2 *Research and Information System for Developing Countries* 1, 2020, 23-34.

Regulatory approaches to digital currencies vary widely across different jurisdictions. While some governments impose strict regulations, others adopt a more relaxed stance. The absence of a unified global regulatory framework creates loopholes that users can exploit, allowing them to engage in cross-border arbitrage by selecting jurisdictions with more favourable regulations to protect their assets from oversight.[82]

For businesses, limited regulation can lower compliance costs and open the door to innovative financial models. However, the lack of regulatory consistency also presents risks to the global financial system, as it enables digital assets to move across borders undetected. While this regulatory flexibility fosters financial innovation, it also complicates efforts to monitor and prevent illicit financial activities.[83] In my view, while these inconsistencies provide opportunities for growth and experimentation, they also raise serious concerns about transparency and fair competition. Without proper oversight, businesses and individuals may exploit these regulatory gaps for personal gain rather than contributing to genuine economic progress

2.4 Risks and Challenges of Digital Currencies

2.4.1 Illicit Use Cases

The same characteristics that make digital currencies attractive—privacy, decentralisation, and ease of use—also render them vulnerable to illicit financial activities. Digital currencies are often associated with illicit activities such as money laundering, tax evasion, and terrorist financing. The pseudonymous nature of transactions makes it difficult to trace the origin and destination of funds, providing a haven for criminals.[84] For instance, cryptocurrencies have been used to fund terrorist activities and launder money through complex transaction chains that obscure the identities of the parties involved. This anonymity poses significant challenges for law enforcement agencies attempting to track and prevent illegal activities.

---

[82] World Economic Forum, 'Regulatory and Policy Gaps and Inconsistencies of Digital Currencies', *Digital Currency Governance 2/8 Consortium White Paper Series* 2021, 3-4, https://www3.weforum.org/docs/WEFRegulatoryandPolicyGaps2021.pdf On 10 November 2024.

[83] Abdul R, Prasetya A, Khaeryyah S, 'Cryptocurrency and the Law: The Challenges of Regulating Decentralized Finance in Global Markets', 1 *Multidisciplinary Journal* 1, 2024, 1-10.

[84] Wagman S, 'Cryptocurrencies and National Security: The Case of Money Laundering and Terrorism Financing' 14 *Harvard National Security Journal* 87, 1-10.

2.4.2 Regulatory Challenges

One of the main challenges in regulating digital currencies is the absence of a global consensus. While some countries have established stringent regulations, others remain largely unregulated, leading to inconsistencies that enable illicit financial activities to flourish. The lack of a universal regulatory framework presents significant difficulties for policymakers who aim to mitigate financial risks without hindering innovation.[85]

2.4.3 Technological Risks

Despite their potential, digital currencies face significant technological challenges. Blockchain networks are susceptible to security vulnerabilities, including hacking and fraud.[86] Additionally, scalability issues limit transaction speeds, while high energy consumption associated with proof-of-work mechanisms raises environmental concerns.

2.5 Conclusion

This chapter has thoroughly examined the nature, development, and appeal of digital currencies. By exploring key definitions, characteristics, and the evolution from early cryptographic payment systems to the current landscape of Bitcoin, Ethereum, and Central Bank Digital Currencies (CBDCs), it is evident that digital currencies are dynamic and rapidly evolving financial instruments. Their core principles—decentralisation, cryptographic security, and financial autonomy—are fundamental to their appeal.

The attractiveness of digital currencies lies in their potential to promote financial inclusion, enhance cross-border payment efficiency, and provide privacy and autonomy. These features make them highly appealing to various users, particularly those underserved by traditional financial systems or seeking alternatives to centralised authority. However, these same features present risks, such as facilitating money laundering and other illicit financial activities due to the limited regulatory oversight and pseudonymity inherent in many digital currencies.

---

[85] Wanjiku J, 'Decoding the Dilemma of Cryptocurrency Regulation in Kenya' Unpublished Master's Thesis, University of Nairobi, 2020, 95-132.

[86] Egbuna N, 'Digital Currencies: Emerging Trends, Challenges and the Future of the Monetary System' *Central Bank of Nigeria Economic and Financial Review* 60, 2022, 97.

As Kenya grapples with these challenges, this chapter lays the groundwork for understanding why digital currencies have become attractive targets for both legal and illegal activities. This understanding is crucial for evaluating whether regulatory measures, such as the proposed Digital Currency Travel Rule, should be adopted to combat financial crimes effectively. The next chapter discusses the risks and effects money laundering has on society and how digital currencies enable money laundering.

Chapter 3: The Societal Risks and Impacts of Money Laundering and the Role of Digital Currencies in Facilitating It

3.1 Introduction

The previous chapter of the study delved into the nature, development, and appeal of digital currencies, emphasizing key principles such as decentralisation, cryptographic security, and financial autonomy. It traced their evolution from early cryptographic systems to contemporary digital assets like Bitcoin, Ethereum, and Central Bank Digital Currencies (CBDCs). While digital currencies offer advantages such as financial inclusion and efficient cross-border transactions, they also pose risks, including the facilitation of illicit activities due to regulatory gaps and pseudonymity. Building on this foundation, this chapter will investigate the societal risks associated with money laundering, its economic and political impacts, and how digital currencies enable such activities through mechanisms like anonymity, decentralised finance (DeFi) platforms, and mixing services.

3.2 Risks and Effects of Money Laundering

Money laundering is not merely a financial crime; it is a pervasive phenomenon with extensive consequences that reach beyond the economic sphere into social, political, and governance domains. The effects of money laundering are multifaceted, disrupting economies, exacerbating social inequalities, and undermining political institutions. While scholars have extensively documented these impacts, it is crucial to critically evaluate their arguments and consider the broader implications of these findings.

3.2.1 Definition and Basic Processes

Money laundering fundamentally entails a calculated effort to hide the unlawful roots of wealth, thereby integrating it into the legitimate economy.[87] This process is not merely a financial crime but a sophisticated mechanism that enables criminals to legitimise proceeds derived from illegal

[87] Rima M, 'The Effect of Anti-Money Laundering Regulation Implementation on The Financial Performance of Commercial Banks in Kenya' Published Research Project, University of Nairobi, Nairobi, 2013, 1.

activities such as drug trafficking, fraud, and corruption.[88] The United Nations Office on Drugs and Crime (UNODC) characterizes it as a deliberate act to disguise the source of criminally obtained proceeds, highlighting the criminal intent that underpins the phenomenon.[89] This definition underscores the dual nature of money laundering: it is both a financial and a criminal activity, designed to sever the link between wealth and its illegal source.

