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July 2019

TECHNICAL NOTE ON FINANCIAL INCLUSION, RETAIL PAYMENTS, AND SME FINANCE

This Technical Note on Financial Inclusion, Retail Payments, and SME Finance for The Bahamas was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on May 29, 2019.

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FINANCIAL INCLUSION, RETAIL PAYMENTS, AND SME FINANCE

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in The Bahamas. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

ACH	Automated Clearing House
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
API	Application Programming Interface
ATM	Automated Teller Machine
AUM	Assets Under Management
CAR	Capital Adequacy Ration
CBOB	Central Bank of The Bahamas
CPMI	Committee on Payments and Market Infrastructures
CRS	Credit Reporting Systems
DFS	Digital Financial Services
E-Money	Electronic Money
ECB	European Central Bank
EMV	Europay, MasterCard, Visa
EU	European Union
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
FSP	Financial Services Providers
FX	Foreign Exchange
GDP	Gross Domestic Product
GOB	Government of The Bahamas
ID	Identification Document
IDB	InterAmerican Development Bank
IFC	International Finance Corporation
IFIs	International Financial Institutions
IFMS	Integrated Financial Management System
IMF	International Monetary Fund
IPS	Instant Payment System
KYC	Know-Your-Customer
LAC	Latin America and Caribbean
LTD	Loan-to-deposit ratio
MDR	Merchant Discount Rate
MFI	Microfinance Institution
MIS	Management Information System
MNO	Mobile Network Operator
MOF	Ministry of Finance
MSME	Micro, Small and Medium Enterprise
NBFI	Non-Bank Financial Institution

NFIS	National Financial Inclusion Strategy
NPL	Non-Performing Loan
NPC	National Payments Committee
PAFI	Payment Aspects of Financial Inclusion
PFMI	Principles for Financial Market Infrastructures
POS	Point of Sale
PSD	Payment Systems Directive
PSMI	Payment System Modernization Initiative
ROA	Return on Asset
ROE	Return on Equity
R&D	Research and Development
SBDC	Small Business Development Center
SME	Small and Medium Enterprises
TSA	Treasury Single Account
VAT	Value Added Tax
WB	World Bank
WEO	World Economic Outlook
WTO	World Trade Organization

EXECUTIVE SUMMARY

1. The CBOB considers increased financial inclusion as a critical reform area. In this regard, the FSAP assessed developments in financial inclusion for individuals and enterprises (SME finance), retail payments and provides recommendations for improvements. A review of the market was undertaken using the Payment Aspects of Financial Inclusion (PAFI) framework covering areas such as the legal/regulatory framework and oversight, retail payment systems and instruments, access to transaction accounts and use cases, as well as SME policy, credit infrastructure, economic empowerment funds and consumer protection and financial literacy.

2. Even though the Payment Systems Act of 2012 and the Payment Instruments Oversight Regulations of 2017 constitute a good legal basis for the payments market in The Bahamas, there is still room for clarity and expansion in certain areas, given the rapid technological advancements in the field. More specifically, the definition of payment institution is narrow and focuses mainly on e-money issuers. As such, it needs to be expanded in order to accommodate new types of players that offer both, payment services and/or payments infrastructure (i.e. FinTech). In the context of FinTech, the concept of open banking can be considered in the regulatory framework whereas banks have to open up their infrastructure so that it is accessed by third party providers through application programming interfaces (APIs) in order to perform transactions or check balances on behalf of an account holder.

3. The law allows payment service providers to outsource their activities to agents in The Bahamas, upon approval by the CBOB. Given the unique nature of banks as deposit taking institutions, it is not clear under the current framework if banks can outsource their deposit taking activity to agents and thus, more clarity is needed. Moreover, even though there is no reference to agent exclusivity, it is imperative that explicit language is added on banning agent exclusivity agreements so that competition is not impeded, particularly in remote areas where there are limited agents.

4. The CBOB has an oversight framework pertaining to payment systems and instruments. The framework could further benefit from the issuance of detailed and comprehensive guidelines for on-site and off-site oversight as well as the incorporation of guidelines for cyber resilience. Furthermore, as an additional oversight tool, the CBOB should continue exploring how it can publish in a comparative format the fees for accounts, payment services, and remittances across banks and non-bank financial institutions (NBFIs) on its website.

5. The main retail payment system in the country is The Bahamas Automated Clearing House Limited (ACH), jointly owned and operated by all commercial banks, which clears cheques, direct debits and credit transfers. Domestic debit/credit card transactions are routed through the international card networks outside the country. The expansion (to regulated and supervised NBFI participation) and modernization (migration to ISO 20022 standards for clearing messages) of the existing ACH should be seriously considered as it would lead to more competition and financial inclusion.[1] With regards to payments cards, banks should complete migration to chip-based cards as well as differentiate between debit and credit card merchant discount rates (MDR) as presently merchants are charged the same fee. Moreover, the introduction of new payment systems such as an Instant Payment System for retail payments could advance financial inclusion by driving down transaction costs for individuals and merchants, offering real-time settlement for the end-users, and expanding use cases and access channels. However, any new system introduced in the country should be interoperable with existing systems. In order to further facilitate the shift away from cash and cheques, the CBOB should actively promote the establishment of effective and sound payment network by the private sector via its role as a catalyst in retail payments and put in place an action plan for cheque reduction (particularly among businesses).

6. Commercial banks have been the main providers of payment services in The Bahamas thus far, but they have not been able to meet all market needs. In this context, NBFIs such as credit unions and e-money issuers are expected to play an important role in filling the void, by utilizing their presence in areas where banks are not present (e.g., some of the Family Islands) as well as their competitive pricing, new business models and innovative technologies. The digitization of government payments (especially on the collection side) can further drive the shift away from cash in The Bahamas. In order to accelerate the process, the Treasury should implement an Integrated Financial Management System (IFMS). The introduction of an e-government portal where all government payments can be made electronically should also be a priority for the government along with introducing electronic tickets for the country's bus system. The CBOB should also work with commercial banks so that a "basic" account is introduced with lower than existing opening/maintenance fees for those that have never held a bank account before. The process of opening a bank account or performing a payment transaction can be further simplified if the government introduces a multi-purpose national digital identification program (i.e. unique ID), taking into consideration data privacy safeguards.

7. On the SME side, The Bahamas face difficulties in accessing appropriate finance needed to support their growth and increase of productivity. Issues with access to finance are of a systemic nature and bottlenecks currently exist on both the demand and the supply side of credit. In order to address these issues, a set of reforms and actions are needed, including finalizing the draft SME Act and introduction of an official SME policy to serve as a reference point. The policy should introduce a uniform definition of SMEs (it is being prepared as part of the draft SME Act) and provide for a set of well-planned actions aimed at facilitating access to finance for SMEs. One of the priorities should be to collect verifiable data on SME finance in order to enable development of appropriately targeted policy actions. To support this the CBOB should start collecting data on SMEs lending from all of its supervised entities using the new uniform definition.

8. Credit to SMEs is nominally offered by banks and NBFIs. However, banks focus primarily on large corporate borrowers and less risky salaried consumers while existing NBFIs do not have

[1] This measure is already under policy consideration, with provision for all supervised entities to maintain balances at the Central Bank to be used for clearing purposes. This will be permitted under the proposed amendments to the Central Bank Act.

enough capital or distribution networks large enough to make a more substantial impact. Many SMEs cannot provide dominantly required fixed collateral or present reliable financial information which makes them risky clients. These risks in turn cannot be efficiently mitigated due to inefficiencies in the existing credit infrastructure, collateral registration and credit reporting. These inefficiencies should be addressed through a series of legal and regulatory reforms to modernize collateral registration process, enable seamless offering of various alternative financial products and reduce information asymmetry in the market.

9. Diversification and increase of finance by private sector should be supported through investments and risk sharing activities of existing public economic empowerment funds (credit guarantee schemes, development bank and venture capital funds) which need to be reorganized in order to improve coordination, governance, targets, and reliability. Innovative digital financial services should be facilitated through improvements of efficiency of licensing and product authorization process, transparency of policies, and legal/regulatory adjustments.

10. A National Financial Inclusion and Payments Strategy/Action Plan can give impetus to the ongoing and new initiatives of the CBOB and the government, as well as revitalize the role of the National Payments Committee. In addition to the linkages between payments and financial inclusion, the Action Plan could particularly focus on financial education for merchants and consumers, including campaigns to incentivize people in remote areas to sign up for transaction accounts as well as familiarize the migrant community with the benefits of accounts and electronic payments. In this context, the authorities could also introduce a robust financial consumer protection framework followed by the appropriate financial consumer supervision practices as well as the establishment of a formal mechanism within the CBOB for dispute resolution.[2] Low levels of financial education and relatively weak standards of consumer protection contribute to the lack of trust between providers and customers undermining access to finance and usage of electronic payment instruments.

[2] This is under consideration by the authorities. The CBOB has already completed the work to define the role of an ombudsman and will seek to recruit to the post in 2019.

TABLE OF RECOMMENDATIONS

Recommendation	Timing	Agency
Payments Legal/Regulatory Framework and Oversight		
Expand the definition of payment institutions in the regulations.	NT	CBOB
Consider introducing the concept of open banking.	NT	CBOB
Clarify in the regulation if agent banking is permitted.	NT	CBOB
Use specific language for agent exclusivity in the regulation.	NT	CBOB
Implement detailed and comprehensive guidelines for off-site and on-site oversight for payment service providers and payment system operators.	NT	CBOB
As part of oversight, include cyber resilience guidelines and monitor their implementation for payment service providers and system operators.	NT	CBOB
As part of oversight, publish bank fees on the central bank's website as well as consider establishing a national remittances price database.	NT	CBOB
Establish a formal body within the central bank for dispute resolution pertaining to payment services.	NT	CBOB
Retail Payment Systems and Instruments		
Expand access to the ACH beyond banks.	I/NT	Banks, CBOB, NBFIs
Improve the risk management of the ACH by eliminating the practice of unwinding.	I/NT	Banks
Undertake a cost-benefit analysis for migrating to ISO 20022 standards for clearing messages going through the ACH.	NT	Banks
Consider implementing an Instant Payment System.	MT	CBOB
In upgrading existing payment systems or introducing new ones, ensure interoperability.	NT	CBOB, Banks, NBFIs
Complete full migration to chip-based payment cards.	I	Banks
Differentiate between debit and credit card merchant discount rates.	I	Banks
Conduct financial literacy campaigns for merchants.	C	CBOB, Banks, Chamber of Commerce
Put in place an action plan for reducing the use of cheques among businesses.	NT	CBOB, Banks, MoF, Chamber of Commerce
Financial Inclusion – Account Access and Use Cases		
Design a National Strategy on Financial Inclusion and Payments.	NT	CBOB, NPC
Design a basic bank account product for the unbanked.	NT	Banks

Recommendation	Timing	Agency
Conduct campaigns for training and incentivizing individuals in remote areas to sign up for transaction accounts.	C	CBOB
Consider designing a comprehensive digital ID program.	NT	GOB
Financial institutions other than commercial banks should play a greater role in expanding access to transaction accounts and usage of electronic payment instruments in The Bahamas.	NT	NBFIs, CBOB, MoF
The Treasury should channel payments such as public salaries, pensions and social transfers directly to the beneficiaries' accounts via the ACH.	NT	MoF, Banks, CBOB
The Treasury should implement a Single Account Model and an Integrated Financial Management System.	I/NT	MoF
Implement an e-government portal for government payment collections.	NT	MoF
Introduce an electronic bus ticket system.	NT/MT	Ministry of Transport
Continue the financial literacy campaign and also introduce a component focusing on the migrant community.	C/NT	CBOB
SME Policy		
Introduce an SME policy as a formal policy paper or finalize a draft SME Act, with clear development goals and planned targeted support for SMEs. Define SMEs for data gathering and policy formation purposes (to facilitate reporting on SME lending and ensure that SME disaggregated information from all credit providers is collected).	NT	MoF, CBB, (and other relevant government agencies as needed)
Remove or decrease stamp duty on collateral registration for SMEs.	NT	MoF, (and other relevant government agencies as needed)
Consider introducing a late payment law (strict payment terms and penalties) for payments to SMEs applicable both to private and public-sector contractors.	MT	MoF
Economic Empowerments Funds		
Introduce formal coordination mechanism and action plan for cooperation between various public economic empowerment funds targeting SMEs (credit guarantee schemes, development bank and venture capital fund/start-up funds).	NT	MoF (and other relevant government agencies as needed)
Revise governance of economic empowerment funds, ensure that transparent and efficient claims procedures are followed, and revise investment limits reflecting realities of the start-up market in the economy (venture capital fund).	MT	MoF (and other relevant government agencies as needed)

Recommendation	Timing	Agency
Credit Infrastructure		
Reform collateral registration system to introduce digital, centralized and on-line registry for all types of collateral.	MT	MoF (and other relevant government agencies as needed)
Operationalize future credit bureau and facilitate collection of data from all banks, but also credit providing NBFIs and other valuable sources of alternative credit information such as utilities companies, telecommunication services and other post-paid services providers.	MT	MoF, CBOB
Conduct a feasibility study on introduction of the central "clearance model" for VAT instead the current post-audit one in order to facilitate development of B2B e-invoicing and improve tax compliance.	MT	MoF (and other relevant government agencies as needed)
Product and Providers Diversity		
Introduce legal definition of factoring and the most typical (basic) versions of factoring products in order to facilitate development of the product and enable uniform legal / business interpretation of factoring transactions	MT	MoF
Introduce definition of NBFI financial services in the Financial and Corporate Service Providers Act to increase legal certainty, and enable disaggregation of data per type of financial service offered.	NT	MoF, Securities Commission
Introduce a FinTech strategy with the aim of increasing transparency of regulatory process towards potential newcomers in the financial sector and improving efficiency of licensing procedures for new financial products	MT	CBOB, Securities Commission
Enact regulation facilitating market-place lending (crowdfunding), both debt and equity.	MT	Securities Commission
Consumer Protection and Financial Education		
Introduce a robust financial consumer protection framework based on international good practices applicable to all regulated financiers.	MT	MoF, CBOB
Introduce new and expand existing SME financial training segments to financial literacy campaigns and financial education strategies including on digital financial services.	NT	MoF, CBOB

SCOPE

11. Financial infrastructure comprises all institutions, rules, and standards of all the systems which enable financial intermediation. Payment systems[3] constitute a prominent component of financial infrastructure. They facilitate the discharge of financial obligations and the safe transfer of funds across distances, institutions and retail customers, supporting the stability of the financial system. For governments and central banks, both strengthening the security and reliability of the national payments system and fostering the use of efficient payment instruments are important public policy goals. Public authorities have at their disposal policy tools in order to provide a legally sound environment for the private sector to provide a wide range of affordable payment instruments, products and services to individuals and merchants as well as paying particular attention to those financially excluded. The fulfillment of those policy objectives results in economic and social benefits.

