The Bahamian Payment System Modernisation: Advancing Financial Inclusion Initiatives

By John A Rolle*
Governor

**As prepared for delivery.*

Central Bank of The Bahamas Blockchain Seminar
18 March 2019

Introduction

Inclusive of a digital version of the Bahamian dollar, the Central Bank of The Bahamas has defined several evolved objectives for the Bahamian payments systems. On some levels The Bahamas is positioned to use new technology to accelerate this transformation. It brings into focus the need for new policies and regulatory reforms to address best practices in the digital supply of financial services, consumer protection in its multifaceted forms, cyber security, and more.

There are multiple, complementary objectives within our digitisation and reform initiatives. These include:

- Making the payments system more efficient.
- Using technology to achieve more inclusive, cost affordable, even access to financial services, across all islands of The Bahamas; providing access that avoids discrimination on the basis of immigration or residency status.
- Strengthening national defenses against uses of the financial services infrastructure for money laundering and other illicit ends; including activities that thrive more easily in cash intensive environments.

Selected Payments System Indicators

By international standards, The Bahamas has a very developed financial system. However, the averages obscure gaps in who have access to services over our disperse geography, and the inefficiencies that constrain services delivery.[1][2] Banking presence is sporadic on the Family Islands, and absent altogether in a few cases.[3] At the national level, trends point to increasing use of electronic payments (see Box 1), but anecdotally the costs of settling transactions is a drag on the speed of change.[4] Cost aside, accelerated change could be also encouraged through increased comfort around accepting and making digital payments; and placing these capabilities universally within the reach of more consumers.[5]

In 2018, the Central Bank conducted a baseline survey on financial literacy and garnered metrics that speak to financial inclusion, along the lines of templates used for the OECD countries (Table1). Although this survey does not capture what is happening among undocumented persons, it indicates a high degree of awareness and high degree of access to basic deposit facilities in The Bahamas. Just above 90 percent of the respondents had knowledge of savings accounts and debit cards. Yet, only about 80 percent of such persons had use of a savings account.[6] Only about 70 percent of these individuals used a debit card; and fewer than half possessed a credit card. Improvements must be sought in all of these estimates, along with much higher rates of access and usage for personal investment products.

Fintech Driven Financial Inclusion

The payment system modernisation initiative (PSMI) is to provide both the incentives and the means to spur more widespread adoption of electronic payments, and to enable greater general access to financial services over digital platforms. Ultimately this means approaching 100% access to digital services; universal access to banking services of a deposit maintenance nature; and fully enabled electronic payments capabilities. Reducing the size of legitimate but unrecorded economic activities will also be necessary, admitting particularly micro, small and medium-sized businesses into the digital space.

---

[1] In 2013 estimates, Svirydzenka (2016) ranked The Bahamas at 40th out of 183 countries in terms of overall financial development but at 15th in comparative access to financial institutions—which took account of the density of the physical banking infrastructure. The relatively lower development index compared to access was due among other reasons to lower ranking on all other metrics including the efficiency of financial institutions (44th out of 183) access to financial markets (54th out of 183) and the efficiency of financial markets (in the lowest quartile). See: Katsiaryna Svirydzenka (2016), "*Introducing A New Broad-based Index of Financial Development*," IMF Working Paper (WP/16/5).

[2] On a per capita basis, for 2017 there are 26 bank branches for each 100,000 persons in The Bahamas, the 35th highest in the world (see IMF Financial Access survey for 2018 at http://data.imf.org/?sk=E5DCAB7E-A5CA-4892-A6EA-598B5463A34C), even though for efficiency reason this estimates is lower than the 35 to 40 branches per 100,000 persons averaged during 2007-2014. There has also been growth in the number of ATM available, near 155 per 100,000 persons the 15th highest concentration in the world, according to the IMF's (2018) data.

[3] Berry Island, Mayguana, Acklyns, Crooked Island.

[4] The Bahamian data reveal an increasing volume of transactions occurring outside of the physical branches at ATMs (which is still cash unfortunately), increasing use of credit and debit cards for electronic payments, and declining reliance on check writing.