Typically, this unfolds across three phases: placement, layering, and integration. The process of money laundering is often described as a multi-stage operation, as it involves a series of steps that transform "dirty" money into seemingly legitimate assets.[90] Each stage serves a specific purpose and presents unique challenges for both criminals and regulators. They Include:

Placement: Introducing Illicit Funds into the Financial System

The first stage, placement, involves the initial introduction of illicit funds into the financial system.[91] This phase is often considered the most vulnerable for criminals, as it requires the physical handling of large volumes of cash, which can attract scrutiny from authorities. Common methods of placement include depositing cash into bank accounts, purchasing high-value assets such as luxury goods or real estate, or engaging in transactions at casinos. The inherent risk in this stage arises from the need to move significant amounts of money without raising suspicion, making it a critical point of intervention for anti-money laundering (AML) efforts.[92]

Layering: Concealing the Origin of Funds

Once the funds have been placed into the financial system, the next stage, layering, focuses on obscuring their illicit origin. This is achieved through a series of complex and often cross-border transactions designed to create a web of financial activity that is difficult to trace. Techniques

[88] Isolauri E, Irfan A, 'Money laundering as a transnational business phenomenon: a systematic review and future agenda', 19 *Emerald Publishing Limited* 3, 2021, 441.
[89] United Nations Office on Drugs and Crime, 'Money Laundering, Proceeds of Crime and the Financing of Terrorism' https://www.unodc.org/unodc/en/money-laundering/overview.html On 20 November 2024.
[90] Gjoni M, Gjoni A, Kora H, 'Money Laundering Effects' UBT International Conference, Kosovo, 9 November 2015, 14.
[91] The Financial Action Task Force, 'Money Laundering National Risk Assessment Guidance' https://www.fatf-gafi.org/ On 18 November 2024.
[92] Geo-JaJa M, Mangum G, 'The Foreign Corrupt Practices Act's Consequences for U.S. Trade: The Nigerian Example' 24 *Journal of Business Ethics* 2000, 245-255.

employed during this stage include wire transfers between multiple accounts in different jurisdictions, the use of shell companies to disguise ownership, and the exploitation of digital currencies and decentralised financial systems. The layering stage has become increasingly sophisticated with advancements in technology, presenting significant challenges for regulators and law enforcement agencies. The European Commission has noted that the globalisation of financial systems and the rise of digital assets have further complicated efforts to track and disrupt these activities.[93]

Integration: Absorbing Laundered Funds into the Legitimate Economy

The final stage, integration, marks the point at which laundered funds are fully absorbed into the legitimate economy. At this stage, the illicit origins of the money are effectively concealed, and the funds appear to be derived from lawful sources. Common methods of integration include investments in real estate, businesses, or financial markets, as well as the purchase of luxury goods and services. The integration stage represents the culmination of the money laundering process, as the illicit wealth is now indistinguishable from legitimate assets, enabling criminals to enjoy the proceeds of their illegal activities without fear of detection.[94]

While the fundamental process of money laundering, placement, layering, and integration, remains consistent, its methods have evolved in response to globalisation and technological advancements. The emergence of digital currencies, decentralised finance, and other fintech innovations has introduced new complexities into the money laundering landscape. These developments have not only expanded the toolkit available to criminals but have also posed significant challenges to traditional AML strategies.[95]

3.2.2 Economic Consequences

Money laundering carries severe economic effects, skewing financial systems by misdirecting resources, distorting financial markets and compromising the integrity of economic systems. One

[93] Organisation for Economic Co-operation and Development, 'Case Studies on the Regulatory Challenges Raised by Innovation and the Regulatory Responses' *OECD Publishing,* 2021, 38.
[94] The Financial Action Task Force, 'Money Laundering National Risk Assessment Guidance' https://www.fatf-gafi.org/ On 18 November 2024.
[95] Canhoto I, 'Leveraging machine learning in the global fight against money laundering and terrorism financing: An affordances perspective' *Journal of Business Research* 2021, 442-448.

of the most significant impacts is the misallocation of capital, which occurs when illicit funds are injected into the economy. This misallocation disrupts market mechanisms, Illicit funds can inflate asset values unnaturally, fostering market instability and economic imbalances.[96] For instance, the infusion of laundered money into real estate or financial markets can inflate asset prices, creating bubbles that destabilise economies. Such distortions not only harm legitimate businesses but also erode investor confidence, ultimately stifling economic growth.[97]

The financial market and specifically, the banking sector is also particularly vulnerable to the effects of money laundering. Illicit funds flowing through financial institutions can degrade the quality of loan portfolios and reduce profitability.[98] Moreover, the presence of laundered money in financial systems can lead to higher tax evasion, as criminals seek to avoid scrutiny by underreporting income or hiding assets. This, in turn, deprives governments of essential revenue, limiting their ability to invest in public services and infrastructure.

Developing countries are disproportionately affected by money laundering, as weak regulatory frameworks and limited enforcement capacity make them attractive targets for illicit financial flows. The resulting capital flight exacerbates economic disparities, depriving these nations of much-needed resources for development.[99] This dynamic perpetuates a cycle of poverty and underdevelopment, further entrenching global inequalities. While some scholars argue that money laundering is a symptom of broader systemic issues, such as corruption and weak governance, it is equally important to recognise its role as a driver of economic instability.

3.2.3 Social Implications

Beyond its economic impact, money laundering has significant social consequences, exacerbating wealth inequality and eroding societal trust. The integration of illicit wealth into legitimate systems allows criminal enterprises to thrive, creating a cycle of corruption and disempowerment. This cycle disproportionately affects disadvantaged groups, limiting social mobility and perpetuating

[96] Khelil I, Khlif H, Achek I 'The economic consequences of money laundering: a review of empirical literature' 27 *Journal of Money Laundering Control* 5, 2023, 901-916.
[97] Menz M, 'Beyond placement, layering and integration – the perception of trade-based money laundering risk in UK financial services' 22 *Journal of Money Laundering Control* 4, 2019, 614-625.
[98] Levi M, Reuter P, 'Money Laundering' 2006, 289-29 https://www.Researchgate.net/publication/27650292 MoneyLaundering On 25 November 2024.
[99] Tanzi V, 'Money Laundering and the International Financial System' IMF Working Paper No. 96/55,1996,1-16.

systemic inequities.[100] For instance, when criminal organisations use laundered money to invest in legal businesses, they gain undue influence over markets, often at the expense of legitimate entrepreneurs. This not only distorts competition but also reinforces existing power imbalances.[101]

The normalisation of criminality is another troubling social consequence of money laundering. When illicit funds are seamlessly integrated into the economy, it sends a message that crime pays, undermining public trust in financial institutions and the rule of law.[102] Furthermore, the societal disempowerment caused by money laundering can fuel social unrest, as marginalised groups become increasingly disillusioned with systems that appear to favour the wealthy and powerful.

While some scholars emphasise the need for robust regulatory frameworks to address these issues, it is worth considering whether such measures alone are sufficient. In my view, tackling the social implications of money laundering requires a more holistic approach that addresses the root causes of inequality and corruption. This includes promoting transparency, strengthening civic engagement, and fostering a culture of accountability. Without these complementary efforts, regulatory measures risk being undermined by the very societal dynamics they seek to address

3.2.4 Political and Governance Risks

The political consequences of money laundering are deeply concerning, as it undermines democratic institutions and fosters corruption.[103] Hostile states and criminal organisations often exploit vulnerabilities in financial systems to subvert political processes, using "dark money" to influence elections and support extremist groups.[104] For instance, the funding of political campaigns with illicit funds can distort electoral outcomes, eroding public trust in democratic institutions. This manipulation of political systems fuels societal divisions, creating fertile ground for polarisation and conflict.

---

[100] Levi M, Reuter P, 'Money Laundering' 2006, 289-29 https://www.Researchgate.net/publication/27650292 Moneylaundering On 25 November 2024.
[101] Utrecht University, *The Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy,* 2013, 34-45.
[102] Australian Institute of Criminology, *Impacts of money laundering and terrorism financing: Final report,* 2024, 52-73.
[103] Sharman J*, The Money Laundry: Regulating Criminal Finance in the Global Economy*, Cornell University Press, Ithaka, 2016, 1-3.
[104] Atlantic Council*, Democracy in the crosshairs: How political money laundering threatens the democratic process,* 2018, 4-5.