12. As agreed with the authorities, this technical note contains a high-level assessment of financial inclusion (for individuals and enterprises) and retail payments in The Bahamas with the main focus being on recommendations. The assessment was undertaken in the context of the International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP) mission to The Bahamas from January 15–28, 2018. The assessors were Holti Banka and Ivor Istuk of the World Bank's Financial Inclusion, Infrastructure and Access (Finance and Markets Global Practice). Shalini Sankaranarayan (also World Bank) provided input remotely. The assessors would like to thank the counterparts in The Bahamas for their excellent cooperation during the mission.

13. The assessment covers the following areas: (i) Legal/Regulatory Framework and Oversight of Retail Payments; (ii) Retail Payment Systems and Instruments; (iii) Financial Inclusion – Access and Use Cases; (iv) Small and Medium Enterprise (SME) Finance.

14. On the payments side, the technical note does not provide a detailed assessment of individual payment systems but rather uses international best practices for carrying out a high-level review of the areas listed above as well as provides high level recommendations for the authorities. The main framework used is the Payment Aspects of Financial Inclusion (PAFI)[4] by the World Bank and the Committee on Payments and Market Infrastructures (CPMI), which provides the basis for exploring financial inclusion and payment system interlinkages. The review is also guided by elements found in the Principles of Financial Market Infrastructures (PFMIs)[5] put forward

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[3] A payment system is defined as the set of instruments, procedures, actors and infrastructure that ensure the circulation of funds.

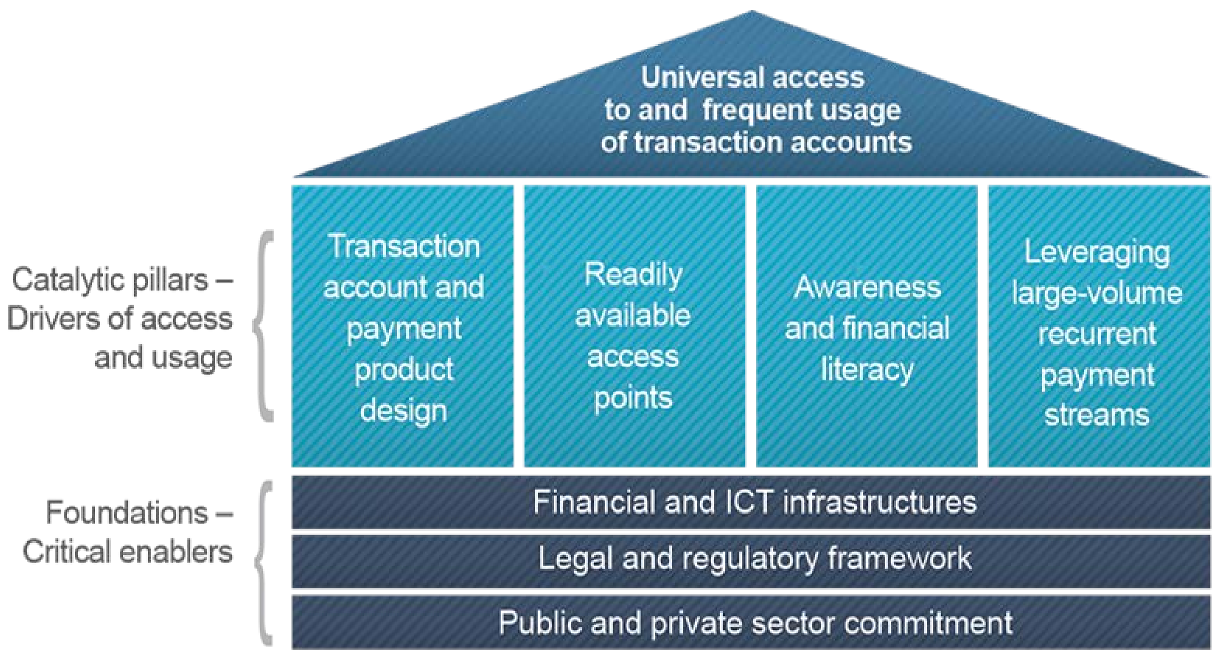
[4] Available at: https://www.bis.org/cpmi/publ/d144.htm

[5] Available at: https://www.bis.org/cpmi/publ/d101a.pdf

by the CPMI, the G20 High Level Principles for Digital Financial Inclusion,[6] as well as by several guidelines in the World Bank's Retail package.[7]

15. On the SME side, the technical note explores access to, and availability of, appropriate finance to meet the needs and demand for credit by SMEs. The main framework used is the G20-OECD High-level Principles[8] on SME Financing and it analyzes access to finance from a supply side perspective primarily, focusing on existing providers of finance, credit infrastructure and relevant government policies. However, challenges and recommendations of improvements on the demand side are also explored to the extent that data availability allows for.

Payment Aspects of Financial Inclusion



Source: Payment Aspects of Financial Inclusion (CPMI, 2016).

[6] Available at: https://www.gpfi.org/sites/default/files/documents/G20%20High%20Level%20Principles%20for%20Digital%20Financial%20Inclusion%20-%20Full%20version-.pdf

[7] The lessons learned during more than a decade of World Bank Group technical assistance, along with the research findings of other international and national agencies, have been merged into a comprehensive package for the development and reform of the national payment systems. Available at: http://www.worldbank.org/en/topic/paymentsystemsremittances

[8] Available at: https://www.oecd.org/finance/private-pensions/G20-OECD-High-level-Principles-on-SME-Financing-Progress-Report.pdf

FINANCIAL INCLUSION AND RETAIL PAYMENTS

A. Overview

16. The Bahamas have achieved a number of milestones in the context of modernizing the national payment system and expanding financial inclusion under the Payment System Modernization Initiative (PSMI). The efforts are ongoing as challenges still remain given that approximately 20 percent of the adult population does not have access to a bank account and also cash and cheques still dominate the payments market.[9]

2000 – **Adoption of the Central Bank Act:** Provides overarching framework for responsibilities pertaining to efficiency and soundness of national payment systems.

2004 – Establishment of the Real Time Gross Settlement (RTGS) System: The Bahamas Interbank Settlement System (BISS) which processes real-time transactions of B$150,000 and above, on a gross basis with finality and irrevocability, is operated by the central bank.

2010 – Establishment of an Automated Clearing House (ACH): Operated by The Bahamas Automated Clearing House Limited (BACHL) and is jointly owned by clearing banks. It processes cheques, direct debits and credit transfers.

2011 – Establishment of the Payments Policy and Oversight Unit (Payments Unit): The unit is housed within the Research Department of the Central Bank.

2012 – Adoption of the Payments System Act 2012: Provides detailed framework for regulatory and supervisory authority for payments to the Central Bank.

2012 – Formal Establishment of the National Payments Committee (NPC): Although informally formed in 2003, the Payments System Act formalized the establishment of NPC which is chaired by the central bank and consists of public and private market actors.

2017 – Adoption of the Payments Instruments Oversight Regulations: Provides a framework for electronic payment services.

2018 – Adoption of the Credit Bureau Bill: The adoption will lead to the establishment of a credit bureau.

17. There are two payment systems in the country—The Bahamas Interbank Settlement System which is owned and operated by the central bank, and which settles large value payments; The Bahamas Automated Clearing House Limited which is jointly owned and operated by all commercial banks in the country and which clears cheques, direct debits, and

[9] The percentage of the unbanked adults is an approximation based on central bank surveys. The Bahamas has not been included in any of the international Findex surveys (measuring the percentage of adults with bank account access, among other metrics) conducted so far.

credit transfers with settlement in central bank money. Card transactions are routed and processed through the international card schemes outside the country and settled in commercial bank money in The Bahamas.

18. There are several payment instruments used in The Bahamas: cash, cheques and money orders, debit cards, credit cards, prepaid cards, direct debits, credit transfers, and electronic money (e-money).[10] Even though there has been a slight decrease over time, cash and cheques still dominate in the country.

19. The main actors in the context of financial inclusion and payments in The Bahamas include the Central Bank of The Bahamas (CBOB), 8 commercial banks (2 of which are domestic), 10 credit unions/financial cooperatives, the Post Office Savings Bank, 5 money transfer operators (MTOs), and 1 e-money institution/issuer.[11]

20. The central bank is the issuer of the legal tender in the country. In the context of payments, it has three roles: operator, since it operates the RTGS system; regulator, since it issues regulations related to payment systems, services and instruments; overseer, as it is in charge of overseeing payment systems and payment instruments. Through moral suasion, the central bank also plays a catalyst role as it uses moral suasion and other non-binding policy platforms to catalyze action in the private sector and to ensure efficient and safe payment systems in the country. Expanded financial inclusion and a shift away from paper-based payment instruments have also been stated as goals by the central bank.

21. Commercial banks in The Bahamas accept deposits and issue payment instruments such as cheques, payment cards, direct debits, and credit transfers. They also acquire merchants, facilitate money transfers, collection and disbursement of government payments, as well as collection of bill payments.

22. Credit unions also hold deposits and partner with banks to issue payment cards for their clients. The Bahamas Post has a bank arm which enables it to hold deposits. However, it does not issue any payment instruments other than money orders.

23. Money transfer operators facilitate primarily domestic and international money transfers, but also collect payments on behalf of private companies and government agencies.

24. Currently, there is only one e-money issuer in the country which was granted its license in 2018 and is expected to be fully operational in the first half of 2019.

[10] E-money is value stored electronically in a device such as a chip card or a hard drive in a personal computer.

[11] By March 2019, a second e-money issuer, CaribPay, was licensed in the Bahamas.

B. Legal/Regulatory Framework and Oversight

25. The CBOB is responsible for regulating and overseeing payment systems, instruments and operators. The first regulatory guidance pertaining to payments can be found in the Central Bank of The Bahamas Act 2000. However, the main Act that covers payments is the Payment Systems Act (PSA) 2012, which details all central bank regulatory and oversight authorities. Through the PSA, CBOB ensures that payment systems and instruments are financially safe for users, efficient, competitive, and do not contribute to increased risk to the financial system.

26. The PSA also provided the basis for the establishment of the National Payments Committee (NPC) which is chaired by CBOB and serves as an advisory body and a forum of cooperation between the different actors (public and private) in the payments field. Bylaws have also been issued with respect to the composition and other logistical details pertaining to the NPC.

27. Finality of payments and settlement rules are also found in the PSA as well as insolvency issues. Related to the clearing of payment instruments, the Bahamian legal framework allows for the physical presentation of cheques as well as for truncation.

28. The duties of the ACH are also clearly defined in the regulatory framework of the country. Clearing Houses are required to report changes on system, fees, and rules, to the central bank thirty days in advance. The central bank can also enter in agreement with the ACH pertaining to issues such as netting arrangements, risk control mechanisms, the operation system and financial soundness of the clearing house, and nature of financial arrangements among participants.

29. The Payment Instruments Oversight Regulations of 2017 introduced the concept of a payment institution which goes beyond the traditional banks, credit unions, and money transfer operators. Payment institutions can hold accounts only in Bahamian dollars and of value not more than B$15,000, unless given special authorization by the central bank.

30. A sub-category of payment institutions are e-money issuers which are also covered in the 2017 regulations. It is explicitly stated that for e-money issuers additional requirements apply such as the fact that e-money issuers are required to hold customer funds in Custodian accounts with commercial banks. Moreover, e-money can be exchanged for physical Bahamian Dollars on par at any point in time. The final settlement of e-money transactions shall occur no more than 24 hours after the payment instruction has been initiated.

31. The Bahaman requirements for payment service provision license are quite rigorous. A new institution undergoes a monitoring pilot period before it is granted a full license.

32. Payment institutions are enabled by law to use agents in order to carry out their activities around the country. As long as a set of requirements indicated by the central bank is fulfilled, any business, financial entity or person can become an agent and provide services on behalf of a payment institution. The payment service provider has to report information on all agents it deploys to the central bank. Liability in terms of funds remains entirely with the payment service provider.