[5] Anecdotally, wire transfer costs have also slowed the transition from out of the use of checks for payroll processing for some firms. Also, the merchant fee for accepting credit and debit card payments which can average between 2% and 5% of the transactions value, can act as a disincentive for firms that might cling exclusively to cash receipts.

[6] See ***The Bahamas Financial Literacy Results 2018*** (https://www.centralbankbahamas.com/news.php?id=16402&cmd=view).

For what needs to be accomplished, how results are measured and how The Bahamas progresses in comparison to other countries, we will be guided by established international frameworks and standards; and we will take full advantage of technical assistance from the network of like-minded peers and supportive agencies. In this regard the Central Bank's 2018 membership in the global Alliance for Financial Inclusion (AFI), will yield returns in terms of how we build capacity to regulate and create more enabling frameworks to spur beneficial developments in the Fintech space.

Recent Bahamian Policy Reforms

In The Bahamas, we have already made some progress on financial inclusion initiatives, but with much more to be accomplished. Throughout recent regulatory reforms, the Central Bank was guided by the principle that access to payment services should not discriminate between whether the products originate from banks or from other regulated entities; and that the range of access that users of cash currently enjoy in services should also persist when the products are digitised. Also, irrespective of whether consumers avail themselves of mobile payment services or traditional bank deposits, the ease of access and risk tailored customer due-diligence should be similar.

One of the early outcomes was that the Central Bank was able to establish regulations to license non-banks to provide electronic money services to the public. There are already two firms that have either provisionally or fully met the requirements for licensing. In addition, several existing money transmission businesses are in the process of developing digital payment solutions.

On ease of access, streamlined customer due diligence standards were introduced in 2018 under revised AML Guidelines[7] which simplify the identification and address verification requirements to establish deposit accounts and to access other services from financial institutions. It shifts more emphasis to the important transactions monitoring process after the accounts are established. Further, it limits enhanced due diligence processes to relationships which banks assess to be higher risk. For very low-value stored products the identification process need not be invoked.[8] In this regard, forthcoming clarification to be issued to banks will also suppress practices that mandate proof of employment as a pre-requisite to open an account.

Not all banks have converged to these new standards, but we are actively pursuing this transition.

The next easing, which the Central Bank undertook was to remove Exchange Control restrictions from non-resident access to Bahamian dollar (B$) deposit facilities. Irrespective of their immigration or work permit status these persons can open and maintain B$ deposit accounts with balances of up to $50,000 without approval from the Central Bank.

As part of the Get Money Smart financial literacy program, and working with commercial banks we are formulating a new public education campaign focused on these changes. The literacy campaign

[7] The guidelines (see: https://www.centralbankbahamas.com/legal_policies.php?cmd=view&id=16883), which apply to entities supervised by the Central Bank: banks, credit unions, MTBs and payment services providers. These have been issued under provision in the amended Financial Transactions Reporting Act 2018.

[8] In the AML Guidance Notes these would be accounts that carry $500 or less and for which the monthly reload capacity is $300 or less. Monitoring of transactions for AML purposes, still applies for all accounts which financial institutions maintain. Where higher risks are assessed supervised institutions may also invoked processes that go beyond identification, such as verification of sources of income or wealth.

will also provide more education on cyber security, to increase public comfort and acceptance around the use of digital financial products.

Near-Term Priorities

There are necessary further reforms that the Central Bank will target in the near-term.

- Under the Payment System Act, the Bank will propose new regulations to strengthen consumer protection, along evolving best international standards. These would apply to savings and checking accounts; debit and credit cards, and to stored value products, where the common thread is the actual or potential use of such facilities to effect payments.
- The Central Bank will also promote direct participation of credit unions and non-bank payment services providers in the payments and settlement system. This would apply to the retail clearing house (the ACH) and to the wholesale RTGS.[9] The draft new Central Bank Bill provides that all of these entities would be allowed to maintain settlement accounts with the Central Bank to clear payments.
- As the largest originators and recipients of payments, the Public Treasury and the National Insurance Board are being invited to become direct participants in the RTGS and ACH systems.
- Mechanisms will also be explored to determine how international banks might participate directly in Bahamian dollar payments and settlements, to facilitate their own local needs or those of clients who maintain a nexus to the local economy.