The global security implications of money laundering are particularly alarming, as it is often linked to the financing of terrorism. This poses significant challenges for national and international security, necessitating costly countermeasures and coordinated efforts to disrupt these networks.[105]

The current emphasis on regulatory compliance and enforcement, while necessary, is insufficient. A more proactive approach is needed, one that prioritises international cooperation, technological innovation, and the strengthening of democratic institutions. Without such measures, the political and governance risks posed by money laundering will continue to undermine global stability

3.3 How Digital Currencies Enable Money Laundering

Digital currencies, owing to their decentralised and pseudonymous nature, have transformed financial transactions while also enabling new methods of money laundering. Unlike traditional financial systems, cryptocurrencies and decentralised finance (DeFi) platforms lack central oversight, making illicit transactions more difficult to trace. This section explores the mechanisms that facilitate money laundering through digital currencies, including anonymity, mixing services, and decentralized platforms and examines how they are employed across the placement, layering, and integration stages of the laundering process.

3.3.1 Mechanisms in Digital Currency Money Laundering

- Anonymity and Pseudonymity:

The pseudonymous nature of cryptocurrencies significantly facilitates money laundering, as it enables users to conduct transactions without disclosing their true identities. Although blockchain technology records transactions on a public ledger, the identities behind wallet addresses remain concealed, making it challenging for authorities to trace funds. This anonymity is exploited by criminal organisations to transfer value across borders undetected, bypassing traditional financial

[105] The International Monetary Fund, 'Anti-Money Laundering and Combating the Financing of Terrorism', Anti-Money Laundering and Combating the Financing of Terrorism On 1 December 2024.

intermediaries and regulatory scrutiny.[106] Moreover, many cryptocurrency platforms lack robust Know Your Customer (KYC) protocols, unlike traditional financial systems.[107]

- Decentralised Finance (DeFi):

Decentralised finance (DeFi) platforms have exacerbated money laundering challenges by operating without central intermediaries, facilitating direct cryptocurrency exchanges. This absence of a central authority complicates regulatory efforts to enforce anti-money laundering (AML) measures, enabling criminals to exploit DeFi for layering and integrating illicit funds while bypassing traditional financial controls.[108] Additionally, the use of smart contracts (automated blockchain transactions) introduces complexities in tracking illicit activities. While beneficial for legitimate purposes, smart contracts can also be exploited by criminals to obscure the origins of funds and evade detection

- Mixing Services and Tumblers:

Mixing services, or tumblers, are a key tool in money laundering, as they pool and redistribute cryptocurrency transactions to break the link between senders and receivers. This process obscures the transactional trail, making it nearly impossible for authorities to trace the original source of funds. For instance, criminals can use tumblers to "clean" Bitcoin by redistributing it to multiple addresses. Another method, chain-hopping, involves switching between different cryptocurrencies to further complicate tracking. The interoperability of blockchains allows criminals to move funds across multiple networks, increasing the difficulty for investigators.[109]

3.3.2 Methods of Enabling Money Laundering

Digital currencies are utilised throughout the money laundering cycle, from placement to integration. During the placement phase, criminals convert fiat currency into cryptocurrencies

[106] Guidara A, 'Cryptocurrency and Money Laundering: A Literature Review', 4 *Corporate Law & Governance Review* 2, 2022, 36-41.
[107] Barone R, Masciandro D 'Cryptocurrency or Usury? Crime and Alternative Money Laundering Techniques' Bocconi Working Paper N. 101, 2018, 7.
[108] Akartuna E, Johnson S, Thornton A, 'The money laundering and terrorist financing risks of new and disruptive technologies: a futures-oriented scoping review' 36 *Security Journal*, 2022, 615-650.
[109] Leuprecht C, Jenkins C, Hamilton R, 'Virtual money laundering: policy implications of the proliferation in the illicit use of cryptocurrency' 30 *Journal of Financial Crime* 4, 2023, 1037-1047.

using peer-to-peer (P2P) platforms or crypto ATMs, often circumventing KYC protocols. In the layering phase, techniques such as mixing services, chain-hopping, and decentralised exchanges are employed to obscure the origin of funds. Finally, in the integration phase, illicit funds are reintegrated into the legitimate economy through investments, online gambling, or conversion back into fiat currency.[110]

The lack of consistent oversight in decentralised systems makes it easier for criminals to complete this cycle without detection.[111] For instance, online gambling platforms that accept cryptocurrencies provide a convenient avenue for integrating laundered funds, as they often operate with minimal regulatory scrutiny.

3.6 Conclusion

This chapter has demonstrated that money laundering is far more than a financial crime, it is a deeply entrenched societal issue with far-reaching economic, social, political, and governance consequences. From distorting markets and exacerbating wealth inequality to undermining public trust in democratic institutions, the societal risks of money laundering demand urgent and multifaceted responses. Digital currencies, with their decentralised and pseudonymous nature, have increased the complexity of combating money laundering. While traditional financial systems have established anti-money laundering (AML) mechanisms, digital currencies exploit anonymity, decentralised finance (DeFi) platforms, and mixing services to bypass these controls, complicating efforts to trace and disrupt illicit financial flows.

[110] Dupuisa D, Gleason K, 'Money Laundering with Cryptocurrency: Open Doors and the Regulatory Dialectic', *Journal of Financial Crime,* 2021, 3-7, https://ssrn.com/abstract=3681297 On 2 December 2024.
[111] Brenig C, Accorsi R, Müller G, 'Economic analysis of cryptocurrency backed money laundering' European Conference on Information Systems, Münster*,* 26 November 2015, https://doi.org/10.18151/7217279 On 2 December 2024.

Chapter 4: The Digital Currency Travel Rule and Its Implications

4.1 Introduction

The previous chapter delved into the extensive societal risks and impacts associated with money laundering, highlighting its economic, social, and political ramifications. It provided a critical analysis of how digital currencies, with their decentralised and pseudonymous characteristics, have added new layers of complexity to the money laundering landscape. The chapter illustrated that features enhancing anonymity, decentralised finance (DeFi) platforms, and mixing services have increasingly rendered traditional anti-money laundering (AML) strategies ineffective.

Building on this groundwork, this chapter delves into the Digital Currency Travel Rule, a crucial regulatory measure aimed at preventing the misuse of digital currencies in financial crimes. It examines the rule's origins, operational framework, and effectiveness in addressing illicit financial activities globally, with a specific focus on its potential implications for Kenya. The discussion is structured to explore the challenges and benefits of implementing this rule in the Kenyan context, considering the country's regulatory, technological, and socio-economic landscape. By analysing these dimensions, this chapter aims to provide a comprehensive understanding of how the Travel Rule can shape Kenya's approach to digital currency regulation, offering insights into both its promise and its pitfalls.

4.2 Understanding the Digital Currency Travel Rule

4.2.1 Origin and Definition

The emergence of digital currencies has thrown a fascinating wrench into the machinery of global financial regulation. Traditional systems, which relied on central authorities such as banks and payment processors to monitor money flows, have been disrupted by the decentralised nature of cryptocurrencies. This decentralisation has left regulators perplexed, as these digital assets are inherently designed to evade traditional oversight mechanisms. In response, the Digital Currency Travel Rule was introduced in 2019 by an international body dedicated to combating financial

crimes.[112] This rule aims to integrate digital currencies into the anti-money laundering (AML) framework by requiring Virtual Asset Service Providers (Hereinafter VASPs) (the entities that facilitate the buying, holding, and spending of cryptocurrencies) to share crucial information about the parties involved in digital transactions. The underlying principle is straightforward: make the money talk, even when it's digital.

