The Promises and Perils of the Central Bank Digital currency

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A. INTRODUCTION

Digital currency is a currency that exists only in digital or electronic form or also a means of payment that exists purely in electronic form and can be exchanged for a pre- determined amount equivalent to the local fiat currency. They are only accessible through computing platforms. Notably all cryptocurrencies are digital currencies, however, not all digital currencies are cryptocurrencies. Digital currencies do not possess any physical attributes unlike physical currencies that are inform of banknotes or coins.

B. CURRENCY IN KENYA

In Kenya, the first 'local currency' was introduced by the British in about 1921 when through introduction of the East African Shilling, the same was produced by the East African Currency Board. Prior to the EA Shilling the applicable currency to African colonies was the Indian Rupee, which was replaced by the Florin. The EA Shilling was in existence from 1921 to 1969.

Vide the Central Bank of Kenya Act No. 15 of 1966, the Central Bank of Kenya (alternatively ***'Banki Kuu ya Kenya'***) was established as a body corporate. Under the 1966 Act, CBK's principal object was to regulate the issue of notes and coins, to assist the development and maintenance of a sound monetary, credit and banking system in Kenya among other objectives. Section 22 of the 1966 Act, placed the sole right to issue notes and coins in Kenya, and Section 23 provided for the exchange of the East African Currency with the Kenya Shillings at par.

The first version of the Kenya Shilling began circulation in about 1966 with introduction of the first coins bearing the face of the then President Mzee Jomo Kenyatta. As the second President Daniel Arap Moi took over the leadership of the county in 1980 a portrait of him replaced Kenyatta. In 2004, Central Bank of Kenya replaced the portraits and returned Kenyatta.

C. CURRENCY UNDER THE CONSTITUTION OF KENYA, 2010.

In 2010, the country promulgated the new Constitution of Kenya, wherein under Article 231 established the Central Bank of Kenya (CBK), now as a constitutional entity. Under Article 231 (2) of the Constitution, CBK was given the responsibility to formulating monetary policy, promoting price stability, issuing currency and other functions. CBK now being established as an independent entity that existed to operate without being under direction or control of any person or authority (Article 231(3)). CBK is also regulated by the Central Bank of Kenya Act CAP 491 Laws of Kenya. Article 231(4) of the Constitution, made the most significant changes to what currency in Kenya was, the provision reads;

> *Notes and coins issued by the Central Bank of Kenya may bear images that depict or symbolise Kenya or an aspect of Kenya but shall not bear the portrait of any individual.*

This Constitutional provision set the stage for significant changes to the Kenyan currency, and in March 2012, CBK began the process of developing the Kenyan currency banknotes. It was not until 2017 that CBK of begun tendering for the design of the new bank notes, which were formally introduced in May 2019, when it issued the new banknotes that operating to date. During this introduction, CBK phased out the previous 1,000-shilling note that was legal tender until 1st October 2019.

D. DIGITAL CURRENCY

The concept of digital currencies is not new, and has been in existence from the 1980s. However, the modern implementation of it has been seen in the launch of cryptocurrency 'Bitcoin' in 2009. With the development of other cryptocurrencies and advancements block-chain technology in the 21st Century has resulted in the expansion of adoption of digital currencies.

Initially, many governments did not recognize the cryptocurrencies, however with the increase in digitization of economies, more governments are recognizing digital currencies with Central Banks across the world have been debating the possibility of adoption of central bank digital currencies (CBDCS). CBDC is a digital currency issued by the Central Bank and intended to serve as a legal tender[1] and are issued by Central Banks.

According to a report by the House of Lords, the Bahamian Sand Dollar was the first CBDC to be launched, while several other major economies were preparing for possible launches.[2]

E. RATIONALE FOR ADOPTION OF CBDCS

Risk of Private Money Creation

Central Banks have been raising concern that big tech companies may acquire excessive market power from issuance of their own digital currencies thus affecting the monetary system. For instance, on Facebook's Libra project, Rt Hon Rishi Sunak MP, Chancellor of the Exchequer, noted that Facebook's Libra project prompted the Government to ask: *"what do we think about a global stablecoin that we are not in control of? What does that mean? How should we regulate that? Do we have to worry about financial stability? That is probably what has catalysed work on [CBDCs]"...* [3]

CBDCs could therefore help to avoid the risks of new forms of private money creation.

