FinTech in The Bahamas

Prepared By: BFSB FINTECH Working Group – February 2018

Introduction

1. The BFSB FinTech working group
2. The Bahamas Government strongly supports technological innovation
3. FinTech is changing the way financial transactions done and how financial markets operate
4. Broader adoption will usher in a new Digital Age, the next industrial revolution

What is FinTech?

What is FinTech?

Short for financial technology.
The innovative use of technology in the design and delivery of financial services.

- peer to peer lending
- crowdfunding
- Bitcoin
- blockchain
- artificial intelligence
- digital payments
- robo advisors
- chatbots
- big data
- machine learning
- the internet of things
- DIY algorithmic trading

Bitcoin and Blockchain

- Blockchain is one of the technologies invented by the same person at the same time he invented Bitcoin

- Bitcoin = Internet Money? Digital gold?

- Bitcoin is the combination of a few technologies/concepts:
  - Blockchain (database/digital ledger)
  - Cryptography (cryptographic signatures)
  - Scarcity (21 million coins)
  - Decentralized Nodes (distributed computer network)
    - Consensus mechanism (immutability)
    - Maintain a full copy of the public ledger
    - Validation/Verification (source of truth)

What is Bitcoin?

- Purely peer-to-peer version of electronic cash
- A system to store and transfer value. More than money or simply payments.
- Decentralized information network, coordinated by a scarce token, which appreciates in value as user demand for the service grows
- Trusted network that eliminates the need to trust your counterparty
- Be your own bank
- Banking the ‘unbanked’ or ‘underbanked’
- Global economic transformation

Cryptocurrencies

What are Cyrptocurrencies?

Cryptocurrencies are virtual currencies that are created, stored and governed electronically by an open, decentralized, cryptography system.

- 1,500 different crypto currencies (most since 2016)
- Half a Trillion in total market cap (dot com bubble was $6T)
- Securities tokens
- payments
- reward tokens
- funding systems
- other Blockchain innovations
- the Internet of Things
- parts of the underground economy

The Opportunities

Securities and Investment Business

Specific gaps to be filled in The Bahamas as a lead into doing FinTech business:

1. Online trading and portfolio management services
2. Initial Coin Offerings:
    1. Platforms to facilitate an easy launch
    2. Registration of intelectual property
    3. KYC Due diligence portals
    4. Data protection
    5. Auditing of ICO process
3. Crypto-exchanges
    1. Fully online with automated KYC portals
    2. Crypto-ATMs kiosks
    3. OTC exchanges for big ticket purchases (real estate and large-scale investments)
4. Portfolio management and Investment advice
5. Financial planning considering cryptocurrencies as a new asset class

Blockchain for Funds and Companies

Funds touch all aspects of financial services and they tend to be laborious and can be expensive to launch, and there is room for innovation.

Crypto-Funds

- Funds investing in cryptocurrencies

Crypto Funds of Funds

- Funds investing in other crypto funds to further diversify risk and gain access to big ticket managers

Digital Incorporation

- New Public Registry for the digital incorporation of companies, funds and other entities to be incorporated and publically registered on a public blockchain

SMART Contracts

- Automation of fund admin operations
- Transactions that can be streamlined and will benefit from SMART contracts are:
  - Subscriptions
  - Redemption
  - Share transfers

SMART CONTRACTS

Use of SMART Contracts to improve and automate existing processes:

- Holder of identity information (encrypted)
- Execution of Documents (encrypted private key)
- Corporate Governance (automation)
- Corporate Actions (automation)
- Accounting (automation)
- Central Repository of all company activity
- SAFE = Simple Agreement for Future Equity (equity options contracts) used in ICO's for security tokens

Ease of Doing Business:

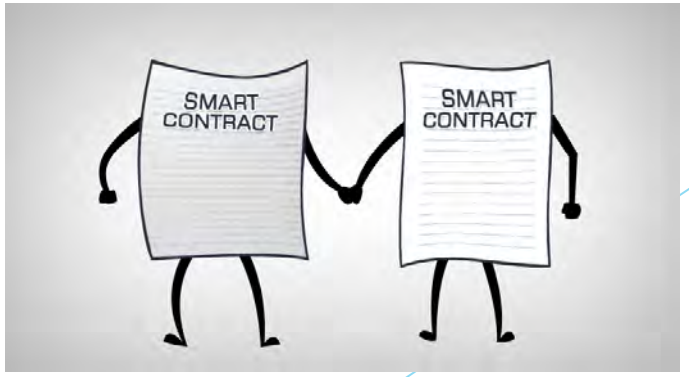
- Opportunities for processes improvement:
- Efficient entity incorporation and registration
- Digitalization of constitutive documents (3rd party validation)
- Digital Asset Registry (e.g. real estate)

Better Operational Risk Management:

- Automation provides for better quality controls
- Processes cannot be circumvented and retroactively changed
- Proof of communication

Additional Risks:

- Software bugs
- Cyber crime / attacks
- No central responsibility or control of some blockchains



Fiduciary & Advisory Services

1. Succession planning for a new asset class – cryptocurrencies and other digital media (e.g. social media accounts and data)
2. Succession planning for fund managers and directors holding Private Keys
   - Highlights the need for independente directors
3. Asset Protection structures
4. Escrow Services to support OTC exchange of crypto to fiat and fiat to crypto
5. Trustees

Education and Training

1. Community awareness involvement is where innovation begins
2. The government can also learn and solicit feedback on what policies would encourage growth in FinTech
3. Blockchain developers and analysts are already in high demand as well as executive training
4. Academy School of Blockchain (just acquired UniSoft 150,000+ students), @ Kingsland University - A SACS accredited school
5. Increased awareness and knowledge can be achieved through the launch of an education series that can include:
    - Lunch & Learn Sessions
    - Fintech Seminars
    - National Tech Seminar/Symposium
    - Online knowledge core

Policy Objectives

- **Ensure that The Bahamas takes a leading role in the region in the development/regulation of Fintech**
- Create an environment (from a policy and regulatory perspective) which promotes responsible FinTech development
- Facilitate the development of new products
- Mitigate/minimize risk associated with Fintech

Policy Objectives

- Consumer protection
- Provide recommendations to improve the ease of doing business through the use of FinTech
- **Establish a Bahamas FinTech Development Group comprised of public and private sector representatives**
- Secure funding for FinTech education and training

Next Steps

1. Encourage the establishment of a Bahamas Fintech Development Group – with all key stakeholders and relevant regulators represented:
   - BFSB
   - Bahamas Chamber of Commerce and Employers Confederation
   - Financial Services Regulators – Securities Commission, Central Bank of The Bahamas, Insurance Commission, Compliance Commission
   - BISX
   - Ministry of Finance and Ministry of Financial Services

Next Steps

2. **Formulate a strategic plan for the development of FinTech**
3. Establish a development and regulatory sandbox
4. Leverage the Commercial Enterprises Act, 2017

Clear Crypto Regulatory Policy Matters

- Supports clarity and certainty of outcomes and thus allows private sector to drive the innovation .
- Ensures a minimum level of consumer protection and oversight of more risky activity.
- Good examples and Bad examples of attempts to regulate this space. The Bad = “literal” and “virtual” exodus of the business.
- Do we need to define the nature of cryptocurrencies to regulate?
  - “Depending on their end-use, virtual currencies may be structured in various ways, thereby embedding different properties. Therefore, a “one size fits all’ definitional approach poses significant challenges for both the industry as well as the regulators worldwide.” ie look at the difference between Bitcoin and Ethereum in terms of technology. One is a ledger and the other a super computer running smart contracts and the many iterations of new ICOs.