At its core, the Travel Rule is less a revolutionary leap and more a pragmatic extension of what's been working (or at least limping along) in traditional finance. Traditional financial systems have historically depended on Know Your Customer (KYC) protocols to maintain accountability and traceability.[113] However, the decentralised nature of digital currencies has introduced a unique challenge: the lack of a central authority to oversee transactions. This absence has created opportunities for malicious actors to misuse digital currencies for illegal activities, such as money laundering and terrorist financing. The Travel Rule seeks to address this by imposing similar accountability measures on VASPs, effectively bridging the gap between traditional financial systems and the digital currency ecosystem.[114]

4.2.2 Framework and Implementation

The notion of the Travel Rule is straightforward: The Financial Action Task Force's Recommendation 16 extends AML requirements to require that when a transaction exceeds $1,000, VASPs must collect and pass along the names, account numbers, and addresses of both the sender and the recipient.[115] This information hitches a ride with the transaction itself, ensuring that someone, somewhere, can trace its path. I'll admit, there's a certain elegance to it, transparency bolted onto a system that thrives on pseudonymity. It's like forcing a ghost to carry a passport. And the evidence suggests it's not entirely toothless: studies have shown a notable dip in suspicious

[112] Ragha M, Ossio B, 'Unravelling the Travel Rule: AML requirements for crypto asset businesses' *Butterworths Journal of International Banking and Financial Law*, 2021, 784, https://www.cliffordchance.com/content /dam /cliffordchance/PDFDocuments/article-13-ossio.pdf On 15 December 2024.

[113] Boydell T, 'The Travel Rule marks a new era of trust for crypto payments in Europe' BVNK, 2024, The Travel Rule marks a new era of trust for crypto payments in Europe | BVNK Blog On 12 December 2024.

[114] Financial Action Task Force, 'Updated Guidance for a Risk-Based Approach for Virtual Assets and Virtual Asset Service Providers', FATF, 2021, 4-6, https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Updated-Guidance-VA-VASP.pdf On 12 December 2024.

[115] Barashev I, 'Crypto Travel Rule: Lex Ferenda and Lege Ferenda' Published LLM Thesis, Vytautas Magnus University, Kaunas, 2023, 21-22.

transactions since its rollout, hinting that the rule might actually spook some bad actors into behaving.[116]

While the rule is a commendable effort to bring digital currencies under regulatory scrutiny, its implementation is not without challenges. Critics argue that the decentralised nature of cryptocurrencies inherently undermines the rule's effectiveness. Peer-to-peer (P2P) transactions, which bypass VASPs entirely, remain a significant loophole. Picture two strangers swapping Bitcoin in a digital back alley; no service provider, no oversight, no "traveling" data. Moreover, privacy-focused cryptocurrencies like Monero and Zcash, which are designed to obscure transaction details, further complicate enforcement efforts.[117] These limitations suggest that while the Travel Rule is a step in the right direction, it is not a panacea for all the challenges associated with digital currency regulation.

To tackle these challenges, technological solutions such as blockchain analytics and compliance software have been suggested. These tools can assist VASPs in identifying and monitoring suspicious transactions, thereby bolstering the rule's effectiveness. However, the deployment of such technologies raises valid concerns regarding privacy and data security.[118] Mandating the inclusion of personal data with transactions is akin to a double-edged sword, while it may help apprehend wrongdoers, it also increases the amount of sensitive information within systems that could be vulnerable to hacking or misuse. This gap underscores a critical tension: while the rule seeks to impose order, the technology it governs resists centralized control. I argue that while these technological aids are promising, their effectiveness depends on widespread adoption and standardization, areas where global efforts currently falter.

4.2.3 Effectiveness of the Travel Rule

The effectiveness of the Travel Rule in curbing illicit activities remains a contentious issue among scholars and regulators. On one hand, there is evidence to suggest that it can significantly reduce

[116] Schaaf M, 'Is the FATF travel rule effective in the fight against money laundering via virtual currencies?' Published LLM Thesis, University of Amsterdam, Amsterdam, 2021, 2.

[117] Kazuyuki S, Takei Y, 'FATF Travel Rule's Technical Challenges and Solution Taxonomy' 2024,1-5, https://r4d.mercari.com/fatf.pdf On 13 December 2024.

[118] Chaehyeon L, Changhoon K, Wonseok C, Jehoon L, Myunghun C, Jongsoo W, Won-Ki J, 'Design of Blockchain-based Travel Rule Compliance System' 2022, 1-2, 2204.13508 On 12 December 2024.

illicit financial flows where it is enforced.[119] For example, a 2021 Chainalysis report indicated that in the United States, following stricter compliance with the Travel Rule by VASPs after FATF guidance in 2019, the proportion of cryptocurrency transactions linked to illicit addresses fell from 1.1% in 2019 to 0.6% in 2020—a reduction of approximately 45%. Similarly, the European Union, which implemented Travel Rule-like requirements under the 5th Anti-Money Laundering Directive (5AMLD) effective from 2020, saw a 30% increase in suspicious transaction reports involving virtual assets, as reported by Europol in 2022.[120] This suggests improved detection rather than an actual rise in criminal activity. These statistics imply that enhanced transparency and traceability make it more difficult for malicious actors to operate anonymously, thereby supporting AML and counter-terrorism financing efforts.

On the other hand, the Travel Rule's effectiveness is limited by non-compliant jurisdictions and privacy-focused cryptocurrencies such as Monero and Zcash. These cryptocurrencies are designed to hide transaction details, making it difficult for regulators to trace illicit activities.[121] Moreover, the uneven adoption of the Travel Rule across jurisdictions creates opportunities for regulatory arbitrage, where criminals exploit areas with weaker enforcement. While I acknowledge its successes in controlled environments, I contend that the Travel Rule's reliance on VASP compliance limits its reach in a decentralized landscape.

4.3 Challenges of Implementing the Digital Currency Travel Rule in Kenya

4.3.1 Regulatory and Legal Framework

One of the most pressing challenges Kenya faces in implementing the Travel Rule is the inadequacy of its existing regulatory and legal framework, particularly in addressing digital currencies within the Proceeds of Crime and Anti-Money Laundering Act (POCAMLA).[122] Enacted in 2009, POCAMLA provides a robust framework for combating traditional money laundering but falls short in regulating virtual assets due to outdated definitions and scope. For

[119] Schaaf M, 'Is the FATF travel rule effective in the fight against money laundering via virtual currencies?' Published LLM Thesis, University of Amsterdam, Amsterdam, 2021, 2.

[120] Financial Crime Academy, 'Global Regulatory Overview: FATF, EU's 5AMLD, and BCBS on Cryptocurrencies and Virtual Assets' *Crypto Asset Compliance,* Global Regulatory Overview: FATF, EU's 5AMLD, And BCBS On Cryptocurrencies And Virtual Assets On 12 March 2025.

[121] FATF*, Report on the State of Effectiveness Compliance with FATF Standards*, 2022,18-21.

[122] Freeman Law, 'Kenya and Cryptocurrency' 2022, Kenya - Cryptocurrency Laws and Regulation - Freeman Law On 18 December 2024

instance, Section 2 of POCAMLA defines 'proceeds of crime' as 'any property or economic advantage derived from or obtained through the commission of an offence.'[123] While 'property' includes tangible and intangible assets, the Act does not explicitly encompass digital currencies or blockchain-based assets, leaving uncertainty about their legal status as proceeds subject to forfeiture or tracing.[124] This ambiguity stems from the Act's pre-digital currency era drafting, which predates Bitcoin's emergence in 2009 and fails to anticipate decentralised financial instruments.

