Consumer-Centric Aspects of the Proposed Regulations for the Bahamian Digital Currency

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I. BACKGROUND

In further preparation for national adoption and public education, which is planned to increase over the second quarter of 2021, the Central Bank of The Bahamas developed and circulated draft Regulations for the digital currency for public consultation on 15 February 2021: **Central Bank (Electronic Bahamian Dollars) Regulations, 2021**. The draft Regulations are intended to enhance the existing legislative framework governing Payment Services Providers (PSPs), specific to their provision of central bank digital currency (CBDC) linked services. These include specific obligations to safeguard the security of the financial market infrastructure, affirmed obligations around the financial integrity (AML/CFT) of digital currency transactions, and intensive focus on financial inclusion and consumer protection. After the consultation period closes on 31 March 2021, the Bank will finalise the Regulations for issuance by 01 May 2021. The consultation package is available on the Bank's website at:

> https://www.centralbankbahamas.com/news/press-releases/public-consultation-on-proposed-legislation-for-the-regulation-of-the-provision-and-use-of-central-bank-issued-electronic-bahamian-dollars?N=N

This policy paper provides a synopsis of key consumer-centric provisions provided under the draft Regulations. The terms "PSPs", and "wallet providers" are used interchangeably.

The Central Bank began the gradual national release of the Bahamian digital currency in October 2020. Since then, participating financial institutions have worked to integrate their proprietary mobile applications (apps) to the Sand Dollar infrastructure. As of mid-March, nine PSPs—the Authorised Financial Institutions (AFIs)—have completed cybersecurity assessments of their technology systems and have been cleared to distribute the CBDC. That is, four money transmission businesses (MTBs), three payment services institutions, one commercial bank, and one credit union. These institutions are either enabled to offer Sand Dollars through their proprietary mobile wallets or through the Central Bank developed app.

The Central Bank is working with PSPs to achieve the interoperability of all proprietary mobile apps. Interoperability means that businesses and individuals would be able to send and receive funds with any other digital wallet once the transaction is in Sand Dollars. Payment providers that adopted the Central Bank app already satisfy interoperability, while institutions that are using proprietary apps are expected to meet a deadline of 31 March 2021.

The Central Bank expects to imminently complete the technical integration of the digital infrastructure with the commercial banking system. This will establish links between wallets and bank deposit accounts, through the Bahamas Automated Clearing House (the ACH), and allow transfer of funds in both directions. As participants in the ACH, commercial banks also play a direct role, as the respective online wire transfer platforms are being updated to accommodate these transactions. The ACH has established protocols to be followed for such updates.

II. EXIISTING LEGISLATIVE FRAMEWORK

The Payment Systems Act, 2012 (PSA), and the Payment Instruments (Oversight) Regulations, 2017, (PIOR) define the overarching framework for the Bahamian payments system oversight and development, with the Central Bank as regulator and promoter of payments system development. The Bank is empowered to develop best practices regulations, standards and codes, which advance the sector, in the interest of the economy and the financial system. In this regard, the PSA provides for the establishment of a National Payments Council (NPC), as an advisory body with which the Bank consults on sector initiatives. NPC participation includes all supervised domestic banks, credit unions, MTBs, payment services institutions, and major non-bank stakeholders.[1] With the PIOR, the Bank defined the domestic framework for electronic payments and issuers of electronic money. The draft regulations provide extensive consumer protection features and provisions for licensing new payment service providers other than Central Bank supervised banks, credit unions, and MTBs. The payments services institutions fulfil their licensing requirements under the PIOR.[2] They are subject to the customer due diligence (CDD) requirements as provided for in regulatory guidance issued by the Central Bank, the provisions of the Financial Transactions Reporting Act, 2018, and all other applicable anti-money

[1] These are the Ministry of Finance, public utilities and the National Insurance Board.
[2] Section 3 of the Payment Instruments Oversight Regulations, 2017.

laundering and countering the financing of terrorism statutes. The PIOR also makes PSPs, including those licensed under other statutes,[3] responsible for ensuring that the rights of users and merchants are set out in relevant contracts. They must also take measures to ensure that the terms and conditions for the use of retail electronic payment instruments are easily accessible and understood by consumers; develop and implement adequate fraud and risk management frameworks; and implement measures that address consumer protection, education and privacy.

