SECURITIES COMMISSION OF THE BAHAMAS

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"The New Securities Industry Act and FCSP Regulatory Regime Overview"

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INTRODUCTION

Hon. K. Peter Turnquest, Member of Parliament for East Grand Bahama, Jasmine Davis, President of The Bahamas Institute of Chartered Accountants, Reece Chipman, 2nd Vice President and Chair of CPE Committee, ladies and gentlemen, good morning.

It is my honour to be invited once again to speak at one of the Bahamas Institute of Chartered Accountants' engagements. The last occasion was a little over a month ago now at the 'auditing the auditor' workshop held in Nassau on the 12th of February.

I'm never certain if after a presentation I'll get any further invitations, but here I am. I hope it speaks to the shared commitment the Commission and BICA have to world class regulation for the nation's financial services industry—in the case of the Commission for the capital markets, securities and investment fund industries, and for our financial and corporate services industry.

This type of engagement, collaboration and ongoing communication between Regulator and a key industry stakeholder such as BICA, is the foundation of the type of holistic, balanced regulation sought by practitioners, investors, the various international organizations which we wish to be a part of, and the public.

Today I will remind you of some of the key changes to the legislation governing the securities industry—the Securities Industry Act, 2011, and look at some key developments to the regulatory regime for FCSPs.

DISCLAIMER

Before I go on, let me say that this presentation is meant for information purposes only. Nothing in it supersedes duly promulgated legislation, rules or guidelines.

CHANGES TO THE SECURITIES INDUSTRY ACT, 2011

HISTORY

In 1995, the Securities Board Act was passed – the legislation which actually established the Commission as a statutory body. The Act was repealed and replaced by the Securities Industry Act, 1999, which itself was later repealed and replaced by the Securities Industry Act, 2011--on 30th December of that year. The changes in the legislation I will reference are, of course, changes vis-a-vis the 1999 Act.

FLEXIBLE LEGISLATIVE STRUCTURE

The new legislation was developed following a legislative framework now commonly used in a number of jurisdictions for securities legislation. The key legal obligations appear in the Act itself, while detailed requirements are set out in subordinate instruments such the Securities Industry Regulations, and Rules promulgated by the Commission. This structure is intended to enable the Commission to respond quickly and effectively to meet the needs of changing financial markets and evolving financial products.

This structure is used in many major jurisdictions, such as the United Kingdom, the United States, Canada, Hong Kong and Singapore. This flexible legislative structure is one of the changes in the SIA, 2011.

We often talk about the objective of achieving holistic, balanced regulation; of not taking a one-size-fits-all approach to regulation. Striking on just the right regulation formula for a jurisdiction such as ours—small, but both participating and competing with the largest financial players in the world—is more achievable with a flexible legislative structure, and capable, competent professionals such as yourselves sharing your expertise and wisdom in the formation and ongoing development of the legislation, rules and guidelines comprising the regulatory framework.

New Registration Regime

The categories of registration for firms and individuals was also changed in the new SIA, with the legislation moving from categorization based on 'title' to categorization based on 'function'.

The move to a registration process focused on the activities a person would perform rather than the title of the person or business was a recommendation of the International Monetary Fund. The categories of activity that must be registered under the Act are similar to those in use by other Commonwealth and Caribbean countries.

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; and
- Firms, or persons authorized to carry on securities business in or from within The Bahamas.

Part 2 of the First Schedule to the Act lists activities that would be considered securities business for the purpose of the act as:

- dealing in securities,
- arranging deals in securities,
- managing securities and
- advising on securities.

Dealing in Securities involves Buying, selling, subscribing for or underwriting securities as an agent or principal.
Arranging Deals in Securities involves Making arrangements with a view to another person (whether as agent or principal) buying, selling, subscribing for or underwriting securities, or a person who participates in the above.
Managing Securities involves Managing securities belonging to another person in circumstances involving the exercise of discretion.
Advising on Securities involves Persons offering advisory services to a portfolio/person where no discretion is exercised.

So whereas under the 1999 Act, a firm may have been approved as a Broker Dealer I, under the new legislation, the firm would be registered for specific functions. An existing broker-dealer I, for example, would have been mapped for registration under the SIA 2011 to deal in securities, manage securities, arrange deals in securities and advise on securities. The 'mapping' or 'grand-fathering' was prescribed in Regulation 146 of the SIR, 2012.

The registration categories for individuals also changed under the 2011 Act, with five categories of individual registration set out under Section 56 of the SIR, 2012. The categories of individual registration are:

- Trading Representative;
- Discretionary Management Representative;
- Advising Representative;
- Chief Executive Officer; and
- Compliance Officer.

According to Regulation 51 (2), an individual may only be registered to carry on a securities activity that the firm for which he or she works is registered to undertake.

