Cytonn Report: Note on the Draft Virtual Asset Service Providers Regulations,2026 & Impact on Stablecoin Market Introduction

On 17th March 2026 The National Treasury officially released the Draft Virtual Asset Service Providers (VASP) Regulations, 2026, which are intended to operationalize the provisions of the Virtual Asset Service Providers Act, 2025, the primary law establishing Kenya's legal framework for licensing and regulating virtual asset service providers. This marks a significant step toward formalizing the country's stablecoin industry and the regulations, introduce a comprehensive framework for the regulation of stablecoins in Kenya. The provisions also represent one of the most detailed attempts in Africa to formalize stablecoins as regulated financial instruments, particularly in payments, remittances, and digital finance. In line with statutory requirements, the National Treasury invites comments from the public on the draft Regulations by Friday, 10th April 2026.

In our previous report on Stablecoins and their potential applications in Kenya , we reviewed the evolving regulatory landscape globally and within Kenya, highlighting considerations that policymakers may need to address as digital asset adoption continues to expand. In this note, we review the draft regulations applicable to stablecoins (Part VIII, Regulations 64-81), with a special focus on the following;

i. Key Items of the regulations
ii. Recommendations
iii. Conclusion

i. Key Items of the regulation

a) Licensing, White Paper and Market Entry Controls

The framework adopts a pre-authorisation model anchored on licensing and disclosure. Under Regulations 64–67**,** any entity intending to issue a stablecoin must obtain regulatory approval, submit a comprehensive business and reserve framework, and publish a white paper before offering the asset to the public. The white paper must contain detailed information on the issuer, the structure of the stablecoin, and the associated risks. Additionally, issuers are required to notify regulators in advance of any planned issuance and ensure continuous disclosure of material development. This design mirrors securities market frameworks, relying heavily on ex-ante disclosure and regulatory vetting to protect consumers and ensure market integrity.

The regime is disclosure-centric rather than prudentially prescriptive. While issuers must explain their reserve and operational structures, the regulations do not impose sufficiently detailed minimum standards at the point of licensing. This creates a scenario where regulatory approval may depend more on completeness of disclosure than on the actual robustness of the underlying financial model.

b) Issuance and Redeemability of Stablecoins

Regulation 68 establishes the fundamental monetary characteristics of stablecoins. It requires issuance at par value, guarantees redemption at par on demand, and grants holders a legal claim against the issuer. Redemption must also be free of charges. This effectively positions stablecoins as cash-equivalent instruments, combining features of e-money and money market funds. The design aims to ensure price stability and user confidence by eliminating redemption uncertainty.

Despite establishing a legal claim, the regulations do not clarify the priority of that claim in insolvency scenarios. Without explicit bankruptcy protection or segregation of claims, holders may be exposed to issuer credit risk. This creates a disconnect between the promise of immediate redemption and the legal enforceability of that promise during financial distress.

c) Prohibition of Interest (Narrow Banking Model)

Under Regulation 69, issuers and related service providers are prohibited from offering any form of interest or economically equivalent benefit to stablecoin holders. This provision enforces a non-yield-bearing model, aligning stablecoins with traditional e-money frameworks and preventing them from functioning as deposit substitutes. The intent is to limit systemic risk and avoid competition with the banking sector for deposits. Prohibition of Interest Payments. The prohibition on interest payments limits the risk of stablecoins behaving like deposit-taking instruments, thereby reducing systemic risks and regulatory arbitrage.

On the downside, the restriction significantly limits the economic attractiveness of regulated stablecoins. In practice, it may reduce user adoption relative to yield-bearing alternatives, encourage migration to offshore or decentralised platforms and Incentivise regulatory arbitrage. As a result, the rule could undermine domestic market development while failing to eliminate risk globally.

d) Reserve Assets and Investment Rules

The prudential framework for reserves is outlined in Regulations 72–74. Stablecoins must be backed by reserve assets dedicated to meeting redemption obligations. At least 30.0% of these reserves must be held in Kenyan bank accounts for issuance and redemption purposes, while the remainder must be invested in high-quality, low-risk assets, particularly for fiat-referenced stablecoins. The reserve assets should consist of one or a combination of the following.;

- Cash including central bank reserve deposits and bank deposits;
- Government securities with residual maturity of not more than ninety days;
- Repurchase agreements with a maturity of not more than seven days backed by cash including central bank reserve deposits and bank deposits;

This creates a hybrid reserve structure, combining liquidity (cash deposits) with yield-generating but relatively safe instruments.