33. The Know-Your-Customer (KYC) procedures for opening a bank account or performing a money transfer have been simplified in The Bahamas for low-risk customers, without compromising the Anti-Money Laundering and Counter Terrorist Finance (AML/CFT) standards. Nevertheless, challenges still remain for certain population segments that might not have identification documents such as elderly or migrants, and those without an email address or phone number, in the absence of postal addresses in The Bahamas.[12]

Recommendations

34. Expand the definition of payment institutions in the regulations. The regulation states that payment institutions are payment service providers other than banks, credit unions, and money transfer operators. The definition of payment institution is narrow and focuses mainly on e-money issuers. As such, it needs to be expanded in order to accommodate new types of players that offer both, payment services and/or payments infrastructure (i.e. FinTech).

35. Consider the introduction of the concept of open banking. With the emergence of new technologies, clients are trusting third party service providers to access accounts or make payments on their behalf. The regulatory environment in The Bahamas should also reflect the new trends in order to increase competition and empower customers to have all possible options at their disposal. This means adjustments of the regulatory framework so that banks would have to open up their infrastructure to be accessed by third party providers through application programming interfaces (APIs) in order to perform transactions or check balances on behalf of an account holder.[13] However, this intervention should be accompanied by adjustments to privacy laws.

36. Clarify in the regulation if agent banking is permitted. While the 2017 regulatory framework states that payment service providers can outsource their services to agents upon permission from the CBOB, more clarity is needed in terms of agent banking. Unlike other payment service providers, banks are unique in that they hold deposits. As such, the language should be adjusted in order to indicate more clearly if banks can outsource their deposit taking services to agents and what requirements would need to be fulfilled in those cases. The model of agent banking has successfully been implemented in a number of countries across the world, whereas among other entities, postal offices have become agents of banks, utilizing their widespread network and physical presence in remote areas.

37. Use specific language for banning agent exclusivity in the regulation. The current legal framework does not have any clause pertaining to barring agent exclusivity arrangements. The regulation should include specific language that would not permit agent exclusivity. As international

[12] In August 2018 the CBOB eliminated the exchange control restriction on access to B$ accounts by non-residents.

[13] More on open banking available in the European Payment Systems Directive (PSD2): https://www.ecb.europa.eu/paym/intro/mip-online/2018/html/1803_revisedpsd.en.html

experience indicates, banning agent exclusivity explicitly would result in more competition, lower costs and financial inclusion. Subsequently, that means that agents can sign agency agreements with multiple payment service providers. Exclusivity agreements would give rise to monopolistic behaviors, especially in areas where the supply of agents is limited (e.g., Family Islands), and high costs to users.

38. Implement detailed and comprehensive guidelines for off-site and on-site oversight for e-money providers. The CBOB is in charge of overseeing the payment systems and instruments in the country. The oversight activity comprising off-site monitoring and on-site inspections should be a risk-based approach based on international standards, guidance and best practices. The off-site activities should include reviewing systems' integrity by collecting and processing information regarding the functioning of the technical and risk-management infrastructure of the e-money providers. The overseer should request the operators, service providers and participants to submit selected information on the various stages and phases of the payment process. The on-site oversight activities refer to the inspections processes. On-site activities require a very rigorous planning and preparation process. Through the on-site oversight, the CBOB should determine the level of risk and the quality of risk management of the payment system providers and systems. The CBOB should develop a risk profile for each e-money service provider and system based on all information available, collected through the previous on-site inspections as well as through other oversight activities (off-site reporting) or independent third parties (e.g., external audits).

39. As part of oversight, include cyber resilience guidelines and monitor their implementation for payment service providers and payment system operators. As cyberattacks at financial institutions and payment systems rise around the world, it is imperative for central banks to be proactive and incorporate cyber resilience policies into their oversight framework. In this context, CBOB can provide general guidelines based on international best practices as well as monitor how payment system operators are following those guidelines in order to safeguard systems, given that cyberattacks on systems (particularly the systemically important ones) might pose risk to the entire financial system of the country. In this context, the recent guidelines published by the CPMI[14] and the European Central Bank (ECB)[15] could be used as reference, given they cover all main areas: Identification – Protection – Detection – Response and Recovery.

40. As part of oversight, publish bank fees on the central bank's website as well as consider establishing a national remittances price database. While commercial banks in The Bahamas publish fees on their website, it is recommended that CBOB gathers fees on basic products and services from all banks and publish them on its website as an oversight tool, so that individuals and merchants can use it as an online "one-stop-shop" for comparative purposes. This practice can further increase transparency and hold banks accountable to applying the fees that are reported on

[14] CPMI guidelines on cyber security for financial market infrastructures available at: https://www.bis.org/cpmi/publ/d146.pdf

[15] ECB guidelines on cyber security available at: https://www.ecb.europa.eu/paym/pdf/cons/cyberresilience/Cyber_resilience_oversight_expectations_for_financial_market_infrastructures.pdf

the CBOB's website. This would also require standardization of the terminology used to describe main products and services across banks. Following the same logic, CBOB should also consider creating a similar consolidated platform for outgoing remittance prices across different service providers, given that The Bahamas has net outflows of remittances.

41. Establish a formal body within the central bank for dispute resolution pertaining to payment services. Even though CBOB can act as an intermediary between an individual and a financial institution, the establishment of a formal body such as an Ombudsman would signal to the market that consumers are well-protected and thus serve as a deterrent to market abuses.

C. Retail Payment Systems and Instruments

Automated Clearing House

42. The ACH in The Bahamas, established in 2010, is jointly owned (i.e. equal shares) and operated by all commercial banks. In addition to all banks being participants, CBOB is also a direct participant to the system. The system works on a cost recovery basis. While the system rules allow for indirect participation, there are no indirect participants yet to the system. The ACH clears cheques,[16] direct debits and credit transfers.

Table 1. Volume and Value of Instruments Cleared Through the ACH

	Cheques	Direct Debits	Credit Transfers	Total (across instruments)
Volume (2014)	2,808,412	38,564	1,429,321	4,276,297
Value B$ (2014)	6,930,832	30,882	3,577,536	10,539,250
Volume (2015)	2,743,184	60,309	1,621,476	4,424,969
Value B$ (2015)	7,122,776	258,975	4,700,273	12,082,024
Volume (2016)	2,611,102	97,677	1,976,068	4,684,847
Value B$ (2016)	7,033,584	281,866	6,444,773	13,760,223
Volume (2017)	2,521,096	90,648	2,192,637	4,804,381
Value B$ (2017)	7,157,368	97,476	10,311,602	17,566,446

Source: Global Payment Systems Survey 2018 (World Bank)

43. As the data indicates, among the three instruments that are cleared through the ACH, cheque volumes demonstrate the highest. Cheque volumes have been declining across time, but the decline is minor. Credit transfers have shown a rapid growth over the last three years and are on the verge of overpassing cheque volumes. Direct debit volumes remain still remain quite low although they have doubled since 2014.

44. There are multiple clearing cycles that take place during the day in the ACH while settlement happens in central bank money through the RTGS. For credit transfers and direct

[16] The system allows for the processing of truncated cheques as well.

debits settlement happens the same day while for cheques on T+1. While there is no guarantee fund in place, there is a settlement risk management framework whereas an unwinding procedure would be initiated if a participant is unable to settle its debt position. The participants have access to information during the day on their preliminary position. Banks incur a standard charge of B$0.9 for clearing a direct debit and credit transfer and a charge of B$0.27 for clearing a cheque. Any transaction of B$150,000 or below is processed through the ACH. Transactions between B$150,000 and B$1 million can be processed through the ACH or the RTGS. If processed through the ACH, the charge for the banks is higher than the standard rate. Any transaction of value B$1 million or above must be processed through the RTGS.

45. While the clearing happens in local currency, the ACH has capabilities to also process transactions in U.S. dollars. The system also has the technological capacity to process other payment instruments (after necessary adjustments) such as cards.

46. In terms of safety, the system is scanned on a weekly basis for security breaches, while the system operator works with external experts in order to perform annual cyber crisis response simulations and assess the level of preparedness in case of cyberattacks.

Payment Cards

47. Commercial banks issue all main international card brands in The Bahamas. The types of cards issued are debit, credit, and prepaid. The prepaid cards in particular are offered by some banks to employers who choose to load the salaries of their employees (particularly those without a bank account). Also, individuals who do not want to carry cash when they travel opt for prepaid cards which they can use to then withdraw cash at their travel destination.

48. Typically, the issuance of debit cards is linked to a savings account in The Bahamas. This is because traditionally the Bahamians have opted for savings accounts and thus a debit card issuance became part of it.

49. Banks in The Bahamas have also forged partnerships with credit unions in that they issue debit and credit cards for the members of some of the credit unions in the country. Those are typically co-branded cards which also include the logo of the particular credit union and can be used at any ATM or POS that has the logo of the issuing bank/card network since in the absence of interoperability, ATM and POS are not unified.

50. There is no national card switch in the country and as such, all domestic card transactions are processed through the international card networks, outside The Bahamas. The settlement, though, happens in local currency in one of the commercial banks in The Bahamas.

Table 2. Volume and Value of Payments via Debit and Credit Cards Across Time			
	Debit Cards	**Credit Cards**	**Total**
Volume (2014)	4,900,090	566,247	5,466,337
Value B$ (2014)	562,2691	206,589	5,829,280
Volume (2015)	7,691,395	828,344	8,519,739
Value B$ (2015)	1,123,887	283,258	1,407,145
Volume (2016)	870,7159	1,319,748	10,026,907
Value B$ (2016)	130,5134	313,977	1,619,111
Volume (2017)	9,712,919	1,634,548	11,347,467
Value B$ (2017)	145,3463	455,820	1,909,283
Source: Global Payment Systems Survey 2018 (World Bank).			

51. It is not surprising that debit card payments are at a much higher volume than credit cards, given that credit cards are associated with more requirements to obtain. Data shows that both, debit and credit card payments have shown a consistent rise across time. Credit cards, however, show a higher growth rate than debit card payments in terms of volume. It should be mentioned that debit cards are still used to a large extent for cash withdrawals at automated teller machines (ATM).

52. Payment cards issued in The Bahamas cannot be used for e-commerce with foreign e-merchants, given that the cards would need to be linked to a foreign physical address. This constitutes a major limitation in that it inhibits a major driver for card usage given that The Bahamas is primarily an import country.

53. Each bank in The Bahamas operates and maintains its own ATM network. While it is common that users withdrawing cash from an ATM that does not belong to their primary bank get charged, in The Bahamas banks also charge customers a flat fee for withdrawing cash from the ATM of their bank.[17]

54. As a number of commercial banks have withdrawn their branches from some Family Islands, this is also evident with the ATMs, given that the overall number of ATMs in the country has decreased over the last year.

55. Most issuing banks are also acquiring banks in The Bahamas. Even though there has been an evident increase in the number of point of sale (POS) terminals for accepting electronic payments in The Bahamas, most of them are concentrated in the main islands. As such, the availability of POS terminals in the Family Islands still remains a challenge. This is primarily driven by lack of financial literacy, high costs, and low usage of cards by buyers.

[17] Banks argue that this is to cover the operating costs and also to disincentivize users from withdrawing and using physical cash and rather use debit cards for payments.

Table 3. ATM and POS Terminals in The Bahamas Across Time		
	Number of ATMs	**Number of POS**
2014	334	4,908
2015	345	8,853
2016	402	9,146
2017	362	11,306
Source: Global Payment Systems Survey 2018 (World Bank).		

56. Even though merchants have the option to negotiate with acquirers the merchant discount rate (MDR), often times they are not aware of it and thus end up paying a high per transaction fee for every card payment they accept.

57. A paradox that occurs in The Bahamas is that there is no differentiation between debit and credit card merchant discount rates. There is no economic rationale for this practice given that interchange fees (which are the main driver of MDR) are higher for credit cards compared to those for debit cards. In other words, merchants are "punished" for accepting debit cards.

58. There are also cases where the merchants are willing to install a POS terminal but in the absence of significant usage by buyers, they opt out since they still have to incur fixed costs for terminal maintenance, thus reverting to cash and cheques. This is primarily observed in areas with elderly communities or other population segments that do not have access to bank accounts and use exclusively cash such as part of the migrant community.

E-Money

59. As of January 2019, there is only one e-money issuer in the country (Island Pay) which was granted its license end of 2018. The company is still conducting its beta testing among a set of consumers and merchants in The Bahamas and is expected to fully launch its services in 2019. Even though an e-money issuer can accept funds deposits from clients, it must then open Custodian accounts with commercial banks where client funds can be held according to the Bahamian regulations. Under the e-money model, a user would be able to exchange e-money (held in an e-wallet) for physical cash and vice versa, at a representative agent of the e-money issuer. However, players like Island Pay are utilizing new technologies and want to minimize the use of physical cash and keep transactions in the electronic ecosystem. Island Pay is working with both major mobile phone networks in the country.

Box 1. Criteria for Adoption of Payment Instruments

The adoption of any given retail payment instrument by consumers, businesses and governments is influenced by how well-suited that instrument is to the specific payment needs of the payer and the payee, as well as how each of these perceive the instrument in terms of risk, liquidity, cost, acceptance, and convenience. For a payer, the choice of payment instruments is typically influenced by the following factors:

- **Cost:** Usage of payment instruments entails both explicit as well as implicit costs. Explicit costs include the direct charges paid by the payer for using the instrument, such as per-transaction fees. Implicit costs incurred include, for example, the waiting time for processing the payment request or the cost of time spent commuting to a designated place to obtain cash to make payments or to be able to use the non-cash payment instrument.