Ease of Cross- Border Payments

Adoption of CBDCs may promote better cross -border settlements where central banks collaborate to link their domestic CBDCs to enable fast and efficient cross-border payments. [4]

Promoting a Resilient Payments System

Adoption of CBDCs will provide a new way to make payments, thus diversifying the range of payment options. This will in turn promote financial stability. A well designed and robust CBDC system will also offer a vast and efficient payment system to users to cater for the potential market failures in the existing payment systems.[5]

F. RISKS ASSOCIATED WITH CBDCS

While the adoption of CBDCs has potential benefits, we also note that there are also risks associated with CBDCs, as discussed below;

Risk to Individual Privacy

Privacy and data protection is a core concern that should be carefully considered before implementing the CBDC. Users should have control over how their personal data is used or who it is shared with.

It has been argued that CBDCs may be used by governments and central banks as state surveillance to monitor individuals' spending choices thus posing a threat to individual privacy.

Financial Inclusion

Financial inclusion is one of the driving forces behind the push for adoption of CBDCs.[6] We note that a majority of the population may not be able to access the technology required to participate in CBDCs e.g. smartphones

Implications on the Monetary System

It has been argued that where CBDCs create too much inflation which becomes difficult to control, this may lead to blurring of fiscal and monetary policies. There also needs to be safeguards on limits of the amount of CBDCs individuals can hold.

G. DIGITAL CURRENCY IN KENYA.

In Kenya, there is no regulation for the digital currency, neither are any supported by the government or by the CBK. Any investment in the sector by citizens is at their risk and no legal mechanisms are available as would be in forex trading.

The introduction of CBDCs creates new opportunities and poses significant risks, which calls for a discussion on the same before adoption. The Central Bank of Kenya ("The Central Bank ") is also considering the adoption of CBDCs, as are central banks across the world. In line with this, the Central Bank published a discussion paper on Central Bank Digital Currency (CBDC) on **10th February 2022**, welcoming comments from the public on the same.

CBK has also in its under **Section 4 of the Central Bank of Kenya Act** the objective is to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices. The Bank is further mandated to foster the liquidity, solvency and proper functioning of a stable market-based financial system. The CBDC should be designed in a way that promotes these objectives.

In order to achieve these objectives, the CBDC payment system must be designed in a manner that adheres to the following principles, inter alia, to ensure financial stability[7];

a. **Resilience** - The CBDC payment system should be able to recover from disruptions such as hardware/software failures;
b. **Security** - The CBDC system should have safeguards to protect users from cyber-attacks and fraudulent payments;
c. **Privacy** - The CBDC system should adhere to the principles of data protection and privacy under the Constitution of Kenya and the Data Protection Act;
d. **Availability** The CBDC system should be available 24/7 to avoid any downtimes;
e. **Compliance** - The CBDC system should be compliant with the existing regulations and monetary policies e.g., on Anti money laundering. The identity of users should be known by an authority for purposes of validating legitimacy of transactions;
f. **Efficiency** - CBDC payment system should be designed with relatively simple functionality to ensure efficiency and cost effectiveness

We also note that in a report done by the Bank of Canada, European Central Bank, Bank of Japan, Sveriges Riksbank, Swiss National Bank, Bank of England, Board of Governors of the Federal Reserve and Bank for International Settlements, wherein it was emphasized that in order for any jurisdiction to consider proceeding with a CBDC, authorities need to be confident that **issuance would not compromise monetary or financial stability and that a CBDC could coexist with and complement existing forms of money, promoting innovation and efficiency.**[8]

In order to implement digital currencies in Kenya, there is need for considerable engagement with the public. When CBK tried to implement the new currency there was sufficient litigation challenging the new currency some of the cases filed were;

a. ***Nairobi HC Petition No. 477 of 2017 - Okiya Omtatah Okoiti vs. Central Bank of Kenya & Another***, wherein the Petitioner sought to compel CBK to issue new design currency notes in conformity with the Constitution.
b. ***Nairobi HC Petition No. 597 of 2017 Okinya Omtatah vs Central Bank of Kenya & others***, wherein the Petitioner challenged the award of the tender for the design and printing of new bank noted.
c. ***Nairobi HC Petitions No. 210 & 214 of 2019 Simon Mbugua & Another vs. Central Bank of Kenya & 2 others***, wherein the Petitioners challenged the designs and process that introduced the new generation Kenyan notes and coins.

