

2012

SECURITIES COMMISSION OF THE BAHAMAS

DAVE S. SMITH

FEBRUARY 2012



BICA's Two Day Conference  
Pelican Bay Resort, Grand Bahama  
The Accountant's Changing Role in Securities Regulation

Ladies and Gentlemen, I wish to express my thanks to BICA for the opportunity to further advance the topic “The Accountant’s Changing Role in Securities Regulation”. I say further advance because this topic was first addressed by Mr. Philip Stubbs, Chairman of the Securities Commission in November of 2011 at your BICA’s Week.

However, continuing with what has become customary; I must use the Commission’s standard disclaimer: that the views expressed in this presentation are my own and may not represent those of the Securities Commission, its Members, Management or Staff.

#### POINTS OF DISCUSSION FOR TODAY

Today, I will discuss:

- The role of the Commission;
- Objectives and Principles of Securities Regulation – as promulgated by the International Organization of Securities Commissions;
- The Securities Industry Act, 2011 and its Regulations – key changes and implementation;
- Implications of these changes for accountants;
- The role of accountants and auditors in financial reporting and corporate governance; and
- The relationship between the Securities Commission and the accounting profession.

#### COMMISSION OVERVIEW

The Securities Commission of The Bahamas (the Commission) is a statutory body mandated to administer the Securities Industry Act, 2011, and the Securities Industry Act, 1999 until all registrants have been grandfathered; the Investment Funds Act, 2003; and, since January 2008, the Financial and Corporate Service Providers Act, 2000. These Acts empower the Commission to:

- regulate the securities and capital markets;
- oversee investment funds and to license investment fund administrators that operate within or from The Bahamas; and
- supervise and regulate financial service providers and financial institutions not otherwise regulated under securities, banking and insurance laws in The Bahamas.

One of the Commission’s responsibilities is to protect the interest of the investing public. To this end the Commission is obliged to ensure that persons operating in the industry:

- are fit and proper;
- adhere to good corporate governance principles;
- that there is no co-mingling of clients’ funds with operating accounts;
- that issuers of securities are providing information on <sup>1</sup>material change in a timely fashion to ensure that there are no opportunities for insider trading or manipulation of the market; and to ensure that consumers are in a position to make informed decisions about their investments.

---

<sup>1</sup> <http://www.scb.gov.bs/documents/Guidance%20Notes%20-Material%20Change%20Information%20Guidelines.pdf>

## SCOPE OF TODAY'S PRESENTATION

It is hoped that many of you would find today's presentation of considerable interest given:

1. the role of the accounting profession in relation to the new legislation and how that translates into a relationship with the Securities Commission as a regulator; and
2. your influence and leadership to promote sound corporate governance and meaningful financial reporting.

I will touch on aspects of the legislation at a high level and the more salient details can be gained through a review of the Act, Regulations and proposed Rules. Moreover, as many of you "ply your craft" you will find that you are involved in a cross-section of securities market activities. This involvement includes roles such as:

- Principals of registrants and market participants;
- Chief financial officers;
- Internal and external auditors;
- Direct practitioners in the industry:
  - Compliance Officers,
  - Securities investment advisors,
  - Broker-dealers,
- Governance role as directors, and
- Regulators.

## IOSCO'S OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

The Commission is a member of the International Organization of Securities Commissions (IOSCO). IOSCO is recognized as the leading international policy forum for securities regulators. Previously, IOSCO identified thirty principles of securities regulation<sup>2</sup>, which are based upon three main objectives:

- **protecting investors;**
- **ensuring that markets are fair, efficient and transparent; and**
- **reducing systemic risk.**

Further, in June 2010, IOSCO published its revised *Objectives and Principles of Securities Regulation* (Principles), incorporating eight new principles based on lessons learned from the global financial crisis and the subsequent changes in the regulatory environment.

Of the thirty eight principles you might find the following of particular interest:

Principles covering audit independence and oversight:

- **Principle 19** – Auditors should be subject to adequate levels of oversight; and
- **Principle 20** – Auditors should be independent of the issuing entity that they audit.

---

As per IAS No. 1 <http://www.worldgaapinfo.com/pdf/IAS/IAS1.pdf>,

SAB 99 <http://www.sec.gov/interps/account/sab99.htm> or FASB Concept Statement No.2

<http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175820900526&blobheader=application%2Fpdf>

<sup>2</sup> <http://www.compliance-exchange.com/governance/library/ioscoprinciples2010.pdf>

Principles that relate to accountants, auditors and financial reporting:

- **Principle 16** – There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors’ decisions;
- **Principle 18** – Accounting standards used by issuers to prepare financial statements should be of a high and internationally accepted quality; and
- **Principle 21** – Audit standards should be of a high and internationally accepted quality.