- **Safety and reliability**: A payer needs to have a high level of trust that a payment instrument will work as expected and discharge the payer's payment obligation to the payee as required. This includes aspects related to system uptime, fraud misuse, correcting processing errors, and so forth.

- **Convenience:** The payment instrument needs to be convenient to use. This includes aspects like what the payer needs to remember or what the payer needs to physically carry or use when making the payment, how much time the transaction takes to complete when using that payment instrument, and other related considerations.

- **Acceptance:** A payer would want the payment instrument to be widely accepted for his payment needs. For example, a payment cardholder might not find his card useful if the card is not accepted at locations like grocery shops and restaurants, or for utility payments and other uses that constitute a significant share of the cardholders' routine payment needs.

- **Payment confirmation and reconciliation:** A payer would want a confirmation that his payment has been initiated and will be processed as per a defined timeline. This is to serve as a reconciliation record and also as proof that payment has been made. This would help the payer in managing and monitoring his payment account.

For a payee, the factors influencing his choice of payment instruments are similar to those mentioned above, but have some important differences:

- **Cost:** The payee incurs various explicit and implicit costs when accepting a payment instrument. Cash, for example, has associated handling and safekeeping costs. One major implicit cost is the time taken for receipt of funds into the payee's account. The longer the delay, the higher the cost in terms of unearned interest and/or higher liquidity management costs, among others.

- **Acceptance:** In general, the payee would want to accept those payment instruments that a significant proportion of the payers like to use (i.e., "payer's choice"). Some payment instruments will require the payee to have some type of deposit account with a bank or another payment service provider. In addition, for some instruments the payee will need to deploy certain infrastructure, like POS terminals and the associated telecommunications means.

- **Safety and reliability:** The payer needs to trust that the payment instrument he has accepted will be processed as expected and the payment will be honored. This includes aspects like assured processing timelines, system uptime, non-repudiation of payment, and settlement finality.

- **Payment reconciliation and audit trails:** A payee needs payment reconciliation information to enable proper bookkeeping. Payment audit trails are also crucial, for example when defending repudiation related claims.

Source: "Developing a comprehensive national retail payments strategy" (World Bank, 2012)

Recommendations

60. Expand access to the ACH beyond banks. Currently only banks are direct participants to the ACH. However, the market and the end users would benefit if the ACH was open to non-bank financial institutions so that they could also initiate credit transfers and direct debits, especially for the facilitation of cost-efficient remote payments which cannot be conducted using debit/credit cards.[18]

61. Improve the risk management of the ACH by eliminating the practice of unwinding. Through this practice, participants are exposed to credit and liquidity exposures which in extreme circumstance can lead to knock-on effects and systemic risk. Instead, other suitable risk mitigation measures should be used such as a settlement guarantee fund.

62. Undertake a cost-benefit analysis for adopting ISO 20022 standards for clearing messages going through the ACH. The eventual migration to ISO 20022 standards would allow for process efficiency given that they use extensible markup language (XML) syntax and have a common data dictionary that can support end-to-end payment message flow. However, it should be ensured that any investments needed from banks will not be passed onto end users as additional fees. In this context, a cost-benefit exercise can help clarify if the returns from the adoption of ISO 20022 can compensate for the initial investments from banks.

63. Consider implementing an Instant Payment System. Since financial inclusion is one of main priorities of the Bahamian authorities, implementing an Instant Payment System (IPS) could help with the goal and with filling some of the gaps in the current payments infrastructure. From an infrastructure point of view, an IPS could be operated by the central bank, as is the case with other countries that have already implemented.[19] Instant payments facilitate the exchange (settlement) of funds between the payer and the payee in real-time (less than 10 seconds), thus addressing the challenges that the archipelago nature of The Bahamas brings to access and usage of electronic payments. Instant payments are used for a number of use cases, including person-to-person transfers, business-to-business payments, bill payments, and government payments. Moreover, instant payments have the potential to be used at the point of sale through QR code payments acceptance infrastructure, that is typically easier to install and maintain. When merchants accept an instant payment, their account is credited in real-time. This could also decrease the demand for physical cash in the Family Islands. Specifically, some of the IPS characteristics include:

- Interbank execution of instant payments – i.e. exchange of payments between its participants (banks, other payment service providers, etc.) measured in seconds;

[18] See footnote 1.

[19] For more on the countries that have already implemented instant payments, please see CPMI (2016) report available at: https://www.bis.org/cpmi/publ/d154.pdf

- Central addressing scheme enabling client identification using "alias" e.g. tax id number, phone number, e-mail address, based on which participants in the system can obtain other data necessary for the execution of instant payments;

- Instant bill payments and obtaining bill information.

64. In upgrading existing payment systems or introducing new ones, ensure interoperability. When expanding existing payment systems or implementing new ones, the issue of interoperability needs to be taken into consideration. In other words, the different systems need to be on same standards and technology requirements so that they communicate with each other and facilitate the exchange of funds from one system to the other, without time delays or major costs. The central bank can influence the issue of interoperability by using its catalyst role or by including interoperability in its regulatory framework. The banks, non-bank financial institutions (NBFIs) licensed as e-money issuers and the CBOB should aim to achieve Account-to-Account (A2A) interoperability between bank accounts and e-money accounts, as well as among e-money accounts themselves (when more than one e-money issuers start operating in the country). The final objective is that an individual or merchant that has a transaction account, with any service provider, will be able to use it seamlessly with any other payer or payee throughout The Bahamas. Interoperability is not only beneficial to end users but to providers as well given that it allows for cost sharing.

65. Complete full migration to chip-based payment cards. In order to increase the safety of debit and credit cards, all commercial banks in The Bahamas should complete the migration process to EMV (Europay, MasterCard, Visa) payment cards (as is the new global standard) and also invest in the necessary infrastructure upgrades for POS terminals. The CBOB should indicate a designated timeframe for all banks within which the full migration needs to occur.

66. Differentiate between debit and credit card merchant discount rates. The current model of applying the same MDR for debit and credit cards does not have any economic justification and serves as a disincentive for merchants to accept debit cards. As such, acquiring banks need to revise the current fees they charge to merchants, and ensure that a differentiation for debit and credit cards is in place, given the different interchange fees they pay to issuing banks.

67. Provide incentives to merchants for accepting electronic payments. In order to further encourage merchants (particularly small ones) to accept electronic payments (traditional infrastructures or light infrastructure), the Ministry of Finance could explore fiscal or monetary incentive schemes to offer. Such incentive schemes could be of subsidizing nature for the installment and maintenance fees of the terminal, or direct monetary incentives based on the number of electronic payments accepted.[20]

[20] For more on merchant electronic payment acceptance, please see the World Bank and World Economic Forum (2016) study available at: http://www3.weforum.org/docs/Innovative_Solutions_Accelerate_Adoption_Electronic_Payments_Merchants_report_2016.pdf

68. Conduct financial literacy campaigns for merchants: Given that many small merchants face difficulties with understanding the benefits of accepting electronic payments as well as the charge structure of the fees they pay to the acquiring bank, the Small Business Development Centre (SBDC) along with the CBOB could play an important role in conducting financial literacy campaigns and seminars for merchants.

69. Put in place an action plan for reducing the use of cheques among businesses: An action plan is imperative for the reduction of cheque usage in the Bahamian market. Based on the industry's indication, most cheques are used for person-to-business payments in the context of salary payments, and business-to-business payments in the context of payments to suppliers. The Chamber of Commerce along with the banks can take a proactive role in informing businesses about alternatives to using cheques. Presently, the higher cost to processing cheques at the ACH and the high cost of cashing cheques out has not deterred the different actors from using them. As such, in the medium-run, the CBOB might also have to also take regulatory measures such as passing a regulation stating that transactions with high values (i.e. RTGS floor limits) should be made only through credit transfers and follow the model of many other countries including banning the use of cheques in the country.

D. Financial Inclusion – Account Access and Use Cases

Role of Payment Service Providers in the Context of Financial Inclusion

70. Banks have been the main service providers of payment products and services up to this point in The Bahamas. Nevertheless, they have not managed to fully cover the needs of the market or go beyond offering the traditional electronic payment instruments (i.e. payment cards, credit transfers, direct debits). This is evidenced by the fact that a number of them have removed their physical branches from Family Islands while individual and merchant fees pertaining to account and payment services remain high.

71. Banks charge a fee for opening an account, maintaining an account, as well as for ATM cash withdrawals. According to a CBOB survey on consumer satisfaction pertaining to banks, the average monthly fees associated with an account vary between B$5–$19.[21] Based on the same survey, 40 percent of the respondents reported that they do not understand the structure of the fees they are charged. Moreover, 78 percent of the respondents find overall fees to be high and somewhat high, with the ATM withdrawal fees being the most commonly viewed as costly.

72. Banks in The Bahamas require show of a passport or two other forms of identification in order for a client to open a bank account. Due to central bank intervention, banks have moved away from asking for proof of physical residence and instead require a valid email address or phone number. While a bank account can be opened within a day, it might not be fully functional until the

[21] CBOB consumer survey (2018) available at: http://www.thebahamasinvestor.com/wordpress/wp-content/uploads/2018/04/075358700.pdf

next day or the day after because of due diligence and screening processes that have been completed. Such processes take even longer for corporate accounts.

73. In the context of financial inclusion, there are certain population segments that the banks have not been able or willing to attract such as the migrants, elderly, people with low income that do not bank frequently and people in Family Islands. In addition to the aforementioned reasons related to high costs and lack of physical presence in some of the Family Islands, banks have not fully utilized new technologies and electronic access channels. For example, there is a large potential for banks to collect utility bill payments and government payments via internet or mobile banking (i.e. credit transfer or direct debit) so that cash payments at branches are avoided. While some banks are offering those channels, they can further improve them by offering user friendly, full internet/mobile banking packages where the user can find all such services in one place. Furthermore, in order to make such offerings more attractive, the fee structure should be such that the public or private institution for which the bank collects payments bears the fee rather than the user/payer. Informational campaigns will also have to be deployed on an on-going basis alongside those offerings for users to understand the benefits.

74. Banks should also design tailored bank and payment products depending on the characteristics and needs of the population segments that they have not attracted thus far. Some banks are already issuing prepaid cards in order to cover the needs of employers who want to pay employees without a bank account and as such, are doing away with cash and cheques. Similarly, electronic direct debits which require a one-time authorization, could be of value to people living in the Family Islands for utility bill payments as users would not need to pay in person using cash at a physical location or mail a cheque.

75. Credit unions play an important role in the payments realm of The Bahamas, given that they tend to work with clients of different sociodemographic profile than banks. Credit unions are accessible to everyone in The Bahamas. There is a one-time membership fee, but no other fees related to account opening and/or maintenance are applied. Moreover, the account holders in the credit union become automatically shareholders, which makes the business model different than those of commercial banks.

76. There is appetite from credit unions in The Bahamas to be more involved in providing payment services and products and thus to play a more proactive role in contributing to financial inclusion. Unlike banks, credit unions have physical presence in small Family Islands. The large credit unions have partnered with commercial banks in order to provide debit and credit cards to their clients that can be used for payments and cash withdrawals.

77. Some credit unions have also expressed interest in issuing payments cards directly, circumventing commercial banks, but that would require them to forge direct partnerships with the international card networks. The fact that the settlement of domestic card transactions happens in commercial bank money in The Bahamas is also an enabler, vis-à-vis settling through the RTGS which would require an account with the central bank.

78. Credit unions have also expressed interest in being able to process credit transfers and direct debits which would require them to become direct participants to the country's ACH. An attempt was made by one of the major credit unions, but it was not successful despite their comprehensive business plan and technological preparedness. Membership to the ACH of credit unions can have a positive impact because it would expand services for the end users as well as decrease the use of cash and cheques in the areas they are present, particularly in the Family Islands.

79. A number of credit unions engage in bill and government payment collections although they can offer more in this area if they have direct access to the ACH since currently they collect payments primarily in cash and cheques. Additionally, some credit unions have indicated that they are exploring the opportunity to partner with international money remitters in order to facilitate cross-border money transfers.

80. The Bahamas Postal Service has a bank component (Post Office Savings Bank) which enables it to hold deposits that yield interest. However, the Post does not issue any payment instruments other than money order. Its physical presence in almost every inhabited island presents large potential for utilizing its banking arm in order to reach the unbanked or underbanked communities. However, in order to be a viable alternative to commercial banks and credit unions, more progress is needed in terms of modernization and deployment of new technologies and automated processes to allow for electronic payments given that presently all its internal activities are performed manually.

81. Money transfer operators have also established physical presence in many remote areas in The Bahamas. In addition to facilitating domestic and cross-border fund transfers, they also collect bill payments on behalf of utility companies and government agencies in some instances. The migrant community tends to use money transfer operators more than banks to transfer funds due to lower fees as well as the fact that most migrants are unbanked and deal primarily in cash.

82. E-money products can be a great supplement to the Bahamian payments market even though there is only one e-money issuer that is not fully functional yet. E-money allows for different types of payments (e.g. person-to-person, person-to-business, person-to-government, business-to-business, business-to-government). Moreover, the infrastructure needed for accepting e-money at merchants is typically light and mobile (quick response codes and mobile POS), adding to the convenience and cost efficiency of accepting electronic payments for merchants. Overall, such solutions could replace the need for physical cash in the Family Islands whereas consumers can accept their funds electronically but also use them as such at the point of sale, without the need of withdrawing physical cash.

