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SECURITIES COMMISSION OF THE BAHAMAS

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BICA's Accountants Week:
The Accountant's Changing Role in Securities Regulation

INTRODUCTION

Good Morning Ladies and Gentlemen, I am thankful to BICA's Accountant's Week Committee for the opportunity to speak on new securities legislation and the accountant's changing role as part of securities regulation. However, before I begin, I must use the Commission's standard disclaimer: that the views expressed in this speech are my own and may not represent those of the Securities Commission, its Members, Management or Staff.

POINTS OF DISCUSSION FOR TODAY

Today, during my presentation, 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

As many of you already know, the Securities Commission of The Bahamas (the Commission) is a statutory body mandated to administer the current Securities Industry Act; the Investment Funds Act; and, since January 2008, the Financial and Corporate Service Providers Act.

The Securities Industry Act, 1999, provides the Commission with specific powers to regulate the securities market. Equally, the Investment Funds Act, 2003, empowers the Commission to regulate investment funds and to license investment fund administrators that operate within or from The Bahamas. The Financial and Corporate Service Providers Act provides the Commission, in its role as Inspector, powers to supervise and regulate financial service providers and financial institutions not otherwise regulated under securities, banking and insurance laws in The Bahamas.

The Commission's primary responsibility is to protect the interest of the investing public. In protecting the investing public the Commission has to ensure that persons operating in the industry:

- are fit and proper;
- adhere to good corporate governance principles;
- that there are no co-mingling of clients' funds with operating accounts;

- that issuers of securities are providing information on 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.

Scope of Today's Presentation

The parameters of today's presentation include the development and current status of new securities legislation, the role of the accounting profession in relation to the new legislation, how that translates into a relationship with the Securities Commission as a regulator, and 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.

Many of you are involved in various aspects of the administration of the securities legislation. 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.

In other words, Members of the Institute and of the accounting profession are involved in a cross-section of securities markets' activities, which range from financial reporting to auditing to regulation and even as investors.

IOSCO's Objectives and Principles of Securities Regulation

The Commission is a member of the International Organization of Securities Commissions (IOSCO). IOSCO is the body recognized as the leading international policy forum for securities regulators. IOSCO had previously identified 30 principles of securities regulation, which are based upon three main objectives. These are:

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

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. Thus we now have thirty-eight principles.

Two of these new principles cover auditor independence and oversight, becoming:

- **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.

Other continuing principles that relate to accountants, auditors and financial reporting are:

- **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.

The implementation of the 38 IOSCO standards is critical to our jurisdiction being viewed as having a sound regulatory system for the securities market and which meets international best practices. 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 – one of which is expected to be conducted in The Bahamas sometime in 2012.

Meeting the standards outlined in these principles, including other initiatives led by IOSCO, is one of the factors that contributed to the need to amend and update the securities legislation being administered by the Commission.

DEVELOPMENT OF SIA 2011

The new legislation was developed following a legislative framework commonly used for securities legislation. 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 develop. This structure is used in many major jurisdictions, such as the United Kingdom, the United States, Canada, Hong Kong and Singapore.

CURRENT STATUS

Having established the basis and background for the new legislation, I would now like to discuss its current status. The new 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. The regulations were drafted and are expected to be signed into law immediately after the Act has been brought into force, which is set for December 30, 2011.

SIA IMPLEMENTATION PLAN

In planning for the promulgation of the Act (or the appointed day notice), the Commission has launched an eighteen-month project to fully implement the new SIA. This project is multi-phased with 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 implementation plan the Commission has created an ongoing communication strategy to ensure that the industry is kept abreast of developments. 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, it is intended to release them in phases so as to reduce the burden on the industry; however, occasionally the Commission may find it necessary to release more than one at the same time. The consultation period, for each paper, will be for a minimum of 45 calendar days but may be longer depending on the urgency, complexity of the paper or other considerations. The key rules and processes identified to facilitate the promulgation of the SIA and early period of transition to the new Act are: Physical Presence Rule; Fees Rule; Regulatory Capital Rule; Corporate Governance Rule; Takeover Code; Disciplinary Rule and Development of the Re-categorization Process. There will be other rules developed and put in place during the remaining implementation period.

Currently, the Physical Presence and Fees Rules have been released for public consultation and can be found on the Commission's website (www.scb.gov.bs). The consultation period for these proposed rules will end on November 18 and December 2 respectively. The Commission invites and urges each of you to take this opportunity to review and provide comments on the rules released for consultation.

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 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;
- The reduction of systemic risk;
- The reduction of the use of regulated business in financial crime; and
- Fostering 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

I would now like to shift my focus on the changes that impact you, as accountants. As previously noted, an accountant's role in the securities markets is broad, therefore this section will highlight the importance of accountants and auditors in the execution of provisions of the new SIA, which provides a legislative framework for the Securities Commission to comply with the IOSCO principles.

But before I delve further, I would first like to briefly go over the entities to be regulated under the new securities legislation. The major categories of registration include:

- Marketplaces and securities exchanges;
- Ancillary facilities, which provide certain services to a marketplace, clearing facility, registrant or public issuer;
- Registered firms, or persons authorized to carry on securities business, which is further categorized in four categories:
    - Dealing in securities;
    - Arranging deals;
    - Managing deals; and/or
    - Advising on Securities
- Public issuer – someone filling a prospectus who has issued a security that is listed or lists for trading on a securities exchange or is a public company under the current Act.

The Key changes impacting the accounting profession includes:

INCREASED FINANCIAL REPORTING: Audited financial statements of the above 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 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 also 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, which will be outlined in Commission-made rules, which will have to be developed and with consultation by the industry and the profession.

The Commission notes that the accounting community has concerns regarding these provisions in relation to the confidentiality obligations to clients. The Commission clarifies that this relationship is superseded by the statutory obligation to report to the Commission as established under the new legislation. It is advisable that there is 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. In any case, 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 our various functions as accountants that we 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

I am of the view that the Act will provide the Commission with a new and effective regulatory tool, which in turn can only enhance the effective and efficient 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 you have now identified the important role accountants play in the securities and financial markets. I hope you are as excited as I am about this new piece of legislation, and will work alongside the Commission in developing the securities and capital markets in The Bahamas, making it attractive for local and foreign investors.

I thank you once again for this opportunity and extend best wishes for the success of the remaining activities of Accountant's Week.

Thank you and Good Morning.