III. HIGHLIGHTS OF THE DIGITAL CURRENCY REGULATIONS

The draft digital currency regulations comprise provisions that will supplement the existing legislative framework, for the operations and oversight of wallet providers and support the use of Sand Dollars, while maintaining consumer protection. The areas covered below relate to customer due diligence and AML/CFT requirements, financial inclusion, interoperability, confidentiality, financial stability, and cyber security.

a. Customer Due Diligence (KYC/AML) Requirements

Existing regulations require that PSPs adhere to the same risk-based customer due diligence standards for mobile wallets that apply for account opening relationships within the banking system. These apply without variance for accounts holding digital currency, also consistent with the PIOR. However, with financial inclusion goals in mind, the AML/CFT risk-tailored customer due diligence (KYC) procedures also permit access to mobile wallets and Sand Dollars for persons who might lack adequate government issued identification (ID). In turn, the KYC rigour determine the transactions and holding limits permitted for persons, businesses and organisations. These categories of wallets and wallet users are outlined in three tiers:

- **Tier I or basic wallets** are designated for individuals who need not be subjected to any customer due diligence documentation. For these persons, no official ID is required to open up a digital account. The account can simply be established by completing a

[3] These are the Bahamas Co-Operative Credit Unions Act, 2015, for credit unions and the Banks and Trust Companies Regulations Act, 2020, for commercial banks and MTBs.

prescribed form developed by the PSP. Tier I wallets are low-value accounts, limited to a maximum holding or storage capacity of $500, and constrained to monthly transactions totals against either payments or receipts of $1,500.

- **Tier II or premium wallets**, also for individuals, require some customer due diligence, which can be simplified but risk-based. The standard is identical to establishing deposit accounts with banks. These require presentation of government issued ID such as the passport in isolation; two other official photo IDs combined; or other non-photo ID process stipulated in the amended Guidance issued to Central Bank supervised financial institutions in 2018. [4] These wallets have a maximum holding authorisation of $8,000, and are subject to an annual transaction limit of $100,000 (not exceeding $10,000 on a monthly basis).

- **Tier III wallets** are reserved for businesses, non-profit organizations and other entities. Holding limits are to be set by the wallet provider using a risk-based template, subject to a maximum of B$1 million. Such accounts have no pre-set transactions limits.

Under the proposed regulations, the Central Bank would be able to vary wallet limits over the course of time, particularly to meet the evolving transactional needs of account holders. In all cases, including for Tier I accounts, the Bank will be obligated to vary minimum due-diligence standards and access levels, as international standards and best practices on AML/CFT evolve.

There are no restrictions on persons under 18 years of age obtaining wallets. Minors may obtain wallets with the assistance and consent of a parent or guardian by the execution of requisite documents during the on-boarding stage. KYC protocols would extend to the parent or guardians as sponsors of the accounts. The Bank is aware that challenges may arise with minors having the requisite means of identification. Therefore, wallet providers are encouraged to rely on the guidance set out in Section IV, A2 of the Bank's AML/CFT/CPF Guidelines and the streamlined

[4] Central Bank of The Bahamas Guidelines for Supervised Financial Institutions on the Prevention of Money Laundering, Countering the Financing of Terrorism & Proliferation Financing (Revised August 2018)

requirements for account opening, provision of financial services and customer identification in Appendix B of those Guidelines.

b. Financial Inclusion

In keeping with the Payment Systems Modernization Initiative (PSMI), one of the goals of Project Sand Dollar is to provide an infrastructure that supports increased financial inclusion for unbanked and under-banked persons and communities. The draft regulations promote universal access to digital wallets for all persons inside The Bahamas, whether these are in Tier I or Tier II. All residents and persons in The Bahamas can subscribe to these wallets, without reference to immigration or work permit status. More importantly, the draft regulations propose that all holders of Tier I and II wallets are entitled to make and receive payments, within the CBDC environment without encountering transactions fees. The Central Bank has also approved customer due diligence procedures that allow the account opening process for supervised financial services to be concluded electronically. PSPs are therefore using remote online tools to enrol wallet holders, including upload of biometrics and identity documentation.

The Central Bank also purposes in the regulations that all retail payments providers adopt financial inclusion strategies that target all geographic parts of The Bahamas. Each wallet provider would be required to disclose to the Bank its strategy to distribute payment services to residents in the Central, South Eastern and North Western parts of The Bahamas. Providers would also be required to report periodically to the Central Bank on financial inclusion data, inclusive of details on gender and island of residency of wallet holders.