However, we note the courts noted in the Simon Mbugua Case (supra)[9] the court in addressing itself to the provisions of Article 231 stated as following;

*"**118.** Returning now to the text of **Article 231 (4)** of the Constitution, we readily find that the language is plain and unambiguous. In the first and permissive limb of the Article, it provides that the new currency may bear images that depict or symbolize Kenya or an aspect of Kenya. It is instructive that up to that point, the word used is image. That word is wide enough to perhaps include the impugned statue.*

*"**119.** However, in the second and prohibitive part of the Article, it is emphatic that the currency shall not bear the portrait of any individual. The word used in that part is portrait and it is important to keep in mind the definitions given earlier.*

*"**120.** None of the petitioners was able to demonstrate that the impugned statue amounts to either a portrait or even a sculpture-portrait. As we demonstrated in the definitions above, the word portrait has a narrower meaning than the word image. The impugned picture of the statue as printed on the new currency is not frontal; it is a sideway shot. It is a full-length representation of the first President from the head to his feet.*

*"**121.** As we have seen, a sculpture-portrait can only be considered a portrait when it is frontal and from the bust or head upwards. We thus find that it would be a strained construction of **Article 231 (4)** of the **Constitution** to say that the image is a portrait.*

*"**122.** Regarding the images at the back of the new Kshs 200 note, we are satisfied that they portray some unidentifiable individuals. Applying our reasoning above, we find that they do not offend **Article 231 (4)**.*

*"**123.** The 2nd petitioner also challenged the new currency on the ground that the notes bear "a name and a signature of individuals on the front side"*

*"**124.** Section 13(4)(c) of the CBK Act provides in the relevant part as follows:*

(4) The Governor shall be the principal representative of the Bank and shall, in that capacity have the authority:

a. …………………
b. …………………
c. to sign individually or jointly with other persons contracts concluded by the Bank, notes and securities issued by the Bank, reports, balance sheets, and other financial statements, correspondence and other documents of the Bank. (emphasis added).

*"**125.** The currency notes were signed by the Governor and a member of the board of directors of the 1st respondent. The petitioners failed to lead evidence to show that the Governor ordinarily signed in a different style than that on the face of the notes; or, that he signed in the format of his name for ulterior motives."*

As noted, the court recognized the need for signing by the governor of Central Bank of notes issued by the Bank. Therefore, in order for notes to be considered as legal tender they require the component of signing by the CBK Governor, however, verification of this may pose a challenge in the case of digital currency. In Kenya, digital signatures (e-signatures) are provided for under the provisions of the Kenya Information and Communications Act No. 2 of 1998, which places certain requirements for recognition of e-signatures.

H. CONCLUSION

While the adoption and issuance of CBDCs may provide great advantages, there is a risk that CBDCs may pose significant challenges for financial stability of the economy. With the sole responsibility of issuance currency on CBK, adoption of digital currencies should be lead by it. In addition, any adoption of any other digital currency should be legislated to provide guidelines on the operation of digital currencies within Kenya.

Digitization of money remains inadequately addressed by the current legislation. Since the Central Bank will be the key player in managing CBDCs, there is need to revisit legislation on monetary policies before the adoption and use of CBDCs or any other digital currencies to address the issues raised. This fundamental as any issuance of currency in Kenya has to conform with the Constitution of Kenya.

Lastly, the **Article 231 of Constitution** recognized *'Notes and Coins'* as what can be issued by CBK; therefore, an amendment of the Constitution will be another consideration CBK may have to factor in prior to the introduction of any CBDC.

[1]Central Bank of Kenya Discussion Paper on Central Bank Digital Currency
[2]https://committees.parliament.uk/work/1504/central-bank-digital-currencies/publications/
[3]https://committees.parliament.uk/work/1504/central-bank-digital-currencies/publications/
[4]Bank of England, Central Bank Digital Currency: opportunities, challenges and design (12 March 2020): https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/central-bank-digital-currencyopportunities-challenges-and-design.pdf
[5]Bank of England, Central Bank Digital Currency: opportunities, challenges and design (12 March 2020): https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/central-bank-digital-currencyopportunities-challenges-and-design.pdf
[6]Siklos, Pierre L. "CBDC: Tailwinds and Headwinds." Central Bank Digital Currency and Governance: Fit for Purpose?, Centre for International Governance Innovation, 2021, pp. 4–11, http://www.jstor.org/stable/resrep31644.7.
[7]Bank of England, Central Bank Digital Currency: opportunities, challenges and design (12 March 2020): https://www.bankofengland.co.uk/-/media/boe/files/paper/2020/central-bank-digital-currencyopportunities-challenges-and-design.pdf
[8]https://committees.parliament.uk/work/1504/central-bank-digital-currencies/publications/
[9]Simon Mbugua & another v Central Bank of Kenya & 2 others [2019] eKLR

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