INDUSTRY BRIEFING

25 JUNE, 2007
VICTORIA ROOM , BRITISH COLONIAL HILTON

REPORT

1. Overview/Welcome

The Securities Commission of The Bahamas (the Commission) hosted its first **semi-annual Briefing** with members of the securities and capital markets, at the British Colonial Hilton, on 25 June 2007.

These Briefings are designed to bring together capital market stakeholders with senior management of the Commission to exchange ideas on developments and challenges within the markets from their individual perspectives – market participant and regulator - with a view to enhancing relationships for improved effectiveness and productivity, through open and constructive dialogue.

Participants in the Briefing came from all of the major investment fund administrators and securities firms as well as some public companies. They were welcomed by Hillary Deveaux, Executive Director of the Commission, who reiterated the importance of the industry's input on ways in which the Commission can more efficiently and effectively discharge its mandate of regulating the securities and capital markets and protecting investors, while strengthening public and institutional confidence in the integrity of those markets. He stressed the need for frank and objective discussions in order to guarantee the utility of the Briefings. He saw the Briefings as contributing to the growth and development of the markets and to the attainment of the Commission's vision of a vibrant financial services sector that has sound regulatory practices and policies that engender confidence.

The Briefing took the form of a round table led by presentations from the various department heads of the Commission on current developments within their portfolios. The details of these presentations follow under the relevant headings. Going forward, the Commission would use these sessions as an opportunity to give the industry an update on recent developments, and on proposals which it was advancing.

2. Presentations

(a)Legal issues

(i) Securities Industry Bill (draft SIA): Participants were advised of the eventual repeal of the Securities Industries Act 1999, and that the Commission had in hand a second draft of the Bill for the new SIA prepared by the Canadian Consultant consigned for this purpose. Subsequent to internal review by the Commission, it was anticipated that the Bill would be forwarded to the Office of the Attorney General (OAG) for review and would then move on to the public consultation phase. The Bill would be presented for the consideration of the Board simultaneously with its review by the industry. It is projected that the review process leading up to the circulation to the industry would cover 4-6 weeks.

The new legislation, inter alia, would:

⇒Establish a new system of registration by 'function' rather than by 'title';
⇒Include enhanced investigative and enforcement powers;
⇒Simplify the Disciplinary Process;
⇒Clarify the regime of information sharing – domestic and international;
⇒Address general issues aimed at ensuring that the Commission's activities keep pace with international regulatory developments and standards.

(ii) Amendments to the Investment Funds Act, 2003 (IFA): Participants were advised of two proposed amendments to the IFA which had been submitted to the Commission by the industry, specifically the Bahamas Financial Services Board (BFSB) Funds Working Group. The proposed amendments are intended to:

⇒ Remove the nexus of the Investment Fund Manager from the definition of "Bahamas Based Investment Fund"; and
⇒ Extend the definition of a Recognized Foreign Fund (RFF) so that a fund would be entitled to register as an RFF even where it is not licensed or registered in a prescribed jurisdiction or listed on a prescribed exchange, if the investment manager or advisor of the fund is regulated in a prescribed jurisdiction the fund .

In response to a concern as to whether non-BFSB members would have a chance to review the draft amendments, participants were advised that Commission policy required industry-wide consultation on proposed legislative changes, which would include these amendments.

(iii) IOSCO MMoU: The meeting was updated on the standards for information exchange which have become a requirement for International organization of Securities Commissions (IOSCO) membership

going forward. These standards are established in the IOSCO Memorandum of Understanding (MMoU) to which The Bahamas will shortly be seeking to become a signatory.

The following background to the IOSCO MMoU was provided:

⇒ The IOSCO MMoU was established and resolved by Members of IOSCO in 2002;
⇒ In February of 2006, IOSCO Members further resolved that compliance with the MMoU would be a requirement for Membership in IOSCO;
⇒ Existing Members had until 2010 to become compliant with the provisions of the MMoU;
⇒ The effect of the MMoU, in general terms, is to establish the parameters governing the sharing of information between Members of IOSCO.

Industry participants voiced their concern that information would be shared wholesale and without a request having received proper examination by the Commission. To this, the Commission confirmed that all requests are reviewed to ensure that they are appropriate and based on reasonable suspicions. Further, while there is no analysis of the investigation being undertaken by the requesting regulatory authority, the information provided by the licensee/registrant in response to a request, is reviewed by the Commission to ensure that only what relates specifically to the request is released.