83. Financial inclusion can be boosted immensely from the expansion in activities of existing players as well as the entrance of new players such as e-money institutions. The Bahamian payments market would benefit from competition and the deployment of new interoperable technologies that would bring convenience, cost efficiency and less reliance on physical cash.[22]

Government Payments

84. The government of The Bahamas has made significant progress in terms of digitizing government disbursements,[23] which to a large extent are channeled to the bank accounts of the beneficiaries. The Treasury holds accounts with two commercial banks in the country through which it executes payments on behalf of all government agencies. The different government agencies send payroll, pension, and social assistance payments information to the Treasury which then initiates its payment orders in batches through its commercial bank accounts. The commercial banks, based on the payment orders they receive, disburse funds to the beneficiaries' accounts, if the beneficiaries' accounts are in the same bank as the Treasury accounts or transfer the funds to other commercial banks (through the ACH) in order for the final disbursement to occur. While the funds eventually reach the beneficiaries accounts, the process is not streamlined in that commercial banks play a large administrative role on behalf of the Treasury by matching beneficiaries' information and accounts and doing the final disbursements to individual accounts.

85. The reason for the absence of a streamlined process is that the Treasury does not have a Treasury Single Account (TSA) model in place, which means that for the funds to reach the beneficiaries accounts, the aforementioned multi-step process needs to occur.

86. The Treasury does not have an Integrated Financial Management System (IFMS), which means that each agency uses its own accounting software system, different from that that the Treasury uses. As such, when agencies send payments information to the Treasury, they enter the information separately into the Treasury's system, a process which requires extra time and resources.

87. On the collection side of government payments, cash and cheques are still prevalent, particularly for the Customs agency which collects about 80 percent of all its payments in cash and cheques at the ports of entry. Depending on the port and the volumes of cash/cheques collected, they are transported to the nearest bank branch on different time intervals. Even though many ports (except for six islands) have a POS terminal for accepting debit/credit cards, they are not sufficiently utilized. The payer has also the option to pay at a bank branch or through internet banking but in that case a transaction fee is charged to the payer. The Customs agency is in the process of exploring the implementation of a payments gateway on its website.

88. Although there are different types of taxes collected in The Bahamas, the main ones are the business license tax and the value added tax (VAT). The payer has an option to pay through the agency's payments gateway via debit/credit card, internet banking, or at the bank branch of a particular bank branch where a B$10 charge is incurred. Cheque payments are also an

[22] The digital currency project contemplates interoperability.

[23] For financial inclusion purposes, the main use cases of government disbursements are: public sector salaries, pensions, and social assistance payments.

option but the delays in those cases are significant given the geography of The Bahamas but also the slow service of the postal office.

89. The bus transportation system in The Bahamas functions entirely on cash. Bus tickets constitute one of the use cases with a high potential in the country given that there are approximately 400 buses covering the equivalent number of routes. Presently, the Ministry of Transport outsources the different routes to private franchise based on an annual permit. Despite the fact that the different routes are covered by different bus companies, the ticket purchase/collection method is common given that a flat fee ticket charge is collected in cash by a bus conductor from each passenger. However, the Ministry of Transport plans to get involved in working together with the bus franchises in order to explore the possibility of a plan that would digitize the ticket system and introduce the infrastructure needed.

90. When banks collect funds on behalf of the government, they need to fund the Treasury's account at the end of the day as they do not have the right to hold government funds overnight. The Treasury pays banks a fee for the services of disbursing and collecting payments on behalf of the different government agencies.

Remittances

91. Even though there are some domestic remittances taking place within The Bahamas, the vast majority are cross-border outgoing remittances. The cross-border remittances are mainly facilitated through informal channels (in the case of illegal migrants) or through money transfer operators by cash-in/cash-out processes.

92. Given that migrants tend to send a large portion of their income to relatives outside the country and as such do not keep funds in a transaction account, they have not been particularly targeted by commercial banks as a potential clientele. However, cross-border remittances constitute a use case with large potential to drive electronic transfers. In this context, banks can play a more proactive role by offering products and services (e.g. prepaid cards) tailored to the needs of the migrant community that go beyond just the transfer of funds. Moreover, given that most banks in The Bahamas are international banks with presence in many other countries, this could make it easier to facilitate account-to-account transfers for migrants to destination countries and banks should utilize more such synergies. This constitutes an effective way to reach out to the unbanked migrant population and expand financial inclusion in The Bahamas.

93. Financial institutions (banks and money transfer operators) offering cross-border fund transfers in The Bahamas have not been immune to the global phenomenon of de-risking. A number of such service providers have lost their relationship with correspondent banks or have had additional requirements imposed by their correspondent banker, which have often led to higher fees for the end users.

Bill Payments

94. Bill payments in The Bahamas are primarily made in cash and cheques, even though alternative electronic channels are in place. For example, the major telecommunication companies collect their bill payments at their stores or through agents, in cash. Other collection channels they offer include online payments gateways, POS terminals at their stores, and internet banking. The transaction fee is typically borne by the telecommunication company itself.

95. The electricity provider in The Bahamas also offers a number of access channels for the collection of the utility bill payments: administrative offices (cash), agents (cash), cheque mailing, payments gateway, and banks in cash or through electronic credit transfer. However, almost half of the payments are made in cash. The transaction fees for the bill payments, regardless of the channel chosen, are borne by the utility provider.

96. Overall, utility providers in The Bahamas are exploring ways to create their own closed-loop system, whereas the user can purchase credits and store it in their mobile wallet, and pay for services given that most of them offer prepaid products. This addition is expected to decrease the cash/cheque collections and drive more payments towards the electronic mobile wallet.

Financial Literacy

97. Financial literacy is an important driver to further advancing financial inclusion in The Bahamas. According to a 2018 financial literacy survey conducted in The Bahamas using standardized questions from the Organization for Economic Cooperation and Development (OECD),[24] less than half (42.3 percent) of the respondents were able to provide answers to basic questions about financial computations and concepts around interest rates, including the compounding effects of interest rates. For its member states, the OECD has a target rate of at least two-thirds (66 percent) of respondents indicating financially responsible behaviors. Only 58 percent of the respondents in The Bahamas sample gave financially responsible responses to questions relating to such behaviors.

98. In May 2018, the CBOB along with the Association of Banks, launched a national financial literacy campaign, "Get Money Smart Bahamas".[25] The campaign, which is ongoing, has a dedicated website and social media tools in order to interact with audience of different ages in a variety of ways. It includes different themes among which training on online banking, electronic payments, so that people become less dependent on physical cash. The website also offers short themed courses and upon completion the person is awarded a certificate (the Financial Freedom Certificate). As the website states, "*the goal of this campaign is to equip Bahamians of all ages and*

[24] "An Analysis of The Bahamas Financial Literacy Survey", Central Bank of The Bahamas, 2018.

[25] More on the financial literacy campaign available at: https://www.getmoneysmartbahamas.com/

socio-economic backgrounds with the knowledge and confidence they need to make sound financial decisions."

99. In order to further enhance financial literacy, campaigns and other efforts will be needed from all relevant actors, and in the process, the National Payments Committee will be of importance in order to come up with a common agenda. Moreover, financial education is not part of the formal school curriculum in The Bahamas and in this context, adding it might have benefits to the younger generations (i.e. future consumers and users of the payment services) and can potentially have positive spillover to the older generations as well that have a younger member in their households.

100. The International Gateway for Financial Education led by OECD provides principles and frameworks for integrating financial education programs in the formal school curricula of countries and provides examples of how a number of countries have achieved the integration.[26] The World Bank has also developed a set of tools on financial literacy (under the consumer protection framework) that the central bank and the government of The Bahamas could benefit from.[27]

101. Financial literacy efforts should target the main aspects that inhibit individuals and merchants to change their payment habits. Hence, the efforts specifically address how accounts can effectively help meet an individual payment and store-of-value needs, and should also target specific "fear" factors, such as: (i) perception of lack of sound proof of payment if paper is not used; (ii) fear that the new modalities may be vulnerable to fraud; (iii) fear of dealing with unresponsive, complicated systems prone to operational error; (iv) perception of loss of privacy; (v) perception of cost structure associated with the different payment instruments.

Recommendations

102. Design a National Strategy on Financial Inclusion and Payments. The CBOB has undertaken various initiatives in the area of financial inclusion and payments. As such, it would be timely to create an action plan/strategy looking at the interlinkages of financial inclusion and payments. This would serve as a roadmap for the CBOB but also for other public and private sector actors which have a role to play in facilitating financial inclusion and shift toward electronic payment instruments. Moreover, such a strategy would give impetus to the National Payments Committee and offer for a more structured division by working groups for the implementation of the strategy.

103. Design a basic bank account product for the unbanked. While the unbanked population in The Bahamas is driven by different reasons, one of them is the fees associated with opening and maintaining a bank account for those under low income. As such, The Bahamas could benefit from

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[26] More on the OECD financial education frameworks available at: http://www.financial-education.org/home.html

[27] More on the World Bank financial literacy work available at: http://documents.worldbank.org/curated/en/775401468171251449/Oversight-frameworks-and-practices-in-114-economies-full-report

the introduction of a "basic" bank account with simplified identification (ID) requirements that would allow for initiating and receiving payments, at low fee for those individuals that have never held an account before. This type of account be based on the model introduced in the Payment System Directive 2 (PSD2) in the European Union. While the pricing will be up to the banks, in determining the pricing structure for usage and other features of the basic account, banks should bear in mind that their key target population are poor individuals for which a minimum balance requirement is not likely to be a viable option and which in addition may potentially receive some type of social transfers from the government. In any event, these basic accounts will make it possible for the respective target populations to transfer (receive) funds and pay electronically to/from as many parties as possible, but in particular to/from those parties with which these individuals transact regularly for routine issues.

104. Conduct campaigns for training and incentivizing individuals in remote areas to sign up for transaction accounts. Given that one of the central bank's objective is financial inclusion, access to some type of transaction account is a prerequisite. The central bank should consider expanding its campaigns geared towards households in order to provide them with information and explain the benefits and logistics of signing up for a transaction account (bank or e-money). This way, the central bank could begin to facilitate the means by which to fill the void left from the private market players which might not have a business incentive to reach out to remote areas of particular demographics of the unbanked population.

105. Consider designing a comprehensive digital ID program. Developing a digital identification program (i.e. unique ID) could further ease the process of opening an account and could open the door to e-KYC procedures so that the interested party that wants to open an account can do so remotely. Presently, the banks and other non-bank financial institutions require interested parties to present a passport or two other forms of ID in order to open an account. A national standardized digital ID would standardize the process. It could also help with particular population segments such as children born to migrant parents that do not have a status until they become 18 years old and as such, they cannot get access to banking services until then. For the design of such a program, data privacy standards need to be taken into consideration.

106. Financial institutions other than commercial banks should play a greater role in expanding access to transaction accounts and usage of electronic payment instruments in The Bahamas. Specifically, The Bahamas Post, given its ability to accept deposits and credit unions could provide access to accounts and liquidity in areas and islands where there is no physical presence of commercial banks. Moreover, e-money institutions like IslandPay can also provide access to alternative e-money accounts and also acquire merchants to install light infrastructure such as mobile POS for the usage of e-money products. In all those cases, the government should consider utilizing those institutions for the collection and disbursements of government payments.

107. The Treasury should channel government payment such as public salaries, pensions and social transfers directly to beneficiaries' bank accounts via the ACH. While government payments are currently disbursed to bank accounts, the process is timely and requires multiple steps. Under the suggested approach, the Treasury would execute government payments such as salaries, pensions and social transfers using the ACH directly to the bank account of the beneficiary's choice, sparing commercial banks from having to do the disbursement from a pool account to each beneficiary's account. It would then need to receive from the various government entities the beneficiary account numbers and the amount payable to each of these accounts.[28] Government entities would remain responsible for the accuracy of this information. In a straight-through-processing environment between banks, the Treasury and government entities, reconciliation of payments would be automatic, only caring for confirmation on the payment having been credited to the recipients' accounts.

108. The Treasury should implement an Integrated Financial Management System. The fact that the Treasury and the different government agencies operate all under different information accounting systems creates inefficiencies and delays in the communication, particularly pertaining to payments related information. The implementation of the IFMS would introduce standardization as well as ensure accuracy and speed in the information transmission among government agencies and the Treasury. This is critical given the fact that the Treasury is the main holder of the government accounts and also the executor of payment orders on behalf of all agencies.

109. Implement an e-government portal. Even though individual government agencies offer electronic access channels for government payment collections, the majority of them still occur in cash and cheques. In order to facilitate the shift toward electronic channels, a standardized and comprehensive collection on an online "one-stop shop" portal constitutes an important step. The Ministry of Finance has indicated that they are examining this option. An e-government portal, where the user would purchase services and also make government payments electronically would reduce the usage of cash, lead to standardization, reduce the cost of handling cash, and also save payers potential transaction fees they currently bear for some of the government payments.

110. Introduce an electronic bus ticket system. Given that payments for bus tickets constitute one of the large use cases of retail payments (in terms of volume) in the country, the introduction of a digital ticket present a great opportunity for advancing the usage of electronic payment instruments. This could also help users of the public transportation system gain trust in the electronic payment means and also potentially start using them for other purposes in their daily transactions. The fact that the Ministry of Transport is already considering this option constitutes a first step in the direction of a digital transportation system.