Current State of Play

- If we did absolutely nothing, what is conceptually possible under current framework and where do activities sit in regulation?
  - ICOs
  - Crypto-Funds
  - Custody & Succession Planning
  - Payment Services Providers
  - Exchanges

ICOs

- ICOs (Initial Coin Offerings) vs TGEs (Token Generating Events);
- Security Tokens vs. Utility Tokens
- Is it a Security or is it a Commodity? Global Patchwork of Regulatory Policy some designed to maximize taxation collected – contrast IRS and SEC approach.
- Cross-border vs. Borderless Issuance – both outside the regulatory scope of the SIA even if a security token but care should be taken as to using technological restrictions to “police” access.

Crypto-Funds

- Crypto Strategy Funds or Funds of Funds.
- Need for transparent and full disclosure but no different than any other asset class.
  - Custody disclosure is key because in many cases the IM will hold or manage the private keys whether directly or through an intermediate entity.
  - Hacking and Security risk disclosures absolutely essential.
  - RED LINE VOLATILITY

Custody & Succession

- Huge issue – the person who controls the private keys controls the world! Possible now and without regulatory footprint.
- Risk if CBB takes the position that custody constitutes banking business or trust business. Neither is necessarily the case because of the definitions in the BTCRA.
- Risk of crypto-custody for banks is regulatory unless a clear policy position is enunciated. In any event we can think of a myriad of solutions for segregating that risk off balance sheet.
- Any number of opportunities in this space for entrepreneurs.
- What happens to your keys when you die? Is there a solution that The Bahamas can find? A Bahamas trust for crypto assets only, A PTC or perhaps a SMART Fund solution?

Payment Services

- Payment Services Act, 2012 - largely domestic in scope
- “payment services” which means “services enabling cash deposits and withdrawals, execution of payment transactions, the provision of money transmission business, and any other services which are incidental to money transmission and shall include the issuance of electronic money and electronic money instruments.”
- “payment instruments” payment instrument” means any instrument, whether tangible or intangible, that enables a person to obtain money, goods or services or to otherwise make payment or transfer money and includes, but is not limited to cheques, funds transfers initiated by any paper or paperless device (such as automated teller machines, points of sale, internet, telephone or mobile phones), payment cards, including those involving storage of electronic money.
- Limited to Banks and Money Transmission Businesses

Crypto-Exchanges

- No “financial instrument” test under the SIA and certainly not one that leads to the type of odd designation of “securities” rulings made by the SEC but the SCB has discretion to designate anything as constituting a security.
- The “securities” definition is narrowly framed
- If deemed a security an exchange could be registered under the SIA as an alternative trading system or exchange depending on how comprised.

Next Steps

5. Review Legislative Framework
   - Consumer protection
   - Securities legislation
   - Incentives for FinTech Development
   - Review the definition of “currency” and “money”
   - Inclusion of cryptocurrencies in AML/CFT and funds laws and regulations
6. Focus on Education and Training
7. Consider implementation of sandbox approach

Next Steps

Sandbox Approach

- National FinTech Development Group to identify areas of activity and functions within FinTech that should eventually be regulated, but do not currently fall within the existing legal or regulatory framework
- Regulatory sandbox could be developed to allow firms to make new products/services available in a restricted environment before being introduced to the market
- Persons or companies seeking to conduct business in these areas would have to register with the appropriate regulator prior to commencing business and would be permitted to offer products to a restricted number of clients whilst appropriate regulatory safeguards are developed

Next Steps

- No regulatory approval is required for the registration of firms however registration may be rescinded in the event of fraud, misconduct or abuse (e.g. AML breaches)
- A list of registered persons and firms participating in the sandbox would be published online
- A periodic communication/reporting feedback loop would be established based on the dynamics of the firm's business model
- After a specified period a determination would be made by the regulator whether to allow the firm to grant full approval to operate outside of the sandbox
- Transition mechanism for firms not granted full approval

QUESTIONS???