The first three categories had comparable registration classes under the SIA, 1999, and Regulation 151 set out the activities individuals previously registered under the 1999 Act would be 'mapped' to perform under the new Act.

The CEO and Compliance Officer Registration categories for individuals are new to the SIA, 2011.

Individuals previously licensed as principal, broker or stockbroker were mapped to the trading representative category, securities investment advisors to discretionary management representatives, and associated persons to the advising representative category.

Related to these change, provisions were made for registrants to apply to be registered for functions other than those which they would have been automatically mapped to perform under to Regulations 146 and 151. Such persons had up until 31 July 2012 to apply for registration for different functions, but only a small number pursued this.

Information Sharing

One of the ultimate objectives of the new Act was to bring the regulatory regime for the Securities Industry into compliance with the International Organisation of Securities Commissions' (IOSCO's) Objectives and Principles of Securities Regulation. IOSCO, of course, is the international standard-setter for securities regulation.

Compliance with IOSCO's 38 Principles set the stage for achieving 'A' signatory status to IOSCO's Multilateral Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information (MMoU), which the Commission successfully achieved effective 27 December 2012.

It is thought that this status will open markets such as Brazil to mutual fund managers and administrators operating in or from The Bahamas.

The 2011 Act brought the information sharing authorities of the Commission up to the international standard. Such clear authority was one of the requirements IOSCO set for any regulator attaining the A signatory status. The Information sharing provisions of the Act are found in Part III.

Expanded Investigation Authority

Part IV of the Act expands the SCB's investigation authority, empowering it to investigate 'any person', whereas under the SIA, 1999, the SCB was only empowered to investigate its registrants. The investigation authority also now includes search and seizure powers.

Part IV of the Act also grants the Commission express powers to conduct both routine inspections and inspections 'for-cause', and authorises the Commission to require an auditor to carry out an inspection.

Enforcement Powers Enhanced

The enforcement powers of the Commission were 'truly enhanced' in Part 15 of the new Act. It allows the SCB to act more immediately and more forcefully when necessary.

I won't get into too many of the details of the enforcement powers under the SIA, but when we discuss the Financial and Corporate Service Providers regulatory Regime later, I will delve deeper into the enforcement process and some of the powers available under the Financial and Corporate Service Providers Act, 2000.

Distributions and Prospectuses

Another new feature of the Act, the legislation establishes the need for a prospectus based on the nature of a transaction rather than the characteristics of the parties involved.

All public issuers are also subject to the same disclosure requirements under the Act. The changes brought some needed clarification to the matter of who should issue a prospectus, and generally modernized the framework for public offers.

Increased Financial Reporting

For Marketplaces including securities exchanges, registered firms and Public Issuers, audited financial statements are to be filed with the Commission within four months of the financial year-end and prepared in accordance with generally accepted accounting standards (International Financial Reporting Standards – IFRSs). Part III, Section 12, subsection (3) of the Securities Industry Regulations, 2012, states that, "*every financial statement that is required by securities laws to be audited must be audited in accordance with Generally Accepted Auditing Standards and accompanied by an auditor's report.*"

Of course, the auditing standard is the ISA or International Standards on Auditing.

Interim financial statements (unaudited) are also required for each quarter and are to be filed within thirty days of the quarter-end, except for public issuers which are to be filed within forty-five days.

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.

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 include such measures that demonstrate compliance with legislation and proper segregation of clients' assets and transactions.

TRANSITION

Much of the transition to the SIA, 2011 took place across 2012, with various provisions taking effect at stages, such as 90 days, six months or one year after the promulgation of the Act.

2012 opened with the promulgation of the Securities Industry Regulations, 2012 (SIR, 2012), effective 9 January 2012. As mentioned earlier, the SIA, 2011 and SIR, 2012 are structured to allow for a sound, internationally respected regulatory foundation with sufficient flexibility to allow regulation tailored to the Bahamian marketplace through the introduction of Rules and Guidelines.

The Securities Industry (Physical Presence) Rules, 2012, came into effect the same day as the Fees Rule on January 30 2012.

Transition dates in 2012 of broad interest to the securities industry include the 31 December 2012 requirement for firms registered under the Act to appoint a Compliance Officer; the requirement of firms registered under the Act to submit annual audited financial statements to the Commission 120 days after the end of its first fiscal year post the implementation of the SIA, 2011; and the requirement that registered firms have approved levels of professional indemnity insurance by 31 December 2012.

If any of you are employed by Registrants who have not met these requirements please do contact the Commission as soon as practicable.

The Act will also bring new regulatory capital requirements, though the capital requirements of Section 55 of the former Act governing the industry (the SIA, 1999) remains in place until the new Regulatory Capital Framework comes into effect. The proposed Regulatory Capital Framework has completed the consultation phase of its development and it is anticipated that it will come into effect this year.