Implementation of the thirty-eight IOSCO standards is critical to support the view that our jurisdiction has a sound regulatory system for the securities market and meets international best practices. The Commission is committed to meeting the standards outlined in these principles and the new SIA, which I will highlight shortly, was a significant step toward that end. It is timely to note that these principles are used by the International Monetary Fund (IMF) and World Bank in assessing the performance of a country’s securities sector as part of the Financial Sector Assessment Programs [FSAP]. The preliminary work for such an assessment, which is scheduled for the third quarter of this year, will be underway shortly.

#### **DEVELOPMENT OF SIA 2011**

The new SIA was developed following a legislative framework commonly used. The key legal obligations appear in the Act itself, while detailed requirements are set out in subordinate instruments such as Regulations or Commission-made Rules. This structure is intended to enable the Commission to respond quickly and effectively as the financial markets and products are developed. This structure is used in major jurisdictions including the United Kingdom, the United States, Canada, Hong Kong and Singapore.

#### **CURRENT STATUS**

The Securities Industry Act, 2011 (SIA, 2011) was passed in the House of Assembly on April 18, 2011 and in the Senate on May 19, 2011 and brought into force, on December 30, 2011. The new legislation requires a number of standards and rules to be formally developed. We note that this process is already underway, and that white papers for a number of Rules have already completed the public consultation process.

#### **SIA IMPLEMENTATION PLAN**

The Commission commenced an eighteen-month project to fully implement the new SIA. The initial phase focused on the development of urgent and critical rules, establishing processes for re-categorization and re-registration, revision of the Inspections Manual and re-vamping of the Commission’s database.

As a part of the SIA implementation plan the Commission embarked on an ongoing communication strategy to ensure that the industry is kept informed of developments. Coupled with the issuance of consultation papers, the strategy includes the use of:

- general industry sessions;
- specific focus group meetings;
- use of the Commission’s website to share information and to facilitate feedback;
- press releases, public notices and other media avenues; and
- letters to licensees and registrants.

In regard to consultation papers for the development of rules and guidelines, the consultation period will typically be forty five calendar days but may vary depending on the urgency, complexity of the subject matter or other considerations. You may have noted that the consultation process has already been completed for some key rules and processes identified to facilitate the promulgation of the SIA, specifically regarding: Physical Presence and Fees. In the near future additional rules such as the Regulatory Capital Rule; Corporate Governance Rule; Takeover Code and Disciplinary Rule will be released for consultation.

Let me take this opportunity to thank you and solicit your continued critical and valuable feedback you provide the Commission through BICA.

#### **KEY CHANGES**

Key changes of the new SIA include:

- A flexible legislative structure, which allows for easier amendments to Regulations and Rules as circumstances in the industry change;
- Simplification of the categories of registration for firms and individuals, as recommended by the IMF, which also reflects a similar definition structure used by other Commonwealth and Caribbean countries;
- Extensive changes to the Commission's investigation, examination, information-sharing and enforcement powers;
- Need for a prospectus based on the nature of a transaction rather than the characteristics of the parties involved; and
- All public issuers would be subject to the same disclosure requirements.

The Act also introduces express provisions setting out the purposes of the Commission. These purposes include -

- To provide investor protection;
- To ensure the conduct of fair and efficient markets;
- To focus on the reduction of systemic risk;
- To mitigate the use of regulated business in financial crime; and
- To foster Investor Education.

The first three of these objectives are derived from the IOSCO Principles, while investor education and the reduction of financial crime result from IMF recommendations.

#### **KEY CHANGES IMPACTING ACCOUNTANTS/AUDITORS**

For the balance of our time, I will focus on the changes that impact you, as accountants and auditors, in the execution of provisions of the new SIA.

Key changes impacting the accounting profession include:

#### **INCREASED FINANCIAL REPORTING:**

Audited financial statements of regulated entities are to be filed with the Commission within four months of the financial year-end in accordance with generally accepted accounting standards (International Financial Reporting Standards – IFRSs), and are to be audited using generally accepted auditing standards (International Standards on Auditing - ISAs). Interim financial statements (unaudited) are also required for each quarter and are to be filed within thirty days of the month-end, except for public issuers which are to be filed within forty-five days.