Regulation 72(c)–(i) requires stablecoin issuers to adopt strong safeguards around reserve assets by ensuring they are fully segregated from the issuer's own funds and from other stablecoin reserves, remain verifiable and accessible to regulators, and are maintained in highly liquid form to meet redemption demands; additionally, issuers must apply internationally accepted valuation standards, legally ring-fence reserves from insolvency risk, and structure and manage them to adequately cover underlying asset risks and liquidity pressures arising from continuous redemption rights, while also ensuring legal separation so creditors have no claim over these assets . Further, under subregulations (2) and (3), issuers offering multiple stablecoins must maintain separate, independently managed reserve pools for each coin, and ensure that any issuance or redemption of stablecoins is strictly matched by a corresponding increase or decrease in reserve assets, thereby preserving a constant one-to-one backing and financial integrity of the stablecoin system

However, the framework lacks precision in several critical areas such as:

- There is no explicit requirement for full (1:1) reserve backing at all times
- The definition of eligible low-risk assets is broad and potentially ambiguous
- There are no maturity or duration limits on reserve investments

These gaps introduce liquidity and valuation risks, particularly in stressed market conditions where asset liquidation may be required quickly.

e) Custody and Safeguarding of Reserves

Regulation 73 requires that reserve assets be held by custodians approved by the Central Bank of Kenya (CBK) and protected from claims by the custodian's creditors. It also requires diversification of custodians to mitigate concentration risk. This is a strong safeguard, ensuring operational separation between issuer and reserve assets, and reducing the risk of loss due to custodian insolvency.

However, regulation does not provide detailed criteria for custodian eligibility or risk thresholds. Additionally, reliance on domestically approved custodians may limit flexibility and create concentration risks if the pool of eligible institutions is small. This could constrain scalability and introduce systemic dependencies.

f) Redemption Framework and Liquidity Management

Regulation 77 requires issuers to establish formal redemption policies covering conditions, timelines, valuation methodologies, and operational procedures. Issuers must also implement mechanisms to manage fluctuations in reserve levels. This builds a structured liquidity management framework, complementing the unconditional right to redemption established earlier.

The regulations allow issuers significant discretion in defining redemption conditions, including thresholds and timeframes. There are no hard liquidity ratios or stress-testing requirements. This creates a risk that redemption rights, while legally guaranteed, may be operationally constrained during periods of high demand, increasing the likelihood of liquidity stress or delayed redemptions.

g) Transparency, Reporting and Audit Requirements

The framework imposes extensive disclosure and reporting obligations. Under Regulations 75, 79 and 81, issuers must:

- Regularly disclose circulation and reserve composition
- Publish audit reports and proof-of-reserve statements
- Report detailed operational metrics, including transaction volumes and de-pegging events

This creates a high-transparency environment, enabling regulatory oversight and market discipline.

On the downside, the regime is heavily reliant on ex-post monitoring rather than ex-ante safeguards. While data availability is strong, there is limited clarity on intervention thresholds, automatic corrective actions and enforcement timelines. This reduces the ability of regulators to act proactively in preventing instability.

h) Liability and Consumer Protection

Regulation 71 establishes a liability regime where issuers and their key officers who may include directors, significant shareholders, senior officers, and external auditors are responsible for losses arising from inaccurate or misleading disclosures in the white paper. This aligns incentives by attaching legal consequences to misrepresentation and strengthens the disclosure-based regulatory model.

However, the burden of proof rests with the consumer, who must demonstrate reliance and causation. This creates practical enforcement challenges, particularly for retail users with limited resources. As a result, the theoretical strength of the provision may not translate into effective consumer protection.

i) Capital Requirements

The fifth schedule of the draft regulations impose minimum paid up capital requirement of Kshs. 500.0 mn and a minimum liquid capital of Kshs 100.0 mn for stablecoin issuers. This serves as a prudential entry barrier, ensuring that only well-capitalised entities participate in issuance.