Consultation Documents, 2012

A number of other papers completed the consultation phase of their development at the end of 2012, as indicated previously. They are anticipated to be implemented as either Rules or Guidelines in short order.

Among them are:

- The Bahamas Takeover Codes;
- Fitness and Propriety Guidelines;
- The Licensing of Compliance Officers;
- Liquidity Risk Guidelines;
- Management of Large Exposures and Related Party Exposures;
- The Fees Rule (for registrants under the Investment Funds Act, 2003);
- The Outsourcing of Material Functions;
- and Corporate Governance Guidelines.

The input of registrants, investors, industry stakeholder groups and the general public is a welcomed and important part of the process for developing the best legislative framework for the jurisdiction.

That concludes some of the key changes to the regulatory landscape as a result of the promulgation of Securities Industry Act, 2011.

The Inspector of Financial and Corporate Service

The Securities Commission of The Bahamas wears more than one regulatory 'hat', as I think most of your know. The Commission was appointed the Inspector of Corporate and Financial Services, or FCSPs, in January 2008, in accordance with Part IV, Section 11 of the Financial and Corporate Service Providers Act, 2000.

As the Inspector, it is the Commission's responsibility to monitor the activities of Financial and Corporate Service Providers. This is achieved through the Commission's Market Surveillance Department's off-site supervision programme and the Inspections Department's on-site supervision programme.

The Market Surveillance Department has a number of ongoing reporting obligations expected of all registrants, but this slide focuses on some of those requirements specific to FCSPs.

FCSP Continuing Obligations

FCSP licensees are required to comply with these key continuing obligations, which are important when considering the potential operational, legal and reputational risks to the jurisdiction.

The Commission is cognizant of the fact that additional reporting obligations, for example, financial records, are necessary for effective regulation and stands committed to balancing good Regulation with market development.

Moreover, the ongoing obligations provide important 'Statistical Data' for the Commission but also for the Industry to:

- Measure Market growth; and
- Identify areas for improved regulatory oversight.

Therefore, timely disclosure of requisite documentation is very useful to ensure that our records as much as possible are reflective of our licensee operations.

As you are aware, Compliance is not limited to the Financial & Corporate Service Providers Act and Regulations, but also extends to -

The Financial Transactions Reporting Act and Regulations – as it relates to customer due diligence; in addition to the Anti-Money Laundering & Anti-Terrorism Financing: Handbook & Code of Practice for FCSPs.

On-site Examinations

When conducting on-site examinations, there are four types that the Commission employs. They include:

- Routine examinations, conducted by agents

- Follow up examinations, conducted by the Inspector
- Random examinations, conducted by Inspector only and
- Special examinations

I will only focus on the Routine Examination conducted by Agents today.

Approval Process for Inspector's Agents

There have been changes to the approval process for public accountants to be approved as agents of the Inspector. These changes are initiated by the Inspector with a view of better execution of its mandate under the law and in line with best practices. During the approval process, the Inspector now evaluates the fitness and propriety of the applicant, and looks to ensure that suitable professional indemnity insurance is in place.

Changes to the Inspections Programme

There are some changes ongoing and envisaged for the Inspection programme I would like to bring to your attention. Just to note, the examination's focus previously was on the licensee's Anti-Money Laundering regime and operational risk was not addressed.

As the Inspector moves to improve the quality of the examination process, there is additional information now being reviewed, which includes:

- Bank reconciliations for companies that hold clients funds;
- Disaster Recovery Plans;
- A current Business License;
- Qualification of persons involved in the activates FCSP; and
- Supporting documents of Financial Transactions over $15,000.

Changes 2014 and Beyond

Looking to 2014 and beyond, the Inspector envisages using a Risk-Based Approach to the oversight of its licensees. This approach will allow tailoring the frequency and depth of examinations to the risk in each FCSP operation, rather than taking a one-size-fits-all approach to the examination process.

In this regards, a Risk Survey was issued to all FCSPs in September 2012. If you know of FCSPs who have not completed the survey, and do not wish to be automatically determined as high risk – which means

more frequent, deeper probing exams--then please encourage them to complete the online survey as quickly as possible.

Legal Challenge

I imagine that most of you here are accountants, but many of you may work with or find yourselves contracted to do work for FCSPs who are also attorneys, and as such may have concerns about disclosure of information protected by legal privilege.

Many of you may be aware that shortly after the FCSPA was promulgated in 2000, a constitutional challenge was brought against the Act as some attorneys thought the examination authorities granted to the Inspector could result in breach of lawyer-client confidentiality provisions for those attorneys who submitted themselves to examination of their FCSP-related business.