#### AUDITORS DUTIES:

Registered firms, marketplaces, facilities and public issuers must all have their annual financial statements audited by an approved auditor as set out in Part III of the regulations. The Commission has the ability to impose additional duties for the auditors of registered firms, marketplaces and facilities by:

- Having additional information reported on other than the auditors' report required under International Standards on Auditing;
- Extending the scope of the audit; and
- Requiring special examinations to be performed.

An applicant for recognition as an approved auditor must submit the prescribed application together with the specified documents and other information to the Commission for consideration. The Commission reserves the right to seek clarification on the information provided on the application or supporting information to the application.

Part III of Regulations states (among other things):

- Only an approved auditor can act for registered firms and marketplaces, facilities and public issuers;
- An approved auditor must be licensed and in good standing with BICA;
- Must be independent; and
- The client must notify the Commission of appointments or changes of auditors.

If in the course of preparing the auditors' report or any other report requested by the Commission, if the auditor comes to the view that a matter that could give rise to a qualification in the audit report is present or there is a material weakness or deficiency in or non-compliance with any of the prescribed requirements – the auditor must:

- (i) Notify the Commission immediately, and
- (ii) Provide a copy of the notice to the registered firm.

The Commission, in making requests of auditors to extend the scope of their audit, having additional information reported on or requiring special examinations, will do so in a prescribed manner, to be outlined in Commission-made Rules, which will be developed in consultation with the industry and the profession.

The Commission is cognizant that the accounting community has concerns regarding these provisions in relation to the confidentiality obligations towards its clients. In this regard, auditors are reminded of their obligation to report to the Commission, any information that maybe of a material deficiency, weakness or non-compliance, as established under the new legislation. Therefore, it would be prudent to ensure there exists a clear understanding between the client and auditor on the nature of any engagement prescribed by the Commission or legislation; and such understanding documented in an engagement letter. However, it is envisioned that any request under the new regulatory regime will be in the context of well-defined legislative provisions or rules, and more likely the subject of a separate engagement.

#### **RECORDKEEPING:**

Market Participants and Registered Firms will be required to maintain books, records and other documents for a minimum period of seven years or longer if required by relevant law. This ensures the proper recording of their business transactions, financial affairs and transactions executed for clients. Such records should be kept using standards necessary to assist with the timely creation and audit of financial statements, permit determination of capital and solvency; and such measures that demonstrate compliance with legislation, and proper segregation of clients' assets and transactions.

Records are allowed in mechanical, electronic or other forms provided information can be provided promptly and there are suitable back-up and recovery programs. Systems and controls must be adequate and appropriate.

#### **FINANCIAL REPORTING AND CORPORATE GOVERNANCE**

Corporate governance is defined as the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. An important theme of corporate governance is the nature and extent of accountability of particular individuals in the organization, and mechanisms that try to reduce or eliminate the principal-agent problem. It essentially involves the relationship among stakeholders including externally: shareholders, auditors and regulators; internally: directors, management (including accountants) and employees. It is through your various functions as accountants that you look after shareholder welfare. This is also a mandate of a securities regulator for companies that are registered and regulated or have issued securities to the public.

Effective auditing, financial transparency and information disclosure are among the benchmarks of any set of corporate governance guidelines. Financial reporting and auditing are critical to governance and complement the function of a securities regulator, even though the focus of concerns may be different. It is with this in mind that some of the new provisions of the securities legislation and new Rules that will be developed will involve auditors performing special and additional examinations on behalf of the Commission. Accountants that are part of management or governance will also be required to ensure that additional requirements for reporting and record-keeping are adhered to.

This will evolve into a closer working relationship and protocols between regulators, auditors, management and directors. This new regulatory approach and awareness will ensure soundness of the economic and business environment, which will enhance investor confidence and growth in the capital markets.

## CLOSING

Finally, I am pleased that I have had this opportunity to address you on these important developments. Certainly, it is my view that the SIA 2011 provides the Commission with a new and effective regulatory tool that supports the execution of the Commission's regulatory obligations. The Act is also expected to support the growth and development of the securities and capital markets while keeping pace with international best practices and providing sound regulation.

I trust that among your "take aways" you have noted:

1. The important role accountants play in the securities and financial markets.
2. The critical need for ongoing consultation regarding the various rules to support the new Act.

Thank you and Good Morning.