The meeting was informed that The Bahamas has been identified for special review by the Financial Stability Forum (FSF) as an Offshore Financial Centre (OFC) with a considerable volume of cross border transactions. As a result, certain action steps had been mandated by the FSF. It was expected that The Bahamas' becoming a signatory to the MMoU would satisfy certain demands of the FSF

(iv) Recent Amendments to the Securities Industry Act, 1999 (SIA) & the Investment Funds Act 2003: The attention of the meeting was drawn to recent amendments to both the SIA and the IFA regarding information sharing. The amendments to the SIA, which became effective in January 2007, were of particular significance as they gave the Commission much broader access to information than had been provided for in the original legislation. In effect, the Commission now has the same powers as the Central Bank and can now track banking records of securities transactions. In response to concern about confidentiality, it was reminded that the provisions do not permit divulgence of complete banking account records – only those relating to the specific transaction under review. Further, any request has to be deemed to be related to a "genuine securities transgression" before the Commission would consider the release of such data. It was felt that the Commission should be more transparent with the industry to give them a certain degree of comfort, particularly in cases where there is no consensus across jurisdictions with regard to what constitutes a transgression of the law. The Commission agreed to review this, and also to take into consideration the proposal that some sort of "closure" notification be provided to licensees once an information request has been satisfied.

(v) Disciplinary Process: It was reported that since January 2006, steps had been taken to enhance the enforcement process provided for by law. To this end, a Disciplinary Committee has been appointed, comprising two members of the Commission and three independent members.

(b)<u>Site Inspections</u> (Examinations)

Given the more structured and focused approach currently being applied to site inspections by the Commission, the industry was given an overview of the inspections process.

In carrying out its mandate, the Commission conducts periodic onsite examinations to ensure that its registrants are complying with legislation governing their specific authorized activities. Inspections are conducted in accordance with Section 4(1) (b) of the Securities Industry Act, 1999 which states "*the function of the Commission shall be – to maintain surveillance over the mutual funds, securities and capital markets ensuring orderly, fair and equitable dealings.*" Work programs are designed both to monitor compliance with the Legislation and the use of best practices. The objectives of the Commission's onsite examination process are to:

⇒ Update the Commission's understanding of the registrant's operations;
⇒ Determine the suitability of licensing/registration;
⇒ Test the Company's compliance with the Securities Industry Act, 1999, the Securities Industry Regulations, 2000 (the SIA Regulations), the Investment Funds Act, 2003, the Investment Funds Regulations, 2003 (the IFA Regulations), the Financial Transactions Reporting Act, 2000, its procedures manual, and generally accepted corporate governance practices; and
⇒ Observe trends in business models to inform the Commission's legislation and policies with a view to keeping them current and relevant

The Commission conducts two (2) types of Inspections: Routine Examinations, and Inspections-for-cause; both employ similar processes, but the conditions that give rise to each type of examination are very distinct. Inspections-for–Cause are conducted based upon a recognized concern (e.g. customer complaint, credible information, specific regulatory concern), without any advance notice to the registrant/licensee. Routine Examinations are scheduled on a periodic basis, at established intervals (usually 3-5 years) taking into account the assessed level of risk of the registrant's business and operations. The Commission is in the process of considering a "Risk Based Approach" toward inspections and regulation in general. The routine examinations process is as follows:

⇒ Notification Letter is sent – usually 30 days in advance. This includes a questionnaire and an initial documents request;

⇒ Initial meeting is held with the registrant/licensee. This normally involves an update on the business and an overview of trends;

⇒ Based on responses to the questionnaire, the Commission tailors a work plan for the inspection;
⇒ Actual examination – can range from 2 days up to 3 weeks depending on the size of the entity and the nature and complexity of its operations;
⇒ An exit meeting is held, during which the Commission provides its initial findings;
⇒ An Examination Report is provided to the registrant/licensee, which is given 30 days in which to respond;
⇒ Initial follow up verification visits are scheduled as required to physically verify that the agreed corrective action has been taken. It is on the basis of this report that continued monitoring is done to ensure full compliance.

In response to what action is being taken on the proposed risk-based approach to inspections, the meeting was advised that the Commission would be benchmarking similar practices in other jurisdictions after which an appropriate model will be established.

(c)Authorizations Issues

Industry participants were notified of developments in the process of the registration of Segregated Accounts Companies (SACs) by the Registrar General's Department (RGD). These developments clarify the requirement for companies to be incorporated as local or international business companies prior to being registered as a SAC, with relevant fees applying. This adjustment would positively impact the licensing process of the Commission, as the ambiguity in the sequence of these processes had occasioned delays in the past. In this context, it was noted that the Commission's fast tracking process, which allows licensing to be done within 72 hours, could also be affected by the delay in the production of final documents even if such delays were caused by the RGD.