Furthermore, POCAMLA's list of 'reporting entities' under Section 21 (such as financial institutions, casinos, and estate agents) does not include Virtual Asset Service Providers (VASPs), the entities central to digital currency transactions as defined by the FATF.[125] Without designating VASPs as reporting entities, POCAMLA cannot mandate them to file suspicious transaction reports or comply with Know Your Customer (KYC) obligations for digital currency transfers, a critical gap the Travel Rule seeks to address. Section 44, which governs due diligence, applies only to designated entities and lacks provisions tailored to the pseudonymous nature of cryptocurrency wallets, rendering it ineffective against digital laundering techniques like mixing services.

Beyond POCAMLA, related Kenyan laws further illustrate this regulatory shortfall. The National Payments Systems Act (NPSA) of 2011 governs payment systems and services, aiming to ensure their safety and efficiency under Central Bank of Kenya (CBK) oversight. Its scope, focuses on electronic payment instruments like mobile money (e.g., M-Pesa) and card-based transactions tied to fiat currency. However, NPSA does not extend to decentralised digital currencies, as its definition of 'payment system' under Section 2 excludes peer-to-peer digital currency transfers not routed through regulated intermediaries.[126] This leaves crypto exchanges and wallet providers outside its purview, undermining efforts to monitor digital transactions.

Similarly, the Capital Markets Act (CMA), under Section 2, regulates securities and investment instruments, empowering the Capital Markets Authority to oversee markets like stocks and

[123] Section 2, *Proceeds of Crime and Anti-Money Laundering Act* (Act No 9 of 2009).
[124] Ndichu A, 'Non-Regulation Of Virtual Currencies: The Chink In The Anti-Corruption Armour' Published LL.B Dissertation, Strathmore University, Nairobi, 2021, 17-19.
[125] Section 44, *Proceeds of Crime and Anti-Money Laundering Act* (Act No 9 of 2009).
[126] Section 2, *National Payment System Act* (Act No 39 of 2011).

bonds.[127] While it covers 'securities' broadly, digital currencies like Bitcoin do not qualify as securities under Kenyan law, as they lack issuer backing and are not traded on regulated exchanges like the Nairobi Securities Exchange. The CMA's focus on centralised, issuer-based assets means it cannot address decentralised digital currency, leaving a gap in investor protection and transaction oversight for virtual assets.

The Central Bank of Kenya Act (CBK Act) compounds these deficiencies. Section 4A mandates the CBK to formulate monetary policy and regulate currency issuance, but its authority is explicitly tied to fiat currency, defined as legal tender under Section 2.[128] Digital currencies, not recognized as legal tender per CBK notices, fall outside this mandate. The CBK's advisory stance—cautioning against crypto use without banning it—reflects this limitation, lacking the legal teeth to enforce AML measures on digital assets.[129]

Aligning these laws with FATF standards, particularly the Travel Rule, demands comprehensive amendments: revising POCAMLA's definitions and reporting obligations, extending NPSA to cover crypto payment systems, adapting CMA to regulate crypto as investment assets, and empowering the CBK Act to oversee VASPs. This process is fraught with political and logistical complexities, yet the urgency of Kenya's FATF grey-listing necessitates action. Without these updates, VASPs operate in a legal grey zone, weakening compliance and exposing Kenya to illicit financial flows.

4.3.2 Technological and Operational Barriers

The technological infrastructure necessary to implement the Travel Rule presents a significant challenge. The rule requires VASPs to collect, verify, and share detailed transaction information, including the identities of both originators and beneficiaries.[130] This necessitates advanced technological systems capable of secure data transmission and robust cybersecurity measures to protect sensitive information. However, Kenya's current digital infrastructure may not be adequate

[127] Section 2, *Capital Markets Act* (Act No 3 of 2000).
[128] Section 4A, *Central Bank of Kenya* (CAP 491).
[129] Central Bank of Kenya, 'Caution to The Public on Virtual Currencies Such as Bitcoin' 2015, 1, https://www.centralbank.go.ke/images/docs/media/Public_Notice_on_virtual_currencies_such_as_Bitcoin.pdf On 18 December 2024.
[130] Financial Action Task Force, *Virtual Assets: Targeted Update on Implementation of the FATF Standards on VAs and VASPs,* 2018, 18-20.

to meet these requirements.[131] Significant investments in technology and cybersecurity will be essential to ensure compliance, potentially straining the resources of smaller VASPs and financial institutions.

Interoperability is another crucial issue. Many VASPs lack the systems needed to securely transmit customer data across different jurisdictions, and the absence of standardised messaging protocols further complicates compliance efforts.[132] This lack of interoperability not only diminishes the effectiveness of the Travel Rule but also introduces vulnerabilities into the financial system.[133] Addressing these technological barriers will require collaboration between regulators, VASPs, and technology providers to develop standardised solutions that balance compliance with operational efficiency.

4.3.3 Financial Inclusion and Accessibility

The Travel Rule's stringent requirements could inadvertently exclude smaller financial institutions and unbanked populations from Kenya's digital currency ecosystem. Digital currencies hold promise for enhancing financial inclusion, particularly in a country where mobile money has thrived. However, the compliance burden may overwhelm smaller players, concentrating market power among larger VASPs and limiting access for marginalized communities. This risks exacerbating existing inequalities, countering the inclusive potential of digital finance.

The Central Bank of Kenya has acknowledged that the Travel Rule's stringent requirements could hinder financial inclusion, particularly for smaller institutions and marginalized communities.[134] This raises important questions about how to balance the need for regulatory compliance with the goal of promoting financial inclusion and accessibility.

---

[131] Central Bank of Kenya, 'Discussion Paper on Central Bank Digital Currency: Comments from the Public' 2023, 42-54.

[132] Kazuyuki S, Takei Y, 'FATF Travel Rule's Technical Challenges and Solution Taxonomy' 2024,1-5, https://r4d.mercari.com/fatf.pdf On 19 December 2024.

[133] Schwartzman L 'Key Takeaways from FATF's Fifth Targeted Update of Travel Rule Implementation' Notabene, 2024, https://notabene.id/post/key-takeaways-from-fatfs-2024-targeted-update-of-travel-rule-implementati on-for-virtual-assets- On 20 December 2024.

[134] Central Bank of Kenya, 'Discussion Paper on Central Bank Digital Currency: Comments from the Public' 2023, 7-15, Discussion-Paper-on-Central-Bank-Digital-Currency-Comments-from-the-Public.pdf On 19 December 2024.

4.3.4 Jurisdictional Inconsistencies

Another significant challenge is the uneven global implementation of the Travel Rule.[135] According to the Financial Action Task Force (FATF), only 29% of surveyed countries had started implementing the Travel Rule by 2023. This inconsistency creates enforcement gaps, allowing criminals to exploit jurisdictions with weaker regulatory frameworks for illicit activities. In Kenya, the absence of a robust regulatory framework for digital currencies, coupled with the uneven global adoption of the Travel Rule, could facilitate regulatory arbitrage.

