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Thriving in a digital world

Draft Digital Asset Guidelines Consultation Paper

KPMG Risk Consulting

On 28 December 2022, the Central Bank of The Bahamas ("CBOB" or "Central Bank") issued a consultation paper on proposed requirements for digital asset activities in The Bahamas. The proposed requirements outline the regulatory expectations surrounding the governance, risk management, acceptable forms of engagement, prudential treatment and reporting requirements for supervised financial institutions ("SFIs") engaged in or seeking to engage in digital asset business activities.

The comment period closed on 27 February 2023.

What is the Central Bank aiming to accomplish with these guidelines?

- **Establish supervisory oversight** for supervised financial institutions offering digital asset services
- **Regulatory expectations** for interacting with digital asset service providers
- **Adoption of international standards** on the prudential treatment of banks with digital asset exposures (Basel Committee on Banking Supervision - Chapter SCO60 Cryptoasset Exposures)

Who will be affected?

The proposed guidelines apply to all supervised financial institutions engaged in, or seeking to engage in, digital asset business activities. Digital asset business activities are defined by the Digital Assets and Registered Exchanges ("DARE") Act as follows:

- A digital token exchange;
- Providing services related to a digital token exchange;
- Operating as a payment service provider business utilizing digital assets;
- Operation as a digital asset service provider, including providing DLT platforms that facilitates –
  - The exchange between digital assets and fiat currencies;
  - The exchange between one or more forms of digital assets; and
  - The transfer of digital assets
- Participation in and provision of financial services related to an issuer's offer or sale of a digital asset; and
- Any other activity which may be prescribed by regulation

Central Bank SFIs:

- Banks and trust companies
- Co-operative credit unions
- Electronic money service providers
- Money transmission businesses
- Private trust companies
- Registered representatives

Additionally, banks with digital assets exposures, and any SFIs doing business with a digital asset service provider, are also affected.

How Central Bank classifies digital assets for prudential treatment?

The consultation period end February 27, 2023, and there has been no provided timeline on industry implementation.

What are the proposed new requirements?

Governance & Risk Management	CBOB sets oversight and risk management expectations for SFI's management and Board. **Senior Management** should ensure that the Board has granted approval prior to engaging in digital asset activities. **Board of Directors** must also approve and maintain oversight of senior management's execution of their risk management framework. Risk management framework governing digital assets activity should be fully integrated into the overall risk management processes and accounted by full scope of possible risks associated with the activity. Any increase in risk related to digital asset activities should be incorporated into the SFI's Internal Capital Adequacy Assessment Process (ICAAP).
Off-site Supervision & On-site Examinations	Digital asset activity will form part of CBOB's routine supervision and inspection processes where SFIs can expect evaluation and review of their strategies, policies, procedures and management relating to these activities. **Strategy** **Policies** **Procedures** **Management**
Prior Notification for Digital Asset Engagement	Prior notification must be given to Central Bank before engaging in any of the following: ▪ Issuing token offerings; and ▪ Onboarding relationships with Digital Asset Service Providers
Prudential Treatment	Central Bank sets out the prudential treatment of banks' exposures to digital assets, including tokenized traditional assets, stablecoins and unbacked digital assets. A classification system for grouping digital assets along with qualifying criteria is outlined. For the purposes of credit, market and liquidity risk, the prudential treatment of a bank's digital asset exposures varies according to the prudential classification of the asset.
Reporting Requirements and Disclosures	Also, as a part of Basel Pillar 3 requirements, SFIs are expected to report both qualitative and quantitative information regarding business activities, risk and risk management of their digital asset exposures. SFIs must include exposures to Group 1 digital assets in the relevant existing Excel Reporting System (ERS) forms that apply to traditional assets.

How Central Bank classifies digital assets for prudential treatment?