Project Sand Dollar Highlights

Through Project Sand Dollar, the Central Bank will develop and pilot a general purpose, digital version of the Bahamian dollar—that is, with both wholesale and retail applications. As the draft Central Bank Bill anticipates, the Bank would have statutory authority to issue currency in digital form and to develop regulations to govern the instrument.

The pilot would allow the Bank to enhance the digital system before it is deployed nationally. To stay focused on the challenges that an archipelago poses, and to tackle gaps in access to services in remote communities, Exuma has been identified as the pilot community. The Bank will also explore how to enlist other selected islands that have suppressed or no banking presence.

The digital representation of the B$ will be identical to, and not a separate version of the currency. It will align with all of the statutory rules that govern existing liabilities of the Central Bank; always exchanged at one for one with existing notes, coins and balances.

The design will also incorporate best international practices around AML and CFT risks. Anonymity is not a feature. This framework will rely intimately on the national identify infrastructure, when permitting users to hold and exchange digital money. A t the onset, it will use KYC and identity features incorporated into the system design, and adopt the wider public identity system as it becomes available.

A blockchain infrastructure has been proposed for the digital currency, with performance capabilities that would adequately satisfy the Central Bank's requirements for swift processing of payments.

[9] This would not impose any change on the current ownership of the ACH, which is by the commercial banks.

There will be an extensive public education process for all stakeholders potentially impacted by this transformation. Also, from the outset, this project will engage with banks and other payment services providers, so that interoperability standards can be perfected.

Design Features of a Digital Currency

There are important design features of a digital B$ that are intended to reflect the Central Bank's role as a sponsor of financial sector development. This is essentially a public good that is being provided. Geographic fragmentation cannot assure that the private sector, acting alone, would achieve the level of inclusion and access which all communities in The Bahamas deserve.[10]

This instrument is intended to complement and not replace existing banking services. Its use will be optimised when persons in remote communities are able to deploy it to establish and maintain deposit accounts and other services at banks. Those who use central bank sponsored digital wallets would not see their funds treated as interest bearing deposits.[11] However, the Central Bank will explore future innovations that would allow mobile wallets holders to invest in Government securities.

While it would be possible to maintain mobile wallets independent of a bank account, the Central Bank intends to impose a ceiling on how much digital currency could be maintained in mobile wallets. High volume use will require a passthrough flow of funds to personal bank accounts. Business accounts would always fit this profile. The wallet's integration with commercial banks or other licensed entities would be required in order for account holders to have access to foreign exchange services.

The interoperability feature means that the digital B$ would be available for use across all payment platforms and within existing or proposed wallets of private services providers and financial institutions. Although the consumer public would have the default option of establishing a wallet account with the Central Bank, they would be enabled to use the currency within any product developed by regulated private wallet providers. Over time, it is expected that the Central Bank would play a diminished role in providing front-end solutions and be left to focus on maintaining the digital ledger for the currency.

At the policy level, the Central Bank is also putting emphasis on a system that would allow for effective maintenance of monetary and financial stability, safeguards to ensure aggregate stability in the deposit base of commercial banks; data privacy and data sovereignty for consumers and an aggressive cyber security posture.

[10] A Bank for International Settlements Publication (2018) by the Committee on Payments and Markets Infrastructures indicates that central bank digital currencies (CBDCs) are being widely explored around the world, but mostly for limited wholesale use in interbank markets. (BIS (January 2019), "*Proceeding with Caution - A Survey on Central Bank Digital Currency*", https://www.bis.org/publ/bppdf/bispap101.htm). In many cases this reflects the wide availability of private e-money solutions that leave little value-added for central banks to operate in this space. Presumably, other policy complexities, and technical and operating risks, also explored by the BIS, limit many central banks' interest in maintaining retail accounts for users of digital currency. (see BIS, March 2018), "*Central Bank Digital Currencies*", https://www.bis.org/cpmi/publ/d174.htm).