However, the capital framework is not risk-sensitive. It does not scale with issuance size, transaction volume, or reserve composition. Consequently, it may be insufficient for large-scale issuers, excessive for smaller, innovative firms and may reduce regulatory efficiency and distort market entry.

Cytonn Report: Capital requirements for Capital Markets Authority Players	
Player	**Minimum Capital Requirement (Kshs mn)**
Fund Manager	20.0
Stockbroker	50.0
Dealer	20.0
Investment Bank	150.0
Custodian	1,000.0

Source: Capital Markets Regulations 2025

The chart above shows a risk-tiered capital framework applied by the Capital Markets Authority, where minimum capital increases with the complexity and risk exposure of each player ranging from Kshs 20.0 mn for fund managers and dealers, to Kshs 50.0 mn for stockbrokers, and peaking at Kshs 150.0 mn for investment banks, while custodians carry a significantly higher Kshs 1.0 bn requirement due to their asset safekeeping role. In comparison, the KES 150.0 mn capital requirement for stablecoin issuers places them at par with investment banks in headline terms, indicating that the Central Bank of Kenya views them as systemically important entities; however, unlike traditional capital markets players where capital primarily absorbs losses, stablecoin issuers are additionally required to maintain full reserve backing and high liquidity, making their overall prudential burden materially stricter despite having a similar base capital threshold

ii. Recommendations

The stablecoin provisions under the draft Virtual Asset Service Providers Regulations, 2026 establish a strong foundation for oversight of digital assets in Kenya. However, to enhance their effectiveness and

align them with evolving global standards, several targeted reforms are necessary. Below are some of our recommendations to address the gaps.

a) Strengthen Prudential Requirements at the Licensing Stage (Regulations 64–67)

The current licensing framework under Regulations 64–67 is heavily anchored on disclosure through white papers and application materials, which, while important, does not sufficiently ensure the underlying financial soundness of proposed stablecoin models. To address this, the regulatory approach should be recalibrated to incorporate binding prudential standards as part of the approval process. This would include clearly define requirements on reserve composition, minimum liquidity buffers, and permissible asset classes, alongside mandatory submission of comprehensive risk management frameworks covering liquidity, market, and operational risks. In addition, regulators should require pre-authorisation stress testing to assess the issuer's ability to withstand large-scale redemption shocks and adverse market conditions. By embedding these requirements at the point of entry, the framework would transition from a disclosure-based regime to a prudentially robust licensing system that filters out structurally weak issuers before they enter the market.

b) Clarify Legal Claim and Insolvency Protection (Regulation 68)

Although Regulation 68 establishes that stablecoin holders have a claim against the issuer and are entitled to redemption at par, it does not explicitly define the treatment of such claims in insolvency scenarios. This creates legal ambiguity that could significantly undermine user confidence during periods of financial distress. To strengthen this provision, the framework should introduce explicit bankruptcy remoteness mechanisms, including the segregation of reserve assets through statutory trust or fiduciary arrangements, ensuring that such assets are ring-fenced from the issuer's general estate. Furthermore, the regulations should clearly prioritize stablecoin holders above unsecured creditors and require issuers to obtain independent legal opinions confirming the enforceability of redemption rights under Kenyan insolvency law. These measures would transform the current contractual claim into a legally enforceable and structurally protected right, significantly enhancing the credibility of stablecoins as cash-equivalent instruments.

c) Tighten the Reserve Asset Framework (Regulations 72–74)

While Regulations 72–74 establish the requirement for reserve backing and limit the use of such reserves to redemption purposes, they lack sufficient specificity regarding asset quality, liquidity, and risk exposure. To address this, we propose that the framework should mandate a strict 1:1 reserve backing requirement at all times, eliminating any possibility of under-collateralization. In addition, the definition of eligible reserve assets should be narrowed to include only highly liquid and low-risk instruments such as cash, central bank deposits, and short-term government securities, while explicitly excluding long-duration, structured, or lower-quality assets. The introduction of maturity limits, such as a maximum weighted average maturity threshold, would further reduce exposure to interest rate and liquidity risks. Moreover, concentration limits should be imposed to prevent excessive exposure to single counterparties or asset classes. Collectively, these enhancements would significantly reduce the risk of liquidity mismatches and ensure that reserves remain readily available to meet redemption demands under all market conditions.