111. Continue the financial literacy campaign and also introduce a component focusing on the migrant community. Given that The Bahamas is primarily a remittance sending country, particular attention needs to be given to the needs of the community that sends remittances to family and relatives outside The Bahamas. A portion of this community does not have access to the formal banking system, and either uses informal means of remitting or cash-based money transfer

[28] In this architecture, the back-office work needed from commercial banks to process salary payments would be significantly reduced, which could be an argument for the government to negotiate with them lower fees for processing payments from or due to government entities.

operators. In this context, CBOB and the financial sector could benefit from customized financial education programs tailored toward migrants, such as the Greenback Project of the World Bank.[29] Project Greenback aims at increasing efficiency in the market for remittances through an innovative approach: promote change inspired by the real needs of the ultimate beneficiaries of international money transfers, the migrants and their families at home.

SME FINANCE

A. Overview

112. Based on the available data Bahamian economy seems to be dominated by a large number of very small enterprises with relatively low productivity levels. According to the 2014 PROTEqIN Survey 44 percent of Bahamian firms are medium-sized, 36.2 percent are small (5–19 employees), and 19.73 percent are large (over 100 employees).

113. Improvements in productivity, in particular that of SMEs, could support sustainable raise of GDP growth and employment, thereby promoting equitable and sustainable economic development. According to a recent IDB report the firm-level productivity in The Bahamas is on average 17 percent lower than the average Caribbean firm[30].

114. However, SMEs in Bahamas face difficulty in accessing appropriate finance needed to support the desirable increase of productivity. The main factors that hinder SMEs from gaining access to traditional financial services, particularly loans and credit from banks are: information asymmetry, in which lenders are not provided with sufficient data to accurately ascertain the risk of an applicant; the heavy dependence on collateral by banks to hedge risk of default; and the lack of credit reporting (referencing) systems and information sharing arrangements. Many SMEs are unable to access credit through traditional banking institutions either because they cannot provide the necessary collateral, complete the documentation required or are considered too high risk. According to the WB Doing Business The Bahamas rank 144 in ease of Getting Credit, scoring 30 points and trailing the LAC average of 51.6 points.

115. Strong efforts need to be invested to improve the access to finance and ultimately increase the productivity and the potential for growth of The Bahamas SME sector. To address the mentioned failures of the Bahamian credit system a significant dose of reforms is needed, including legal/regulatory reforms of credit infrastructure, but also facilitation of innovation in financial industry (Fintech).These efforts include resolving issues with: (a) underdeveloped and dated credit infrastructure, (b) design and implementation of government policies, (c) levels of financial

[29] More on the World Bank Greenback Project available at: https://remittanceprices.worldbank.org/en/project-greenback-20-remittances-champion-cities

[30] I. Ruprah and R. Sierra, 2016, An Engine of Growth? The Caribbean Private Sector Needs More than an Oil Change, Inter-American Development Bank.

education and business acumen, and (d) financial consumer protection and consumers' trust in the financial sector.

B. Current Status of Access to Finance

116. Access to finance was ranked as the fourth biggest obstacle for business according to the WB Enterprise Survey 2010[31], following poorly educated workers, trade regulations and competition from an informal sector. While Bahamian enterprises ranked well when it comes to access to bank accounts, 95.7 percent of small firms (5–19 employees) had a checking or savings account compared to the 91.6 percent in LAC, and 100 percent of medium firms (20–99 employees) compared to the LAC average of 95.2 percent, they were behind the LAC region in access to bank lending. Based on the mentioned survey only 28.4 percent of small firms had a bank loan/line of credit compared to LAC average of 41.4 percent, and only 43.6 percent of medium firms compared to the LAC average of 56.8 percent.

117. Similarly, the 2014 PROTEqIN Survey showed that SMEs report rejection rates of their application for bank finance as high as 85 percent (higher than Barbados at 35 percent, Jamaica at 55 percent, and Suriname at 27 percent). The survey also found that less than one-fourth of companies undertaking investment projects in The Bahamas have been funded by private banks.

118. Issues with access to finance are of a systemic nature. Bottlenecks currently exist on both the demand side and the supply side of credit, and creation of appropriate public-sector policies is hindered by the lack of reliable information on SME finance**.**

119. Credit to SMEs is nominally offered by banks and NBFIs. However, bank lending to SMEs is scarce and NBFIs do not have enough capital or distribution networks large enough to make a more substantial impact. Banks focus primarily on large corporate borrowers and less risky salaried consumers leaving smaller enterprises widely underserved**.** Even with ample liquidity, banks are cautious to lend given strained borrowers' debt-servicing capacity and high NPLs. From 2012 to June 2018 private sector bank credit dropped by 11 percent as banks tightened lending standards.

120. As a consequence of tightening lending standards many SMEs are unable to access credit through traditional banking institutions. SMEs are unable to do this either because they cannot provide the necessary collateral, complete the documentation required or are considered too high risk.

121. Increased perception of risk of lending to SMEs drives high collateral requirements. Access to finance is also limited due to the relative low business acumen and financial literacy of

[31] http://www.enterprisesurveys.org/data/exploreeconomies/2010/bahamas#finance--size

small Bahamian entrepreneurs which increases the perception of risk of lending to the sector. This in turn limits many assets-scarce SMEs from access to formal credit products**.**

122. Overreliance on fixed collateral is especially harmful to SMEs. Collateral utilized for lending is mostly land and real-estate. Alternative collateral on movable properties and rights (e.g. accounts receivable, inventory) is not widely used (if at all) due to the lack of innovation propensity in the financial market, as well as legal uncertainties and inefficiencies of creation, registration and enforcement of such collateral.

123. While there are some examples of NBFIs extending credit to SMEs these are still rather small and with limited reach. Most of the existing NBFIs lack needed capital to expand or do not have infrastructure to reach customers. There is also an issue of lack of capacity and knowledge to venture into financing of enterprises so they stick to offering profitable consumer loans to salaried customers. The same applies to credit unions. There is also very little innovation in the financial market which is explained by underdeveloped payments infrastructure and cumbersome and long licensing process for new products.

124. Cost of finance is considered reasonable when compared to other development countries, but the scarcity of it for SMEs is an issue. Average lending rates reported by the CBB in December 2018 for residential mortgages were at 5.34 percent and consumer lending at 13.28 percent with prime rate at 4.25 percent. There is no maximum rate of interest imposed on loans in United Stated dollars. However, under the Interest Act of The Bahamas, a maximum of 20 percent per annum simple interest is imposed on Bahamian dollar loans. Further, under the Money Lending Act the courts may in its discretion vary the terms of any loan, which it considers to be oppressive or unconscionable.

C. Public Sector Policy

SME Policy

125. There is currently no universal definition that would categorize local companies into various brackets based on their size in the context of the local economy. Due to this timely data collection on SMEs and dissemination of that information continues to pose challenges and restricts evidence-based policymaking.

126. Each credit provider has its own categorization based on maximum exposure limits. Local banks have adopted their own definitions of SMEs, which also differ among themselves and are usually based on maximum exposure they are willing to accept against a particular customer. This creates difficulty in collecting uniform disaggregated data on SME lending, which is critical for planning reform actions aimed at facilitating access to finance for SMEs.

127. The lack of consolidated and reliable data on SMEs presents an obstacle to the efficient prioritization of SME development strategies, including for access to finance. Having insight in the actual size and diversity of the SME sector and the available finance can enable authorities to identify realistic opportunities for growth and to formulate adequate policies accordingly.

128. As the authorities embark on drafting an SME policy/act planned as part of the SBDC policy making, proper prioritization of actions under this policy will not be possible without reliable data. In order to address this issue, the CBB should collect data on SMEs lending based on a uniform reporting standard that includes a consistent definition of SMEs and share it with other relevant government agencies. This disaggregated data should serve as inputs to creation / update of SME development policies.

129. A realistic criterion for categorizing firms in the micro, small and medium category should be established. There are three main approaches to establishing these criteria, based on: (1) the number of employees; (2) annual turnover; and (3) total assets. The SME draft Act explicitly mentions that the national definition of a SME will be based on the combination of the following: Industry, Annual Sales, Employment Level and Ownership (Capital Structure). A key challenge in establishing this criterion is that different stakeholders find different criteria more useful. For example, a government department aiming to grow employment would likely be more interested in the number of employees as an indication of employment creation potential. A bank designing credit products for SMEs, however, would likely be more interested in annual turnover as an indicator of cash flow. The different criteria are also not necessarily interchangeable – a retail trader, for example, may have few employees (meeting the micro criteria for employee count), but may generate relatively high income selling high-value goods (meeting the medium criteria for annual turnover or total assets). Deciding on the appropriate and locally applicable definition will only be possible with the engagement of all relevant Bahamian stakeholders (MoF, CBB, other relevant agencies, and representatives of the private and financial sector). A possibility to introduce a purpose driven definition just for the financial sector development purposes should also not be discarded.

Financial Grants – Economic Empowerment Funds

130. The GoB has put in place various public-sector finance support programs aimed at supporting access to finance for the enterprise sector. These include equity investment and start-up support funds through Bahamas Entrepreneurial Venture Fund, direct lending through Bahamas Development Bank, and partial credit guarantees funds that used to be run by the MoF.

131. However, these funds have had legacy issues with governance, overall performance, setting realistic investment targets and timely claim processing. For example, the Small Business Guarantee of Loans[32] and the Tourism Development Loan Guarantee[33] previously ran by the MoF were described by market participants as unreliable and burdened with slow and very bureaucratic

[32] The fund was guaranteeing loans up to BS$250,000 dollars on maximum term of 10 years.

[33] The fund was guaranteeing loans up to BS$500,000 dollars on maximum term of 15 years.

claims processing. Another example is The Bahamas Entrepreneurial Venture Fund with a minimum (floor) investment set at US$50,000 which is considered overly high for the domestic start-up needs.

132. These inefficiencies undermined the well-meaning effects of these initiatives. Private banks were unwilling to continue to rely on the credit guarantee schemes as the recovery process was not reliable. Another example is the high minimum investment floor of the venture capital fund which is a barrier to entrepreneurs that need less of investment or causes them to artificially inflate their business plans in order to qualify for finance.

133. Authorities are currently planning to set up a new credit guarantee scheme that would be led by the newly created agency focusing on SME policy (SBDC). It is important to structure this new fund in a way that would provide meaningful contribution to extension of credit to SMEs. Although the final proposal has not yet been made public, the fund's governance structure, lending criteria and claim processing will have to be set-up in a way to instill trust of the private sector, respond to the realistic needs of the SMEs and attract interest of private banks. In addition to providing funding the SBDC is planned to be provider of financial education activities. A move that is most welcome.

134. Other existing programs should also be reviewed to make sure that they are set up and governed in a prudent way and that their lending activities and investment floors reflect the realities and needs of the SME market. The evaluation should be followed up by a potential reorganization and consolidation of funds where needed to increase the coordination, achieve economies of scale and improve development impact of these schemes.

135. Also, a formal coordination mechanism between various empowerment funds and institutions is still missing. **Efficient coordination and a clear action plan would ensure that enterprises are provided coordinated and consistent support on their growth trajectory (see Box 1).** A formal strategy/action plan and coordination mechanism, potentially through SBDC, would ensure that a piecemeal approach to supporting access to finance is avoided and businesses are helped through different stages of their development. Coordination would ensure that viable businesses are supported to graduate from start-up grants to banking with private banking sector (facilitated by partial credit guarantees).

Box 2. Different Stages of SMEs' Development/Funding Needs

At the start of a small business or during the seed stage, personal savings of entrepreneurs, family and friends, as well as second mortgages on property are often the most important sources of financing, as these firms tend to be highly risky with intangible assets, a lack of trading history and informational opacity.

At the second phase of development during the start-up stage, external sources of funding become necessary. At this stage, the investment in small businesses is still regarded as high risk and the business is not large enough to attract the attention of venture capitalists. Government grants or other programs for seed funding become relevant, especially for innovative firms. Wealthy individuals like business angels can also fill the gap between personal funds and institutional finance.

After the small business has passed through the early stages, it requires a further injection of capital to fund growth. At this stage, the SME may still not qualify for longer term debt financing due to its reliance on intangible assets, inability for investors to assess its future growth prospects, low profitability and short track record. This is where alternative lending products such as leasing and factoring, invoice discounting platforms, marketplace finance platforms, integrated on-line merchant platforms and alternative credit scoring come useful.

In the more advanced stages, the firm has established a track record, has the ability to provide collateral and information regarding its performance and has become more transparent, such that it may access longer term lending. Development of corporate governance structures, real-estate registries, as well as debt and potentially equity capital markets becomes relevant in this stage.

Public Procurement and G2B/B2B Payments

136. While the mission team was unable to acquire reliable statistic, anecdotal evidence confirms that one of the causes of liquidity problems for Bahamian businesses are often late payments of their accounts receivable. Long payment terms and late payment (arrears) for products and services places a burden on their working capital management. Businesses need to ensure that they have the necessary cash flow to operate efficiently. Based on discussions with the local private stakeholders, there are often long payment terms for payment for products and services and there are frequent occurrences of late payments that are not consistent with the contractual terms. This includes payment delays from both the private and public sector, although it differs from an agency to an agency.

137. Authorities have undertaken several reform projects recently with the aim to improve the management of public resources and increase efficiency of public procurement. These efforts include the Public Financial Management & Performance Monitoring Reform Project and the eProcurement and Supplier Registry. The eProcurement and Supplier Registry (ePSR) was also introduced as the electronic procurement system that is meant to facilitate the execution of online procurement activities. It is web-based and enables access to opportunities and contracts offered by the GoB, as all offers are displayed on the ePSR website. Authorities also made announcement that under the new public procurement act 20 percent of all procurement of local products and services would be tendered from local SMEs.