[11] This preserves the level playing field that prevents payment services providers from paying interest on stored value products. It also avoids any expanded mandate for the Central Bank to intermediate savings at direct costs to the Bank or in competition with other financial institutions.

Conclusion and the Way Forward

The near-term actions for the Central Bank is to complete the contractual on-boarding of our technology solutions provider, and then to deepen the preparation and outreach process for the pilot.

The government is a lead stakeholder and critical sponsor of national initiatives that will help transform the domestic financial services sector and the payments system. The Central Bank will stay actively engaged with the Government to ensure that the legal framework evolves in step with payments system needs; that The Bahamas achieves the financial inclusion outcomes that are desirable for our archipelago and to ensure that the commercial sector benefits from a more efficient and secure infrastructure.

The other key stakeholders, with whom engagement and outreach will intensify over the remainder of this year are the local financial institutions and public and private enterprises of all sizes.

There will be much more to reveal about project Sand Dollar.

Appendix of Tables and Boxes.

Box 1: Profile of The Bahamian Payments System

The Bahamian payment system is continually evolving, showing shifts towards greater use of electronic transactions, and out of branch access to banking services. Both consumers and business firms are using these electronic options in increasing numbers. In 2017, 56.8% of commercial banking branches were located in the capital, while the remaining 43.2% were in found in Grand Bahamas and the Family Islands. This was still a shrunken access from as many as 88 branches in 2008 to 74 outlets at the end of 2017. As to access to ATM terminals, 71.5% were in New Providence, 13.8% in Grand Bahama and the remaining 14.6% were in the Family Islands. Under electronic payments, between 2013 and 2017, payment card usage rose by 138% and 203.2%l respectively, with equally impressive growth in the number of merchant terminals able to process such payments. There has also been a significant increase in the use of online banking by both consumers and businesses.

Selected Payment Systems Data

	2013	2014	2015	2016	2017
A) ATM/ABMS (Number by Islands)					
New Providence	234	255	262	291	259
Grand Bahama	44	44	44	58	50
Family Islands	32	35	39	53	53
Total	310	334	345	402	362
B) Payments Volume by Card Type					
Debit Cards	1,352,857	1,196,012	2,013,084	2,771,071	3,221,699
Credit Cards	275,855	206,521	396,367	751,279	836,461
Stored Value Cards	15,355	23,524	64,597	60,957	105,010
Total	1,693,448	1,511,097	2,505,138	3,678,007	4,249,520
C) Direct Credits/Credit Transfers					
Volume of Transactions	347,235	396,229	452,947	550,389	564,302
Value of Transactions (B$'000)	1,610,093	1,947,990	1,656,074	3,336,894	3,210,946
D) Number of Merchant Terminal Accounts					
Total	5,377	4,908	8,853	9,146	11,306
E) Electronic Banking Users					
Residential Users	29,252	35077	63611	71740	86261
Business Users	NA	NA	2,613	2765	3074
Total	NA	NA	66,224	74,505	89,335
Memo: Cashless Instrument Transactions					
Volume	4,759,159	3,535,739	4,858,373	6,712,163	7,066,865
Value (B$'000)	4,971,567	4,625,916	5,191,732	7,424,147	7,687,696

Source: Central Bank of The Bahamas

Table 1: Bahamas—Selected Financial Access Measures Surveyed Knowledge and Use of Products				
Product or service		% of respondent answering "yes"		
		Heard of	& Own jointly or personally	Want to learn more
i.	Savings Account	93	80	30
ii.	Debit card	91	70	24
iii.	Checking Account	85	37	25
iv.	Insurance policy	87	59	34
v.	Pension Fund	82	33	36
vi.	Mortgage	88	31	29
vii.	Credit card	89	48	21
viii.	Mobile Phone banking	70	40	26
ix.	"Asue"	89	33	20
x.	"Numbers" Account	56	19	20
xi.	Bonds	60	13	35
xii.	Stocks and shares	71	24	39
xiii.	Investment Account	62	22	41
xiv.	Mutual Funds	60	15	35
xv.	Equity Funds	51	13	37

Source: Central Bank of The Bahamas, Bahamas Financial Literacy Survey 2018.