As a further measure, the Central Bank would be empowered to directly intervene in any Family Island community or settlement so that licensed businesses, churches, and organizations have ensured access to basic wallet services. Such actions could begin to be advanced if it is observed that, for any reason, services are withdrawn by a PSP, or no such service has been made accessible by a PSP as of 30 June 2021. Then Bank would be empowered to designate a wallet provider to provide the services and the mobile application through which such services would be provided.

c. Interoperability

Under the draft regulations, PSPs also have to comply with minimum interoperability standards. The standards mandate the ability of wallets to transmit and receive payments, across applications on all platforms, based on the following:

i. Use of the unique user alias assigned to each wallet account;
ii. Use of the unique, universal account number assigned to the wallet address; and
iii. Optical/camera scanning of payment instructions in a QR code

This minimum functionality must be satisfied independent of the registered domain of the wallet providers. Financial instructions must also satisfy a medium-range technical target for wallet portability. That is, wallet holders must be permitted to retain use of the same account number and user alias, if they were to switch to a different payment services provider.

d. Financial Stability

The proposed Regulations counter financial stability worries around CBDCs which are proposed for wide public distribution and use (retail CBDCs). This is, particularly, if digital wallets are treated as substitutes for bank deposits and if such substitution threaten the stability of banks. Concerns have also been flagged about the speed at which funds could flow out of deposit accounts, and weaken institutions.

To constrain the ability of Sand Dollar wallets to substitute for deposit accounts, the Central Bank would be empowered to limit the amount of the digital currency that individuals, businesses and other non-supervised financial institutions can hold. These are the initial limits imposed within the KYC/AML framework. In addition, affirming the overarching provisions of the PIOR, interest may not be paid on digital currency held in mobile wallets.

To address sudden, potentially destabilising movement of funds, the Bank would also be able to intervene to suspend the withdrawal of deposits, or limit the maximum amount of withdrawals from any financial institutions, which are settled or converted to Sand Dollars. However, any freeze or slowdown in funds movement would only be temporary, as the Central Back would be obligated to shift non-restrictive stabilization measures after a maximum of one week. The Minister of Finance would have to consent to an extension of this period; although, for no more than two weeks in total.

e. Confidentiality

The proposed regulations maintain requirements for strict adherence to confidentiality and data protection. While the Central Bank would not provide front-end customer service, nor directly sponsor retail wallets, it will ultimately maintain the ledger of all individual holdings of the digital currency. This will remain in encrypted format, with the Bank obligated, as principled in the Payment Systems Act, section 35 to maintain confidentiality of such customer information. This obligation transcends to every director, officer, employee, agent and advisor of the Central Bank. The duty of confidentiality also extends to licensed wallet providers or PSPs. Confidentiality breaches are punishable on summary conviction by a fine of up to B$50,000 or to imprisonment for a term up to three years or to both such fine and imprisonment.

However, confidentiality would not equate to a cloak for illicit transactions. PSPs must have adequate systems in place to monitor transactions and report on suspicious activity, in line with their obligations under the Financial Transactions Reporting Act, 2018, and accompanying Regulations. Record keeping and transactions monitoring are core components of the AML/CFT and Anti-Proliferation Guidelines. The draft digital currency regulations therefore mandate that wallet providers have in place record keeping measures for the accurate collection and availability of documents required to be kept by the Central Bank. Wallet providers must still safeguard such information against unauthorized access by third parties.

f. Cybersecurity Standards

Digital wallet providers are also obligated to maintain active, defensive cybersecurity postures. If the assessed vulnerabilities of any provider were considered to pose a security threat to the CBDC infrastructure, the Central Bank would be empowered to suspend the provider from the CBDC platform. Towards this end, the regulations mandate annual cybersecurity audits, the results of which would have to be supplied to the Central Bank soon after completion. PSPs would also have to perform investigative audits and report to the Central Bank on any security breach suffered by their platforms. The Central Bank would also be able to require security assessments before any financial institutions are permitted to join the digital currency infrastructure.

The Central Bank is accountable for security of the core of the digital currency infrastructure. As such, the regulations also mandate that the Sand Dollar infrastructure must be subject to regular, independent security assessments.

Another proposed enhancement to the legislative framework, relative to technology, is the prohibition against attempts to counterfeit digital currency; or to decrypt or decode the security or secrecy of communication of transactions in respect of electronic Bahamian dollars or the distributed ledger technology platform generally.[5]

IV. CONCLUSION

As mentioned, the legal infrastructure governing the electronic payments system predates the Project Sand Dollar initiative. However, the draft digital currency regulations affirm the applicability of consumer protection, cyber security and monetary policy principles advanced in the Payments System Act, 2012 and the Payments Instrument (Oversight) Regulations, 2017. The draft Central Bank Bahamas (Electronic Bahamian Dollars) Regulations, 2021 also target a more focused and robust regime specific to the digital currency platform, and propose governance standards for the Central Bank. The proposals also comprise safeguards to enable a secure operation of the CBDC environment, and are geared towards promoting sustained compliance with international standards and best practices, inclusive of AML/CFT measures.

[5] Further, the Central Bank of The Bahamas Act, 2020 prohibits any person, from making, designing engraving, printing, reproducing, using, or publishing any article or anything resembling or "having a likeness to a note, coin or any electronic money issued by the Bank as to be likely to be confused with or mistaken for such note, coin, or electronic money" without first obtaining consent.