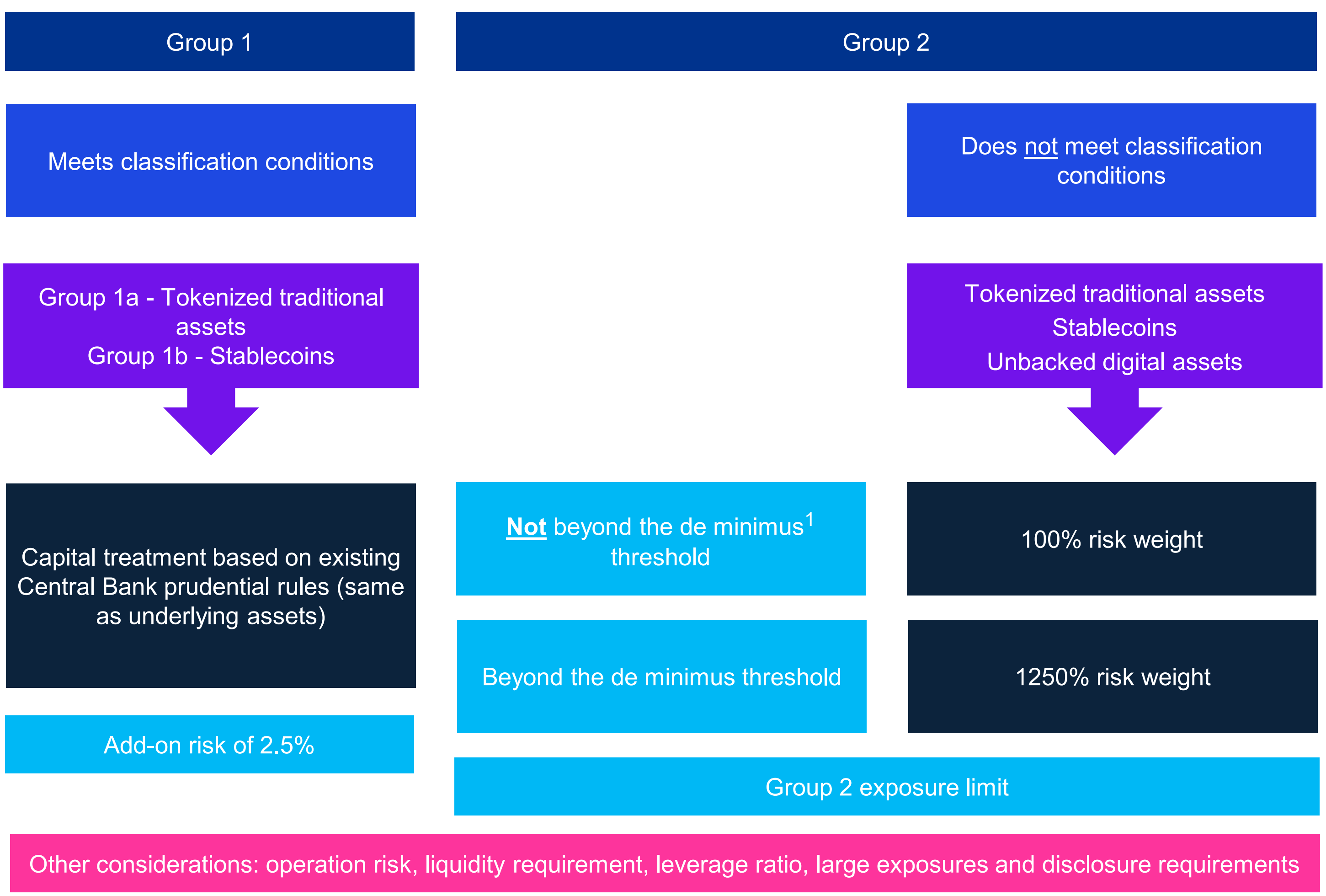
For prudential purposes, digital assets are divided into three separate categories: **Group 1a**, **Group 1b**, and **Group 2 digital assets**.

GROUP 1a	tokenized traditional assets that meet all the classification conditions
GROUP 1b	stablecoins that meet all the classification conditions
GROUP 2	all other digital assets (i.e. tokenized traditional assets, stablecoins and unbacked digital assets) that fail to meet the classification conditions.

Classification Conditions: Given the diversity of digital assets and the varying levels of decentralization that exist within the digital assets ecosystem, Central Bank uses four (4) classification conditions.

Classification Condition 1	Classification Condition 2	Classification Condition 3	Classification Condition 4
(i) a tokenized traditional asset; or (ii) has a stabilization mechanism linking to referenced value to traditional asset	all rights, obligations and interests are clearly defined and legally enforceable where the asset is issued and redeemed.	the network and infrastructure technology that the asset operates on can sufficiently mitigate and manage any material risks	entities that store or execute transactions of the digital asset, or manage/invest reserve assets are regulated or subject to appropriate risk management standards

Illustration of digital asset grouping

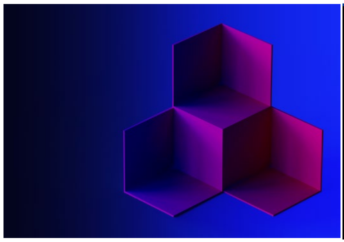


[1] The de minimis threshold is the regulatory materiality measure for being considered a SFI with a trading book. Measure based on SFI's market risk position. Details outlined in Central Bank's Guidelines on the Management of Market Risk.

How can KPMG help?

KPMG offers a broad set of advisory services to help enable our clients to identify, manage, and mitigate risks posed by the adoption of digital assets. Whether it be legacy companies who are routinely subjected to regulatory compliance activities or start-ups looking to build out their risk management framework, our extensive experience in this space can accelerate your company's digital asset strategy and help ensure that risk is aligned with business objectives.

We help financial institutions, digital asset service providers, FinTech start ups and all other firms engaged in or interacting with digital assets by lending our expertise in:



- Strategy and governance
- Risk, controls, and compliance programs
- Readiness and gap assessments

Contact us

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