138. To fully complete the cycle, these efforts to improve management of public resources and include SMEs in public procurement should be complemented by strict commitment of the government and the private sector to pay their payables to SMEs in time. Introduction of a late payment law / rules could help to decrease the level of arrears to suppliers by incentivizing compliance with agreed payment terms. While the current legal framework allows for penalty interests to be contractually agreed, it is not often utilized. A well-regulated term for payments and automatically applied minimum penalty interest could help incentivize compliance with the terms of supplier contracts. The penalty interest rate should be based on an easily accessible market reference rate and a penalty margin. The rules should ideally not oblige a creditor to claim interest for late payment, but rather allow the possibility for a creditor to resort to charging interest for late payment without giving any prior notice of non-performance or other similar notice reminding the debtor of his obligation to pay.

139. This would in turn enable access to working capital finance for SMEs based on their receivables as these would become bankable. Increased legal certainty of payments and strict commitment to pay penalty in case of late payment would make SME receivables against government agencies a valuable collateral enabling them to access formal finance by discounting them to finance providers. It would also demonstrate the authorities' commitment to improving public finances management and send a strong signal of support for SME development.

Recommendations

140. Enact SME act with clear development goals and targeted support for SMEs.

141. Define SMEs for data gathering and policy formation purposes. Defining SME category will facilitate reporting on SME lending and ensure that SME disaggregated information from all credit providers is collected.

142. Consider the introduction of a late payment law (strict payment terms and penalties) for payments to SMEs applicable both to private and public-sector contractors.

143. Introduce formal co-ordination mechanism and action plan for cooperation between public empowerment funds targeting SMEs (credit guarantee schemes, development bank and venture capital fund).

144. Revise governance of empowerment funds. Introduce transparent and efficient claims procedures as well as revised investment limits reflecting realities of the start-up market in the economy (venture capital fund).

D. Credit Infrastructure

145. Development of financial infrastructure is critical for improving access to finance for SMEs. While all firms benefit from improvements in financial infrastructure, the benefits for SMEs is often greater. This is due to problems of opacity and information asymmetry, as well as the fact that many SMEs lack real-estate and land to offer as collateral. The term financial infrastructure used in this note captures both payment system infrastructure as well as credit infrastructure (secured transactions, mortgage finance, credit reporting and financial technology).

146. The (perceived) risks of extending credit to SMEs cannot currently be efficiently mitigated because of the inefficiencies in the existing financial infrastructure. The financial infrastructure gaps should be addressed through a series of reforms to allow for more diversified product offering, more efficient credit risk mitigation and eventually more affordable finance for SMEs. This includes introduction of functioning credit reporting system, dealing with deficiencies of collateral creation and registration, and improvements of the payments system legal and regulatory framework.

Collateral

147. The main types of collateral (security interests) recognized in The Bahamas originate from the country's Common Law heritage and include mortgages, pledges, debentures, charges, and promissory notes. There is no integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of functional equivalents to security interests in movable assets. Current system is based on various separate legal regimes depending on the type of the borrower and the asset in question.

148. A legal mortgage of real property, personal property and fixtures is regulated under the Conveyancing and Law of Property Act. A mortgage has the effect of conveying and transferring title to the mortgagee (the lender) leaving the mortgagor (the borrower) with an equitable right to redeem the mortgage by payment of the mortgage debt. To preserve priority against subsequent encumbrances it has to be created by deed and recorded in the Registry of Records at the Registrar General Department in accordance to the Registration of Records Act.

149. Companies Act and the International Business Companies Act regulate creation of collateral over assets of a company. Under the acts a company may by debenture charge real property and specific personal property (certain movables) by way of legal mortgage and create a first priority floating charge on all other present and future assets and undertaking (including intangibles) which would crystallize in the event of default. A debenture must be made and issued as a deed and recorded to preserve priority.

150. Choses in Action Act regulates assignment of rights (claims) which is a base for factoring and many other receivables finance transactions. The act provides that any absolute assignment, by writing of any debt or other legal chose in action, of which express notice in writing shall have been given to the debtor, shall be, and be deemed to have been effectual in law to pass and transfer the legal right to such debt or chose in action from the date of such notice. The Act is silent on the ability to assign future claims, or whether a claim can be assigned by electronic means. Another positive element is that assignments can also be recorded in order to preserve the assignment against a subsequent encumbrancer or assignees.

151. **However, the current framework for registering collateral at the Registrar General Department is paper-based, slow, rather convoluted, and lacks flexibility that would satisfy the needs of modern business.** Searches are conducted by search clerks or lawyers. Documents recorded at the Registry of Records are available on microfilm up to 2003. From 2003 onwards documents recorded have been scanned and may be accessed online. This creates legal uncertainty when it comes to establishing competing priorities resulting in decrease of the value of collateral.

152. **In addition, both creation of collateral over real-estate and movables, either through a mortgage or a debenture, attracts stamp duty which is considered substantially high and which puts additional financial burden on borrowers**. Under the Stamp Act, a debenture or mortgage which secures a monetary obligation is taxed by a stamp duty of 1 percent of the monetary obligation secured. This creates significant financial burden and substantially increases average cost of finance.

Credit Reporting

153. **The inexistence of a credit reporting system undermines risk analyses, stifles access to finance for existing customers and newcomers and limits competition.** Creation of an efficient credit reporting system requires establishing an appropriate legal and regulatory framework, gathering support from market participants, identifying appropriate operators (including technology solutions and software), enabling the collection of a wide spectrum of data that is relevant, accurate, sufficient (including positive), and updated regularly, ensuring commercial viability of the service, building the capacity of regulators to supervise the system, and raising awareness of the system and its benefits amongst the regulators, policy makers, data providers, users and consumers.

154. **Positive developments are enactment of legal framework facilitating establishment of a national credit reporting system in 2018 and the recent selection of vendor for the future credit bureau in January 2019.** The Bahamas Credit Reporting Act and Credit Reporting Regulations now regulate licensing of credit bureaus, data collection, processing, data protection, disclosure of information to data subjects as well as provide for a process of disputing erroneous data records. According to the Act the credit information providers are banks, NBFIs (regulated under Financial and Corporate Service Providers Act), credit unions, Bahamas Mortgage Corporation and Bahamas Development Bank. In addition to this, the CBB may also designate as a credit information provider, where it is of the opinion that such designation is in the public interest: including other credit providers, any public registry, utility services providers (water, power, etc.), or any other seller of goods on credit. In January 2019 the CBB invited CRIF S.p.A to apply for the license to establish and operate a credit bureau.

155. **In the near term, the authorities should encourage all data providers to submit data as required by the Act and start using credit information in their credit granting processes as soon as it is available**. The authorities should also invest efforts to make sure that the future bureau starts collecting data from other valuable sources of alternative credit information such as utilities companies and telecommunication services post-paid services providers as allowed by the Credit Reporting Act. Utility payments have promising potential as sources of alternative data, since the

majority of business owners will have a history of electricity, phone and internet bill payments. Given the high market concentration in the country, where one electricity retailer, telecommunications company, and internet provider serve the majority of the population, this minimizes the numbers of stakeholders that need to be incentivized to participate in data sharing. Trinidad through its TransUnion Credit report system is an example of the Caribbean country that has successfully begun incorporating payment records from the national electricity retailer. Both online and physical payments can be recorded and verified. To the extent that an appropriate legal and regulatory framework is developed and the factoring and leasing segments gain traction in the market, this data, other relevant trade data, along with transaction data (merchant, mobile/e-money, marketplace (P2P, B2B) and ecommerce platforms) where available, should eventually be collected by the credit bureau as all these types of information are relevant and critical to assessing the creditworthiness of SMEs.

156. To support alternative data processing which is more and more used by FinTech companies and digital lenders to support their risk assessment process the authorities should also consider appropriate regulatory framework for the release of information upon request by the customer or trusted third party, as well as an adequate, but not restricted data protection mechanism. In the absence of collateral or traditional financial history, the use of mobile data, big data and psychometric testing[34] models, for instance, present alternative ways to make more information about the loan applicant available. Relevant government institutions should be made aware of the latest developments and provide for adequate regulatory environments for data sharing, as well as to support public education around new financial technologies.

Recommendations

157. The collateral registration system should be reformed and a modern digitalized system for registration of collateral should be introduced to decrease legal risks and increase efficiency of collateral taking. The registry should be notice based for registering security interest over movable property and be accessible on line. Revision of the legal underpinnings for creation of security interests is also advised to ensure consistency and enable all type of borrowers to create all type of security interest in all type of property in the same manner which is currently not the case.

158. Stamp duty charges on collateral should be revised and/or lowered. Drafting an SME Policy or an Act as discussed above could be used to lower or completely remove stamp duty charges for certain type of (productive) loans for SMEs in order to make the finance more affordable.

[34] Psychometric scoring is currently seen as a way to bring SMEs and other thin-file clients on board to begin with. There is no order of things of course, and in a market like The Bahamas authorities should pursue all avenues to collect the information (through FinTechs or through the bureau). Regardless of the provider, data used and scoring techniques, there needs to be a mechanism to ensure that all creditors use the most comprehensive information possible. Alternate scoring providers should be encouraged to consult with credit bureaus and vice versa to enable the most comprehensive overview of the borrower’s level of indebtedness.

159. Operationalize future credit bureau and facilitate collection of wide diversity of data. Data from all banks, but also credit providing NBFIs and other valuable sources of alternative credit information such as utilities companies, telecommunication services, and other post-paid services providers should eventually be collected and processed by the bureau. Where available, the regulator should encourage the collection of transactions data, trade credit data, and create the necessary conditions to allow for the development of alternative credit scoring technologies, including the use of psychometric tools to develop credit histories for thin-file clients, and in particular for SMEs.

E. Providers of Credit to SMEs and Credit Products

160. Formal credit market in Bahamas is dominated by banks in terms of lending volumes. Among regulated firms there are also NBFIs providing credit and Credit Unions with relatively large membership base but limited participation in lending volumes and somewhat troubled history. The Bahamas still does not have a very vibrant digital financial services sector providing finance to entrepreneurs but some NBFIs are exploring financial technology and leveraging digitization to offer finance to unbanked and underbanked.

161. The Bahamas financial system regulation and supervision is split between two regulators and regulation is provided in several acts depending on the type of institutions. The CBB is the regulator and supervisor of banking activities and activities of credit unions pursuant to the Banks and Trust Companies Regulation Act and The Bahamas Co-Operative Credit Unions Act. The Securities Commission regulates and supervises provision of the financial services outside the banking and credit unions system pursuant to the Financial and Corporate Service Providers Act. There is no specific legal framework for non-bank providers of microfinance services.

Banks

162. Bahamian banks focus primarily on large corporate borrowers and less risky salaried consumers leaving smaller enterprises widely underserved. Profitability (overhead costs of SME business), low level of SME financial education, informality, collateral issues, lack of credit information, registration of collateral and enforcement (foreclosure) were the most cited reasons why banks tend to stay reserved when it comes to SME finance.

163. Although some of the banks interviewed indicated that they have a specialized department dealing with SMEs this was not the case with majority of the banks. Banks in general seem not to have particular focus on SMEs and the understanding of what are the SMEs differ from a bank to a bank. Bank lending is concentrated in the corporate and consumer lending sectors.

164. Banks are also quite conservative when it comes to their product offering to SMEs. Majority of banks relay on heavily collateralized mortgage finance and overdraft (revolving) facilities. Lending against movable property is generally perceived as risky due to the “real-estate bias”. Banks indicated that borrowers are less likely to repay loans secured with movable property than those secured with immovable property (land or buildings). In addition, unreliable court administration and slow enforcements of property rights in general has a negative impact on the perceived value of movable assets.

165. Invoice / receivable finance products like factoring and supply chain finance are known but not widely offered by banks. The stated reasons are the lack of legal clarity and certainty when it comes to assigning invoices and also the lack of potential clients due to the small base of manufacturing in the country. Lack of; business experience, financial records and electronic invoicing were also mentioned as obstacles for development of factoring finance.

166. Asset based finance and financial leasing are also rarely explored by banks. Limited secondary market for repossessed collateral is seen as the biggest obstacle for developing leasing products. Finance leasing contracts are regulated under the Hire Purchase Act.

167. In order to circumvent the issue of lack of available fixed collateral (e.g. real-estate) or the discounted value of movable collateral banks showed great interest in credit guarantee schemes. Banks seem willing to take on more exposure to SMEs and to put more focus on innovation leveraging new financial products if an efficient and reliable credit guarantees would become available. Due to the negative experience from the past the guarantee funds would have to be managed by a reliable institution, have a clear and transparent claim procedures and reflect realistic lending criteria. They were very specific about using guarantees as a collateral supplement/enhancement only and would not be willing to lower their lending criteria.

NBFIs and Financial Innovation

168. The Financial and Corporate Service Providers Act regulates licensing and regulation of financial and corporate service providers outside the banking system. However, the act does not have a definition of "financial services." Instead the term has been interpreted using the definition issued by the WTO. Hence, according to the official Notice[35] of the Securities Commission, the NBFI financial services, include following activities: Money Lending, Financial Leasing, Money Broking, Credit Extension, Mortgage Broking, Escrow Services, Financial Advisory/Consultancy Services, and Financial Intermediation.