d) Recalibrate the Prohibition on Interest (Regulation 69)

The blanket prohibition on interest under Regulation 69 is designed to prevent stablecoins from functioning as deposit substitutes; however, it may also limit their economic viability and competitiveness. In a global environment where alternative stablecoin models offer yield-bearing features, this restriction could incentivise users to migrate toward unregulated or offshore platforms, thereby undermining the effectiveness of domestic regulation. A more balanced approach would involve permitting limited, tightly regulated forms of yield distribution, particularly where such returns are derived from low-risk reserve assets and are fully disclosed to users. Safeguards should be introduced to prevent the mischaracterisation of such returns as guaranteed or risk-free, thereby maintaining consumer protection objectives. By adopting a calibrated approach, the framework can strike a balance between financial stability and market competitiveness, ensuring that regulated stablecoins remain attractive without introducing undue systemic risk.

e) Enhance Supervisory Triggers and Early Intervention Mechanisms (Regulations 75, 79, 81)

While the reporting and disclosure requirements under Regulations 75, 79, and 81 provide regulators with extensive information on stablecoin operations, the framework lacks clearly defined thresholds that would trigger supervisory intervention. This limits the regulator's ability to act proactively in preventing instability. To address this gap, the regulations should establish explicit intervention triggers linked to key risk indicators such as reserve coverage ratios, liquidity levels, and deviations from the stablecoin's peg. Once these thresholds are breached, predefined corrective measures, such as restrictions on new issuance, mandatory reserve rebalancing, or temporary operational suspensions, should be automatically activated. Furthermore, systemically significant issuers should be subject to more frequent or real-time reporting requirements to enhance oversight. By embedding these mechanisms, the supervisory framework would evolve from a reactive model to a proactive risk management system.

f) Introduce Risk-Sensitive Capital Requirements (Fifth Schedule)

The current capital requirements set out in the Fifth Schedule rely on a fixed minimum threshold, which does not adequately reflect the scale or risk profile of individual stablecoin issuers. To improve this, the framework should adopt a risk-based approach to capital adequacy, whereby requirements increase in proportion to the volume of stablecoins in circulation, transaction activity, and the risk characteristics of reserve assets. In addition to minimum paid-up capital, issuers should be required to maintain ongoing capital adequacy ratios and separate liquidity buffers to cover operational and market risks. This would ensure that capital requirements remain sufficient as the market evolves, while also avoiding unnecessary barriers to entry for smaller or innovative firms. A dynamic capital framework would therefore enhance both financial resilience and regulatory efficiency.

iii. Conclusion

The stablecoin framework under the Virtual Asset Service Providers Regulations, 2026 provides a strong starting point for regulating digital assets, particularly through its emphasis on redeemability as par (Regulation 68), reserve backing (Regulations 72–74), and robust disclosure and reporting (Regulations 75–81). These provisions collectively establish a credible structure for market integrity and consumer protection, aligning Kenya with emerging global standards. However, the framework remains heavily disclosure-driven and would benefit from stronger prudential requirements, clearer insolvency protections for holders, and more binding liquidity standards to ensure resilience under stress.

Looking ahead, the outlook for stablecoins in Kenya is cautiously positive, supported by the country's advanced digital payments ecosystem and high mobile money penetration. As per our Cytonn Report, stablecoins have the potential to enhance cross-border payments, improve transaction efficiency, and support innovation in financial services. Their integration into the broader financial system could also complement existing platforms and expand access to digital financial products, particularly for underserved segments of the population.

The future trajectory of the industry will depend on how effectively the regulatory framework evolves. Striking the right balance between risk mitigation and innovation will be critical, particularly in areas such as yield restrictions, capital requirements, and supervisory flexibility. With timely refinements and alignment to global best practices, Kenya is well positioned to emerge as a regional leader in stablecoin regulation, fostering a stable yet innovative digital asset ecosystem.