The meeting inquired whether the RGD would back date IBC incorporations and request payment of IBC fees in those cases where they had simply registered as SACs. It was not known what stance the RGD would take in such cases. It was proposed that consideration be given to the possibility of grandfathering. This proposal was welcomed along with any other input from the industry on an approach that could be recommended to the RGD.

(d) Web Site Upgrades

It was reported that the Commission was upgrading and reconfiguring its website in order to improve the display of information thereon and to generally make it more user-friendly. The cooperation of the industry in ensuring more timely submission of accurate and current data was identified as being critical to the success of this effort. It was expected that the new e-filing procedure would facilitate this process.

The Briefing was advised that two meetings had been held in order to demonstrate the application and to ensure that the industry was sufficiently comfortable to utilize it to file statistical data for the period ending June 30, 2007.

(e) Audit Filings

Based on a request from BFSB's Funds Sector Working Group, the Commission had conducted a benchmarking exercise amongst competing jurisdictions, as a result of which the Commission was moving towards legislative amendments that would extend the deadline for the filing of audited financial statements to 6 months for investment funds. It was clarified that this was separate from filing deadlines for BISX-listed companies – for which, in fact, a proposal has been tabled for a reduction to 3 months.

There was some discussion on the cause of audit delays in the investment funds sector, for which two reasons are normally presented – (i) the work load of the auditors and (ii) inadequate preparation on the part of the administrator. It was noted with regard to the latter that while the monthly management reports might be readily available, reports prepared to the appropriate standards were usually not completed on time. It was also acknowledged that there was a distinct difference between the size of the Big-4 accounting firms in The Bahamas when compared with other jurisdictions where the same firms had significantly larger representations.

Discussion on the rationale for limiting the extended deadline to investment funds only, included consideration of nature of the fund structure versus that of a local listed company, The fact that investors in funds do not base their decisions on the annual audits, was also raised. Although the present proposal had been formulated based on some industry input and a benchmarking exercise, it would be given wider circulation,

3. Questions & Answers

The matter of non-issuance of **annual licenses** was raised to which it was pointed out that this practice had been discontinued since 2004, with licences now having no expiry date imprinted on them, but are valid from the time of issuance until cancellation. Replacements can be issued in case of loss or damage.

There was some discussion on promoting competitiveness and the steps necessary to ensure **sector growth**. The Commission would focus on a positive, collaborative relationship with the industry and would welcome recommendations that could be considered as embodying the potential to facilitate growth. The excellent relationship with the Funds Sector Working Group coordinated by BFSB was highlighted. Mention was also made of the existence of a similar SIA Working Group.

It was considered critical for the industry to take the lead in informing the Commission of sector developments, particularly threats to market share, and submitting recommendations for necessary regulatory action. Assistance in benchmarking competing jurisdictions, or global developments, would also be welcomed.

There was additional discussion on **improving the service level of the RGD** and any role the Commission might play therein, with particular to investment funds. The meeting was advised that arrangements were already in place at the RGD to give special consideration to investment funds. There was doubt, however, as to whether the staff of the RGD understood the value of their service or appreciated the need for an efficient registry.

The Chief Executive of BFSB commented on the efforts of their Registry Services Working Group to work with the RGD to assist in improving its product. The Working Group is in the process of compiling an Exceptions Report for submission to the Minister of State for Legal Affairs based on a survey being undertaken, Registered agents were encouraged to sign up for the Agent Internet Module System the benefits of which had already been proven.

4. Wrap up

Industry participants commented that they considered the Briefing useful and that it should be continued on a regular schedule. This was welcomed by the Executive Director who again stressed the importance of a positive, collaborative relationship with the industry to facilitate its growth and development. In this context, mention was made of the important role of the Funds Sector Working Group coordinated by BFSB, and the role to be played by a similar group specifically addressing the securities side of the industry. It was concluded that this initial Briefing had achieved its purpose, confirming that the Commission's efforts commitment to the harmonization and alignment of its objectives for the sector with those of industry stakeholders.

Going forward, Briefings will be held every six months. There will be separate Briefings for investment funds and securities firms. Service providers (lawyers and accountants) would be invited to the investment funds Briefings. A separate Briefing specifically for Public Companies would be held, hopefully before the end of September.

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