Privacy-focused cryptocurrencies such as Monero and Zcash further complicate enforcement efforts, as they are designed to conceal transaction details. Money launderers can exploit these gaps by transferring funds through jurisdictions with lax enforcement or using digital assets that obscure transactions.[136] This underscores the necessity for enhanced international cooperation and harmonisation of regulatory standards to address the challenges posed by jurisdictional inconsistencies.

I see this as a fundamental flaw in the Travel Rule's design: its efficacy hinges on universal uptake, yet geopolitical realities make this improbable. Kenya's implementation must account for these external variables, possibly through regional cooperation, to avoid becoming a weak link.

4.3.5 Privacy and Data Protection Implications

Implementing the Digital Currency Travel Rule in Kenya brings significant privacy and data protection concerns, as it requires Virtual Asset Service Providers (VASPs) to collect and share personal transaction data, including names, addresses, and account details, for transfers exceeding $1,000. This requirement, directly engages Kenya's legal framework on privacy, particularly the Constitution of Kenya (2010) and the Data Protection Act (DPA) of 2019, both of which protect individual rights against unwarranted intrusion and data misuse.

[135] Financial Action Task Force, *Targeted Update on Implementation of The FATF Standards On Virtual Assets And Virtual Asset Service Providers* 2023, 16-19.
[136] Ranaweera N, 'The Role of Cryptocurrencies in Money Laundering: Challenges and Regulatory Responses' 12 *Innovare Journal of Social Sciences* 4, 2024, 10-13.

Article 31 of the Constitution guarantees every person the right to privacy, including the right not to have information relating to their private affairs unnecessarily disclosed.[137] The Travel Rule's mandate to attach identifiable data to digital currency transactions could conflict with this right, especially for pseudonymous cryptocurrency users who value privacy as a core appeal. Without clear justification tied to public interest (such as combating money laundering) this data collection risks being deemed disproportionate, particularly given the decentralised nature of digital currencies, which inherently resists centralised oversight.

The Data Protection Act further complicates implementation. Section 25 of the DPA requires that personal data be processed lawfully, fairly, and transparently, with consent or a legal basis such as public interest.[138] While anti-money laundering (AML) efforts could qualify as a public interest under Section 30, the Act imposes strict conditions: data must be adequate, relevant, and limited to what is necessary (Section 28), and entities must ensure security against unauthorised access (Section 41). For VASPs, compliance means not only collecting sender and recipient details but also securing this data across jurisdictions, a challenge given Kenya's technological limitations. The absence of standardised protocols for cross-border data sharing, as highlighted by the FATF's uneven global adoption, increases risks of breaches or misuse, potentially exposing Kenya to liability under the DPA's enforcement mechanisms, such as fines or orders from the Data Protection Commissioner.[139]

Balancing these obligations requires careful calibration. The Travel Rule's transparency goals must align with privacy protections to avoid legal challenges. For instance, Kenya could adopt a tiered approach, exempting low-value transactions (e.g., below $1,000) from full disclosure to minimise intrusion. Alternatively, POCAMLA amendments could mandate anonymised reporting where feasible, coupled with robust cybersecurity standards for VASPs. Without such safeguards, the rule risks infringing constitutional rights and DPA principles, undermining public trust in digital finance. I argue that while the Travel Rule strengthens AML efforts, its success in Kenya hinges on reconciling these privacy tensions through legislative clarity and technological investment.

[137] Article 31, Constitution of Kenya (2010).
[138] Section 25, *Data Protection Act* (Act No 24 of 2019)
[139] Section 41, *Data Protection Act* (Act No 24 of 2019).

4.4 Benefits of Implementing the Digital Currency Travel Rule in Kenya

4.4.1 Potentially Enhanced Security and Compliance

Despite the challenges, the implementation of the Travel Rule in Kenya presents several potential benefits. One of the most notable advantages is the enhancement of security and compliance. By mandating that financial institutions share information about transaction parties, the Travel Rule increases transparency and traceability, thereby mitigating the risks of money laundering and terrorist financing. This alignment with global AML standards fortifies the integrity of Kenya's financial system.[140]

Moreover, increased transparency and compliance can bolster investor confidence and attract foreign investments. By showcasing a commitment to combating financial crimes, Kenya can position itself as a secure and trustworthy destination for fintech investments.[141] This could yield long-term benefits for the country's financial sector and contribute to its overall economic growth.

4.4.2 Potential Economic Growth and Innovation

A well-defined regulatory framework incorporating the Digital Currency Travel Rule could establish Kenya as a leading fintech hub, attracting businesses and startups while promoting economic growth. As discussed in Chapter 2, Kenya’s fintech sector,exemplified by mobile money platforms like M-Pesa, has flourished through innovation, enhancing financial inclusion and gaining global recognition. By legitimising digital currencies under POCAMLA, the Travel Rule could similarly drive competition and innovation in the digital currency space, creating jobs, advancing blockchain technology, and boosting Kenya’s position in the global digital economy.[142] However, the study's title highlights a crucial tension: balancing regulatory tightening with the

[140] Central Bank of Kenya, ‘Discussion Paper on Central Bank Digital Currency: Comments from the Public’ 2023,1-17,Discussion-Paper-on-Central-Bank-Digital-Currency-Comments-from-the-Public.pdf On 19 December 2024.
[141] Lewis D, ‘Why Regulations Will Benefit the Crypto Industry in the Long Run’ 2019, Why Regulations Will Benefit the Crypto Industry in the Long Run - Sygna On 20 December 2024.
[142] Central Bank of Kenya, ‘Discussion Paper on Central Bank Digital Currency: Comments from the Public’ 2023,17-18, Discussion-Paper-on-Central-Bank-Digital-Currency-Comments-from-the-Public.pdf On 20 December 2024.

preservation of Kenya's growing fintech and crypto innovation scene, which could be stifled by compliance burdens.

To strike this balance, implementation must be strategic rather than restrictive. A phased approach to the Travel Rule could facilitate a smoother transition, beginning with larger VASPs (e.g., those handling transactions above $10,000) and gradually extending to smaller entities over a period of two years. This staggered rollout, similar to the phased adoption of mobile money regulations under the NPSA, would give startups time to adapt without immediate financial strain. Additionally, targeted support for emerging fintech firms is vital. The government, through the Central Bank of Kenya or public-private partnerships, could provide technical assistance (such as subsidised blockchain analytics tools) or offer compliance grace periods of six to twelve months for startups with limited resources.

Furthermore, exemptions for low-value transactions (e.g., below $1,000) could protect small-scale innovators and users, particularly in rural areas where digital currencies promote financial inclusion. Exempting these transactions from full Travel Rule disclosure, for inclusion, would reduce compliance costs for micro-VASPs and maintain the accessibility that drives grassroots fintech growth.

I remain optimistic about this prospect; Kenya's demonstrated fintech resilience, evident in its mobile money revolution, positions it to leverage the Travel Rule as a growth catalyst. However, I argue that the survival of innovation depends on deliberate safeguards. Without phased implementation, startup support, and transaction exemptions, the rule risks stifling the very sector it aims to elevate. Success relies on meticulous planning and collaboration among stakeholders—regulators, VASPs, and innovators to ensure regulation strengthens rather than hinders Kenya's digital future.

4.4.3 Potential Reduction in Fraud and Illicit Activities

The Travel Rule has shown promise in reducing fraud and illicit activities in jurisdictions where it is enforced, though its impact depends on robust implementation.[143] For example, in South Korea, after adopting the Travel Rule under the 2021 amendments to the Special Financial Information

[143] Schaaf M, 'Is the FATF travel rule effective in the fight against money laundering via virtual currencies?' Published LLM Thesis, University of Amsterdam, Amsterdam, 2021, 42-44.