169. The Securities Commission is responsible for ensuring that all persons operate in accordance with the Act and any persons in the business of providing any of the above-mentioned services requires licensing. Due to inexistence of definition in the Act the register of NBFIs does not differentiate between companies licensed to offer different services. This makes it impossible to discern the number of NBFIs that offer credit services against those that are in agent business for example. NBFIs intending to offer financial services have to submit an application

[35] http://www.scb.gov.bs/documents/Definition%20of%20Financial%20Services%20PN%20No%205%20(FINAL24Aug12).pdf

accompanied by the requisite application fee, in order to begin the registration process. Operating without a license carries a significant financial penalty pursuant to Section 18(1) of the Act.

170. Providing definition of financial services in the Act would increase the level of legal certainty. Also, expanding on the current definition would facilitate development of innovative providers of financial services (FinTech companies). To address the failures of the Bahamian credit system a significant dose of innovation is required, especially within firms focusing and specifically targeting SMEs. Lack of legal and regulatory clarity and burdensome licensing procedures limit the penetration of credit products alternative to plain vanilla lending such as: digital credit, supply chain finance (based on e-invoice discounting) and factoring[36].

171. Current interpretation of NBFI financial services stops short from defining receivables finance (factoring) as well as providing legal and regulatory framework for market-place lending (debt and equity crowdfunding). While one could argue that used interpretation of Money Broking—*bringing together suppliers of funds (lenders) and users of funds (borrowers) enabling them to enter into a contract for money transactions such as short-term loans*—could capture crowdfunding activities, based on the anecdotal evidence this is not very clear among potential market players, and the system definitely stops short from providing more detailed rules on rights and obligations of the parties to such transactions, licensing of the platforms, investment levels and alike. Similarly, a definition of factoring services that would introduce minimum standards and uniform terminology for this type of product is also missing. This would also support the judiciary by providing a clear guiding to local courts on how to recognize, interpret and support factoring transactions. Further development of electronic transactions and e-invoicing will also support improvements in the reliability of invoices and contribute to the exploration of various invoice discount techniques.

172. Since tapping into traditional capital markets to raise finance is not a realistic option for SMEs at this moment, development of regulation for alternative retail-based market-place lending (crowdfunding) might provide a viable solution for some medium sized companies willing to explore this type of finance. The Securities Industry (Business Capital) Rules were drafted in 2017 with the intention to allow entrepreneurs to raise capital using crowdfunding, but have not yet been enacted into a law. Supply side bottlenecks for development of Bahamian capital market finance for SMEs revolve around underdeveloped secondary market for potential exits and perceived high risk of investments in medium companies and local start-ups. The demand side issues are again characterized by the lack of entrepreneurial culture, low level of business acumen among businesses and underdeveloped network of support programs (accelerators, mentorship programs, funding opportunities).

173. In spite of these limitations, there are some positive examples of innovation and diversification of product offering from the NBFI sector. In particular, a FinTech NBFI Omni

[36] While some invoice discounting products exist in the market, they are rarely offered since they are neither legally defined, nor does a register of invoices supporting e-invoicing exist.

Financial Group Limited[37] is seriously exploring offering of receivables-based finance to SMEs and venturing into the digital credit products. However, to increase legal certainty and predictability of these transactions, a clear legal definition of the most typical (basic) versions of such products should be introduced.

174. The VAT Act treats all providers of financial services in the same manner and is creating an even playing field between banks and NBFI providers of finance in that sense. The VAT treatment of financial services depends on the type of services being provided and to whom they are being provided and not on who is providing them. In general, financial services supplied to persons or businesses in The Bahamas are exempt from VAT. Financial services supplied to persons or businesses outside The Bahamas are normally zero rated.

175. Apart from some above stated examples, there is in general still very little innovation in the financial market. This is partially explained by underdeveloped payments infrastructure and cumbersome and slow licensing process for new products. Except from the above mentioned FinTech company the mission team was unable to identify other providers of finance to SMEs based on leveraging digital economy. However, the interviewed market players agreed that more of these are expected in the future and that the authorities, the CBB and the Securities Commission in particular, could help by providing more transparency and improving efficiency of the licensing process.

176. Digitization can help bridge many obstacles hampering the development of SMEs. However, FinTech companies that offer specialized cloud-based business services to SMEs (accounting, supply chain management, e-commerce) or specific SME tailored financing do not appear to have started significantly moving into the market yet. Future entry of FinTech companies has the potential to offer SMEs services that would facilitate access to markets, increase their productivity, quality of products and bankability. Examples include platforms for value chain creation linking producers and sellers, white label POS devices to enable merchants in trade and tourism sectors to accept digital payments, working capital financing invoice-discounting platforms, alternative credit data – psychometric testing/mobile data, etc.

177. However, relevant authorities still do not have a formal FinTech strategy and some providers raised this issue as a bottleneck for further development of digital services. Market participants indicated that there is a need for clarity from the authorities on the regulatory strategy for FinTech companies and the countries in the region have started moving forward in this direction. For example, Bermuda has enacted the Digital Asset Business Act in 2018 for regulating the Fintech sector in Bermuda, Anguilla enacted the Anguilla Utility Token Offering Act, 2018 for the regulation of ICOs, while Barbados introduced a regulatory “sandbox”. Market players indicated that this was a

[37] Omni Financial Group Limited is developing a receivables finance program with the support of the IDB. It plans to launch its new accounts receivable financing (factoring) product, combined with a digital platform, to help expand access to finance for Bahamian SMEs. Omni was approved for $1 million funding through the IDB’s Multilateral Investment Fund (MIF), which is a private sector arm of the IDB Group.

barrier for new entrants and expansion of current players. In 2018 The Bahamas Financial Services Board established a Fintech Working group, in order to provide recommendations to the government and regulators. A well-defined FinTech strategy should be developed in order to provide for clarity to potential FinTech investors, as well as to protect consumers from potential abuse.[38]

Box 3. Different Types of Approaches to Promote FinTech and Financial Innovation

Policymakers have adopted a wide variety of policies and tools first in the developed countries and now more and more in the developing world to promote financial innovation:

Innovation hubs: financial regulators offer assistance to firms not used to dealing with financial regulations and/or which have doubts as to whether certain regulation apply to their activities.

Regulatory sandboxes: financial regulators offer a controlled environment for testing financial innovations that meet certain criteria. Sandboxes typically lower barriers to testing within the existing regulatory framework, while ensuring participating customers, institutions and the broader financial system are appropriately protected. If, after sandbox testing, the firm wants to offer its services to the wider market, it shall comply with existing regulatory frameworks applicable to that type of activity. The regulatory sandbox approach also enables regulators to closely observe the innovations in a live environment and thereby have a better understanding of the risks and opportunities. This could also lead to fine-tuning regulatory frameworks.

Public-private partnerships: public authorities support private entities and create a forum for incumbents and start-ups to exchange resources, know-how and experiences and cooperate in the funding and development of innovative solutions.

Recommendations

178. Introduce definition of NBFI financial services in to the Financial and Corporate Service Providers Act.

179. Enact regulation facilitating market-place lending (crowdfunding), both debt and equity.

180. Adopt a FinTech strategy. **The authorities should strive to create an enabling environment for digital finance by monitoring the developments in the Fintech field and by establishing consulting linkages with these companies.** A well-defined FinTech strategy should be developed in order to provide for clarity to potential FinTech investors, as well as to protect consumers from potential abuse. This includes streamlined licensing procedures and regulation facilitating digital contracting, digital reporting (Regtech), API usage and alike. On the other hand, the authorities should also closely monitor potential risks and implement appropriate rulemaking in

[38] In April 2019 the government published the Digital Asset and Registered Exchanges (Dare) Bill for consultation.

the sphere of data management (storage, protection and usage), AML/CFT and financial consumer protection.

181. To increase legal certainty and predictability of factoring transactions, a clear legal definition of factoring and the most typical (basic) versions of factoring products should be introduced. This would also support the swift resolution of conflicts, by providing clear guidelines to local courts on how to recognize, interpret and support factoring transactions.

F. Demand Side Issues (Consumer Protection and Financial Education)

Business License and the Tax System

182. According to the Business License Act every person conducting business within The Bahamas is required to have a business license. Typical business license is the Annual Business License which covers most typical types of business like: retail/wholesale sales, professionals, barber/beauty shops, banking, etc. It is granted to applicants who regularly carry on a business activity. Other two types of business license are limited in time, the Temporary Business License granted to foreign individuals/companies for a job in respect of a specific contract for a specified period of not more than three years and the Occasional Business License which is granted to an applicant to carry on a business activity at an event or another short-term (up to seven days) purpose.

183. However, there is still high level of informality, particularly among smaller firms. According to the WB Enterprise survey percentage of firms competing against unregistered or informal firms is 74.6 percent in small firm segment and 52.6 percent in medium, compared to 65.9 percent and 59.9 percent in LAC region respectively.

184. Business license taxes are calculated based on a percentage of the turnover for the preceding year and the market considers them to be high, especially for medium sized companies. Where the turnover is less than or equal to $50,000 the tax is $100. Where turnover is between $50,001 and $500,000 per annum the tax is 0.50 percent. Where the turnover is greater than $500,000 per annum but not exceeding $5 million per annum the tax is 0.75 percent. Where the turnover is greater than $5 million per annum the tax is 1.25 percent. The government recently announced its intention to revise these numbers and to introduce new categories of tax starting from 0 percent rate to 2.5 percent.

185. The Bahamas' tax collection systems are merged under one umbrella of the Department of Inland Revenue (DIR). The Department of Inland Revenue is an amalgamation of a number of primary tax and revenue agencies, namely: Business License, First Homeowners Exemption, Real Property Tax and Value Added Tax. The unification of these agencies under one umbrella— The Department of Inland Revenue—was undertaken to increase efficiency for the assessment, collection and overall tax and revenue administration. It is responsible for the collection of taxes and administration of all matters under the Business License Act; the Real Property Tax Act; the Stamp Act and the Value Added Tax Act.

186. A business needs to register for VAT if it makes taxable supplies that exceed the VAT registration threshold of $100,000. Taxable supplies include supplies subject to VAT at the standard rate and zero rate. Where the annual turnover from taxable activity exceeds 5 million dollars the registrant has to file by electronic means. in accordance with the Electronic Communications and Transactions Act

187. VAT system is still based on the traditional post-audit system. Firms declare their output tax each month on their VAT Return. They must declare all sales which fall within the VAT period on the relevant VAT Return. Firms' input tax is offset against their output tax and they pay to the Comptroller of VAT the balance.

188. Alternative approach, where issuing of e-invoices is linked to a tax authority system and every invoice gets pre-approved (cleared) in real time, have been gaining momentum in recent years and Bahamas might benefit from considering making the switch. This so called "clearance" system has now been introduced in many countries around the world, the examples include many countries in Latin America, Russia, Turkey and Tunisia. Under such approach the issuance of invoices is directly linked with the revenue authority whose systems digitally approves invoices while assigning unique identifiers to each invoice. These invoices can also be registered in a centralized and public register, and made available for discounting based on electronic assignment. The unique confirmation and registration of invoices increases the levels of trust, improves tax collection and increases the level of enforceability of invoices. All of this in turn increase the appeal of providing finance against accounts receivable.

189. Due to the specifics of the Bahamian tax system where there is no corporate tax, SMEs do not usually keep books and financial records except for the VAT reporting needs. This creates additional hurdle for lending to the sector as access to valuable information regarding business operation is very limited and of questionable reliability.

Financial Education and Financial Consumer Protection

190. Access to finance is also limited due to the relative low business acumen and financial literacy of small Bahamian entrepreneurs which increases the perception of risk of lending to the sector. Increased perception of risk of lending to SMEs drives high collateral requirements. This, in turn, leads to many assets-scarce SMEs not having access to formal credit products.

191. Many SMEs lack a full understanding of financial products and the potential benefits that various solutions might have for their businesses. This lack of understanding causes mistrust of customers towards financial services providers. SMEs suffer from low levels of financial literacy, which affects their ability to decide on appropriate sources of funding, respond to the due diligence requirements, negotiate the terms and structuring of the financing, and manage accounts.

192. There is also no comprehensive financial consumer protection regulation in The Bahamas. While some requirements relating to disclosure requirements and affordable lending exist these stop short from the standard of good international practices. For example, there is no regulated key fact statement document (truth in lending form) for the banks to apply. The high importance of financial consumer protection for the SME sector is based on the fact that according to the WB Enterprise survey 58.2 percent of small firms and 38.1 percent of medium firms are run as sole proprietorships in Bahamas. This means that individuals running these firms face similar risk and demand similar type of protection that would usually be afforded to individual consumers under a well-developed financial consumer protection framework.

193. Improvements in financial infrastructure and provision of financial support through implementation of public financial grant programs needs to be accompanied by targeted business and financial education activities. A lack of financial education and business skills, as well as relatively weak standards of protection of consumers' rights contribute to lack of trust between financial service providers and customers in general. This further undermines access to finance. Due to this the gaps in financial literacy and consumer protection standards need to be addressed.

Recommendations

194. A robust financial consumer protection framework should be introduced followed by appropriate financial consumer supervision practices. The framework should be based on international good practices and appropriately applicable to all regulated financiers. The framework should include detailed rules on disclosure requirements, fair treatment of consumers, and a mechanism for complaints handling and dispute resolution.

195. Continue expanding the SME training segment of financial literacy campaigns and make it a permanent topic of financial education strategies.

196. Undertake a feasibility study on the introduction of the so called "clearance" VAT system. This would support development of e-invoicing and bring the positive effects for formalization efforts, increase quality of credit information and reduce risk for factoring transactions.