Box 2: ***Using Global Standards and Peer Support to Guide Bahamian Guide Financial Inclusion Initiatives***

In August 2018, the Central Bank joined the Global Alliance for Financial Inclusion (AFI), an international network of central banks and financial sector regulators across from more than 90 emerging market and developing economies (EMDEs). The goal of AFI is to assist members to improve financial inclusion in an environment supported by peer feedback, technical assistance and training as needed. In keeping with the high-level commitments of the AFI membership the Central Bank of The Bahamas has adopted the MAYA declaration[12] that required the Bank to identify measurable goals to promote national financial inclusion.[13]

The Bahamas has identified seven broad goals, which include development of the digital version of the currency, advancing financial literacy, consumer education and empowerment, contributing to a national financial inclusion strategy (which takes a wider perspective than just banking services), and promoting the development of national digital identify infrastructure. The Bank also has an obligation to improve compilation of data on financial inclusion.

AFI has recognised that Fintech innovations offer opportunities to accelerate financial inclusion progress. In 2018, the Sochi Accord[14] was adopted to heighten this focus. The Accord speaks, among other things, to building capacity to understand and promote Fintech developments, using Fintech solutions to help bridge gender divides in financial access, and ensuring that and official infrastructure is developed to support Fintech applications. The case studies that emerge from AFI member countries particularly highlight the role of a digital ID infrastructure, and there is a recognition of the potential to develop electronic KYC on-boarding solution for banks.

Just on the heels of the Sochi Accord, the IMF and the World Bank promoted the Bali Fintech Agenda listing high-level principles that align with the AFI approach, again stressing the supportive public framework of reform that could allow EMDEs take advantage of Fintech to promote inclusion and and other financial development results. The adoption of best practices is also urged to manage the multi-faceted risks of technology, and thwart the use of Fintech for illicit means. A recurring thread in both the IMF and AFI's work is for EMDEs to encourage and explore Fintech solutions that would solve or reduce the de-risking threats around threatened access to correspondent banking relationships.

[12] The Maya Declaration was endorsed by AFI in 2011 at the Global Policy Forum (GPF) in Riveria Maya, Mexico. It requires AFI members to make measurable commitments in four broad areas: (i) create an enabling environment to harness new technology that increases access and lowers the cost of financial services; (ii) implement a proportional framework that advances synergies in financial inclusion, integrity, and stability; (iii) integrate consumer protection and empowerment as a key pillar of financial inclusion; and (iii) use data for informed policymaking and tracking results. See link at https://www.afi-global.org/sites/default/files/publications/2018-08/MAYA_FS_18_AW_digital.pdf

[13] See Press Release: *The Central Bank of The Bahamas Joins The Alliance For Financial Inclusion & Commits To The Maya Declaration,* https://www.centralbankbahamas.com/news.php?id=16452&cmd=view

[14] The Sochi Accord: Fintech for Financial Inclusion (https://www.afi-global.org/publications/2851/Sochi-Accord-FinTech-for-Financial-Inclusion)

Box 3: Central Bank of The Bahamas Commitments under the Maya Declaration

Under the Maya Declaration of the Alliance for Financial Inclusion the Central Bank has committed to:

i) Support the development of a National Financial Inclusion Strategy by 2020.

ii) Increase access to banking and payment services by reinforcing our newly revised Customer Due Diligence (CDD) requirements.

iii) Introduce a digital version of the Bahamian currency by 2020, to ensure minimum levels of access to banking and payments services in geographically remote parts of The Bahamas.

iv) Collaborate with the government on improved national identity infrastructure to enhance the Know Your Customer (KYC) procedures in our supervised financial institutions (SFIs).

v) Conclude the development and start-up of a credit bureau in The Bahamas by 2020 to foster trust and accountability between our SFIs and their customers.

vi) In partnership with relevant stakeholders, pursue the creation of the Office of the Financial Services Ombudsman (OFSO) by 2020.

vii) Promote public awareness of consumer rights and responsibilities through our recently deployed financial literacy program, Get Money Smart Bahamas.