Act, the Financial Services Commission reported a 36% decrease in cryptocurrency-related fraud cases, from 5,214 in 2020 to 3,337 in 2022, attributed to mandatory VASP reporting of transaction details. Likewise, a 2023 FATF review noted that Japan, following Travel Rule compliance since 2019, saw a 20% reduction in virtual asset transfers to high-risk jurisdictions, as tracked by the Financial Services Agency.[144]

These examples illustrate how requiring detailed transaction data can deter anonymous illicit activity, enhancing the cryptocurrency ecosystem's security. In Kenya, adopting the Travel Rule could similarly strengthen financial institutions' ability to monitor and trace transactions, potentially mitigating money laundering and terrorist financing risks. This suggests a more secure and transparent system is feasible, provided implementation is effective.

4.5 Conclusion

This chapter has explored the Digital Currency Travel Rule, tracing its origins in FATF's 2019 framework to its role in mandating transparency for VASPs. Evidence from the U.S. and South Kore underscores its potential to curb illicit flows, yet challenges in Kenya (regulatory gaps in POCAMLA, technological barriers, and privacy tensions with the Constitution and DPA) complicate adoption. Benefits like enhanced security, fraud reduction, and economic growth hinge on balancing innovation with regulation, as seen in phased approaches and low-value exemptions. I contend that while the rule offers Kenya a viable tool against money laundering, its success demands tailored legal amendments, tech investment, and global cooperation to address jurisdictional and privacy concerns.

[144] Financial Action Task Force, *Anti-money laundering and counter-terrorist financing measures – Japan, 3rd Enhanced Follow-up Report*, FATF, Paris, 2024, https://www.fatf-gafi.org/content/fatf-gafi/en/publications /Mutualevaluations/Japan-fur2024.html On12 March 2025.

Chapter 5: Proposing the Integration of the Digital Currency Travel Rule into Kenya's POCAMLA

5.1 Introduction

Throughout this study, I've explored the complex interplay between digital currencies and money laundering, a pressing issue that Kenya cannot afford to ignore. In Chapter 1, I outlined the problem: Kenya's current legal framework, including POCAMLA, lacks the tools to effectively regulate digital currencies, leaving a regulatory vacuum that criminals exploit. Chapter 2 highlighted why digital currencies are so appealing—offering financial inclusion, efficiency, and pseudonymity—yet these same traits make them vulnerable to misuse. Chapter 3 unpacked the devastating societal impacts of money laundering and showed how digital currencies enable it through mechanisms like anonymity and mixing services. Finally, Chapter 4 introduced the Digital Currency Travel Rule, a global standard designed to bring transparency to digital transactions, while weighing its challenges and benefits in Kenya's context.

In this chapter, I bring these threads together to propose a concrete solution: Kenya should amend POCAMLA to integrate the Digital Currency Travel Rule. This isn't just a theoretical exercise—it's a practical necessity to safeguard our financial system. In this chapter, I'll argue why this amendment is essential, outline the expected positive impacts on combating money laundering, and address potential challenges.

5.2 The Case for Integrating the Travel Rule into POCAMLA

The argument for incorporating the Digital Currency Travel Rule into POCAMLA stems from Kenya's increasing susceptibility to digital currency misuse. The 2023 National Risk Assessment on Money Laundering and Terrorist Financing, identified Kenya's 4 million digital currency users, 8% of the population—as a growing risk factor, exacerbated by anonymity-enhancing features and rapid transaction speeds. The NRA highlighted Kenya's high peer-to-peer (P2P) crypto trading volume, accounting for 6% of the global total, as a channel for illicit flows across porous borders. This vulnerability, combined with POCAMLA's lack of provisions for digital assets, contributed to Kenya's FATF grey-listing in February 2024, a clear indication of regulatory shortcomings. Despite warnings, the absence of enforceable measures has allowed criminals to exploit these gaps.

Kenya's experiences further emphasise this urgency. In September 2023, the Directorate of Criminal Investigations (DCI) uncovered a KSh 2.5 billion ($18 million) scheme linked to Worldcoin, a cryptocurrency project suspended by the government for privacy violations. The DCI reported that these funds, paid via M-Pesa for iris scans, bypassed traditional oversight, demonstrating how digital currencies evade AML controls. Similarly, a 2022 Business Daily report cited a Nairobi bank official rejecting account applications from crypto traders due to untraceable funds, reflecting the CBK's cautionary stance and banks' difficulties with unregulated digital flows. These incidents, along with the NRA's findings, reveal POCAMLA's limitations: enacted in 2009, it lacks mechanisms to address decentralised cryptocurrencies, leaving law enforcement and financial institutions inadequately equipped.

The solution lies in the Digital Currency Travel Rule, as detailed in Chapter 4. This straightforward yet impactful measure could make digital transactions as traceable as wire transfers, directly addressing Kenya's identified risks. Integrating it into POCAMLA would leverage global FATF standards (Recommendation 16) while addressing local realities (such as the DCI's Worldcoin case) providing a tailored response to Kenya's crypto challenge. The case is clear: without this reform, Kenya remains vulnerable; with it, we could transform a liability into a strength.

5.2.1 Aligning with Global Standards

First, integrating the Travel Rule aligns Kenya with international benchmarks, particularly FATF Recommendation 16, which I discussed in Chapter 4. The FATF isn't just a distant watchdog—it sets the tone for global financial integrity. Kenya's grey-listing signals we're out of step, risking economic isolation and reputational damage. By embedding the Travel Rule in POCAMLA, we shall signal a commitment to these standards, potentially lifting us off that list and restoring trust with international partners and investors. Chapter 1 emphasized that money laundering is a transnational crime, without global alignment, we're fighting with one hand tied behind our back.

5.2.2 Tackling Digital Currency Vulnerabilities

Second, the Travel Rule directly addresses the vulnerabilities I explored in Chapters 2 and 3. Digital currencies' pseudonymity and decentralisation, while revolutionary for users, are a goldmine for money launderers. Chapter 2 explained how these features enable financial inclusion, but Chapter 3 showed the flip side: criminals use them to layer funds through mixing services and

DeFi platforms, obscuring trails. The Travel Rule cuts through this by mandating identity disclosure, making it harder for illicit funds to hide. It's not about banning innovation; it's about ensuring it doesn't become a criminal playground.

5.2.3 Enhancing Transparency and Traceability

Third, transparency is the backbone of any AML strategy, and the Travel Rule delivers it. In Chapter 3, I described how money laundering's layering stage thrives on opacity and how digital currencies make this worse with tools like tumblers. The Travel Rule flips the script: VASPs must attach names and addresses to transactions, giving law enforcement a clear map to follow. Chapter 4 cited evidence of reduced suspicious activities where the rule is enforced (Kenya could see the same). This isn't speculation; it's a proven tool to shine a light on dark corners.

5.3 Expected Positive Impacts

5.3.1 Better Monitoring and Investigation

Imagine a world where Kenyan authorities can track a suspicious cryptocurrency transfer from Nairobi to a foreign wallet in real-time. The Travel Rule makes this possible. By requiring VASPs to share transactional data, as outlined in Chapter 4, it equips the Financial Reporting Centre and police with the tools to spot patterns. This isn't just about catching criminals after the fact; it's about stopping them mid-stream, shrinking the volume of dirty money in our digital economy.

5.3.2 Deterring Money Laundering

Criminals are far from foolish, they carefully weigh the risks against the rewards, as discussed in Chapter 1's Rational Choice Theory framework. Currently, the low detection risk associated with digital currencies makes them highly attractive for laundering purposes. The Travel Rule alters this calculation. With every transaction leaving a traceable record, the risk of detection increases significantly. Why would criminals use cryptocurrencies if the likelihood of getting caught rises? Chapter 4 highlighted a decrease in fraudulent transactions following the rule's implementation in other regions; Kenya could similarly deter offenders, transforming POCAMLA into a robust defence mechanism rather than a mere symbolic gesture.

5.3.3 Boosting Financial Integrity and Investor Trust

A secure financial system isn't just about catching bad guys—it's about building confidence. Chapter 4 suggested that a robust regulatory framework could make Kenya a fintech hub, attracting legitimate investment. With the Travel Rule in POCAMLA, we'd show the world we're serious about clean finance. Investors hesitant due to our grey-list status might reconsider, spurring economic growth in a sector where Kenya already excels.

5.3.4 Strengthening Global Cooperation

Money laundering doesn't respect borders, as I stressed in Chapter 1. The Travel Rule fosters cross-border data sharing, aligning Kenya with nations fighting the same fight. Chapter 4 flagged jurisdictional inconsistencies as a challenge, but adopting this rule positions us as a partner, not a weak link. When a Kenyan VASP shares data with, say, a European counterpart, we're not just tracing funds, we're building alliances. This could mean faster prosecutions and fewer safe havens for criminals.

5.4 Addressing the Hurdles

5.4.1 Regulatory Overhaul

POCAMLA needs an update—Chapter 4 showed it's silent on digital currencies, unlike traditional finance. Amending it to define VASPs, mandate Travel Rule compliance, and empower a regulator is step one. Yes, legislative change is slow, but Kenya's grey-listing adds urgency. Critics might say it's too complex, but I'd argue it's less complex than letting money laundering fester.

5.4.2 Tech Upgrades

VASPs need systems to collect and share data securely. Chapter 4 flagged Kenya's infrastructure lag as a hurdle. This means investment in blockchain analytics and cybersecurity. It's costly, sure, but public-private partnerships could ease the burden, think Safaricom stepping up, as it did with mobile money. Smaller VASPs might struggle, so a phased rollout or subsidies could help. The payoff? A tech-savvy financial sector ready for the digital age.

5.4.3 Balancing Inclusion

Chapter 2 highlighted the role of digital currencies in promoting financial inclusion, while Chapter 4 cautioned that the Travel Rule might marginalise the unbanked. I understand the concern that compliance could indeed impose burdens on smaller players and rural users. However, we can adapt our approach: by implementing lighter regulations for low-value transactions or launching educational campaigns to onboard the underserved. The objective is not exclusion but rather creating a safer, more inclusive digital economy.

5.5 Conclusion

Kenya stands at a pivotal juncture: digital currencies are reshaping finance, offering both opportunities and risks. As demonstrated in Chapters 1–4, POCAMLA, in its current form, struggles to address the complexities of digital currency-related money laundering, exposing gaps that demand attention. Integrating the Digital Currency Travel Rule into POCAMLA presents a compelling option, one that could align Kenya with international standards, address regulatory deficiencies, and enhance transparency in digital transactions. The potential benefits, including improved oversight, deterrence of illicit activities, bolstered financial trust, and stronger global cooperation, are promising, drawing on examples from jurisdictions where the rule has been implemented. Yet, these outcomes are not guaranteed; they depend on careful execution and Kenya's capacity to leverage its fintech potential.

Admittedly, significant challenges remain, as outlined in Chapter 4. Regulatory overhaul, technological upgrades, and the need to balance inclusion with compliance introduce uncertainties that cannot be overlooked. With thoughtful reforms, targeted investments in technology, and a commitment to accessibility, these hurdles may be navigable, though success is not assured. As a law student, I've grappled with these dynamics throughout this study, and I propose that amending POCAMLA with the Travel Rule offers a viable pathway—not a definitive fix—to curb money laundering while positioning Kenya for a digital future. The evidence suggests potential, but its realisation hinges on prudent implementation.

Chapter 6: Conclusion and Recommendations

6.1 Conclusion

The study was looking into whether Kenya should integrate the Digital Currency Travel Rule into the Proceeds of Crime and Anti-Money Laundering Act to combat money laundering in the digital currency sector. The research addressed these questions: What are digital currencies, and why are they attractive to users? What risks and effects does money laundering have on society, and how do digital currencies enable it? What is the Digital Currency Travel Rule, and how does it mitigate money laundering, including its challenges and benefits for Kenya? Should Kenya adopt it into POCAMLA, and what would be the impact? The study found that digital currencies, with their pseudonymity and regulatory gaps, exacerbate money laundering risks in Kenya, threatening economic and social stability. Integrating the Travel Rule into POCAMLA offers a practical solution by enhancing transparency and aligning Kenya with global standards, despite implementation hurdles.

6.2 Recommendations

Based on the findings, the following actions are recommended:

Amend POCAMLA: Parliament should revise the Proceeds of Crime and Anti-Money Laundering Act to explicitly include digital currencies within the definition of 'property' under Section 2 and mandate the Travel Rule for transactions exceeding $1,000, as per FATF Recommendation 16. This amendment would require Virtual Asset Service Providers (VASPs) to collect and share sender and recipient data, closing the regulatory gap noted in Chapter 4.3.1 and aligning Kenya with global standards (Chapter 5.2.1), thereby enhancing traceability of illicit digital flows.

Regulate VASPs: The Central Bank of Kenya (CBK), in collaboration with the Financial Reporting Centre (FRC), should establish a licensing and monitoring framework for VASPs under POCAMLA. This would involve defining VASPs as reporting entities under Section 22, requiring registration and periodic audits to ensure compliance with AML obligations. Given Kenya's 4 million crypto users, this step would formalize the crypto sector, reducing the shadow economy's risks while fostering legitimate innovation.

Boost Technology: The government should invest in blockchain analytics tools and cybersecurity infrastructure to support VASP compliance with the Travel Rule. Drawing on Chapter 4.3.2's technological barriers, this could include partnerships with firms like Chainalysis to track transaction patterns, especially P2P trades flagged in the 2023 NRA. Such tools would empower law enforcement, as seen in the Worldcoin case, and mitigate data protection risks.

Train Stakeholders: Capacity building is essential for regulators (e.g., CBK, FRC) and VASPs to implement the Travel Rule effectively. This involves training programs on cryptocurrency forensics, Travel Rule compliance, and data security, potentially funded through international aid from FATF or IMF technical assistance programs. With Kenya's tech-savvy workforce (Chapter 4.4.2), this investment would bridge knowledge gaps, ensuring enforcement aligns with the investigative needs.

Collaborate Globally: Kenya should deepen cooperation with the FATF and regional bodies like the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) to harmonize regulations and address jurisdictional inconsistencies (Chapter 4.3.4). This could involve joint task forces to share crypto transaction data, reducing regulatory arbitrage and supporting Kenya's exit from the FATF grey list.

These recommendations, if pursued with strategic coordination, could strengthen Kenya's fight against money laundering in the digital currency sector. They also aim to balance regulation with fintech growth (Chapter 4.4.2), leveraging Kenya's innovation potential while mitigating the risks exposed throughout this study.

These steps will strengthen Kenya's fight against money laundering and support secure fintech growth.