Please note that in such cases the Inspector is interested in the records of the Financial and Corporate Service Provider, and segregation of the FCSP business from the legal practice should easily circumvent these concerns.

There has been no current movement regarding that challenge, and it is the Inspector's position that all Licensees are subject to Inspection, pursuant to section 11(3) (b) of the FCSPA, 2000. As stated earlier, the Inspector encourages Separation of Services and would like to remind you all that compliance is sought *first* though dialogue.

Record Keeping Requirements for FCSPs

I mentioned earlier that there were enhanced financial reporting and record keeping requirements in the SIA, 2011. Well, there have been some significant changes to record keeping requirements for FCSPs as well. Just to give you some background, after the Organization for Economic Cooperation and Development or OECD Peer Review of the Bahamas in 2002, the main deficiency observed was in the area of accounting records.

As a result, amendments were made to the -

- International Business Companies Act;
- Exempted Limited Partnerships Act;
- Partnership (Limited Liability) Act; and

- Foundations Act

requiring them to maintain accounting records.

The Amendments became effective April 1, 2012.

The Amendments are identical in each piece Legislation. The amendments state the purpose of records, rather than defined types of records to be maintained, and requires records that meet objective standards - are 'Reliable' and reasonably accurate. While the generation of financial audited financial statements is not a stipulation of the amendments, they do require accounting records that enable the production of Financial Statements.

Other pieces of legislation are in the process of having amendments made or promulgated to reflect similar requirements. The IBC Companies (Accounting Records) Order 2013 was promulgated [date], reflecting these requirements.

On this note, let me encourage you, individually or collectively, to visit our website(www.scb.gov.bs) and review and provide feedback on the Draft Guidelines on the Management of Accounting Records on the Consultation Documents page there. The purpose of the Guideline is to incorporate the mandatory minimum obligations of FCSPs to ensure that accounting records of their clients and themselves are managed in accordance with aforementioned amendments.

FEES

Allow me to give you a quick update on the Fee structure for FCSPs. Many of you who would have sat in on industry briefing over the last one-to-two years will appreciate the effort the Inspector is making to get the fee structure to just the right mix.

Currently, the prevalent Annual Fees are included in the First Schedule of the Financial and Corporate Service Providers Regulations, 2001 – which of course makes them over a decade old. A Consultation Paper on proposed changes to the FCSPA Fee Regime was circulated for consultation in 2012. Based on comments received from Industry, the proposed revised Fee Regime is being further developed and will be re-circulated for further public consultation.

We look forward to your input once that revised paper is released.

DISCIPLINARY PROCESS

We will take a look at the Inspector's enforcement process and various remedies or sanctions available to the Inspector for various infractions.

Let's take a quick, a look at what the process involved in taking enforcement action on an FCSP registrant.

A licensee must be examined as necessary by Inspector and renew the license annually. As you've seen these duties are overseen by Inspections and Market Surveillance departments, respectively. Where there is a deficiency or complaint an investigation is conducted to determine whether disciplinary action is warranted. The Inspector has authority to take various actions commensurate with the breach in question. We will look at the actions that the Inspector may take and the licensees recourse with respect to those actions.

1. *Impose penalties (s. 18A);*
2. *Suspension (s. 16);*
3. *Revocation (s. 17);*
4. *Criminal offences (s. 18); and*
5. *Appeals.*

Notwithstanding section 18 or any other provision of this Act, where the Inspector is satisfied that a licensee has —

(a) Violated any rules, directives or guidelines issued pursuant to section 11;

(b) Violated any codes of practice issued by the Compliance Commission pursuant to section 47 of the Financial Transactions Reporting Act;

(c) Violated any guidelines issued by the Financial Intelligence Unit pursuant to section 15 of the Financial Intelligence Unit Act;

(d) Committed an offence under this Act; or

(e) Committed an offence under any other Act dealing with the regulation of financial services in The Bahamas,

the Inspector may by order impose a penalty on the licensee which may include one or more of the following —

(i) a public reprimand;

(ii) a ban on carrying on certain operations;

(iii) the temporary suspension of a manager;

(iv) the removal of a director, responsible officer, or other senior manager;

(v) the imposition of conditions on a licence; and

(vi) an order for the licensee to pay a maximum fine not exceeding the amounts set out in section 18.

Where the Inspector makes an order pursuant to subsection (1) —

(a) the order shall be put into writing;

(b) the order shall specify the offence which the licensee committed and the penalty imposed by the Inspector;

(c) a copy of the order shall be given to the licensee;

(d) upon payment by the licensee of a fine as ordered, the licensee shall not be liable to any further prosecution in respect of the offence and where any further prosecution is brought it shall be a good defence for the licensee to prove that the offence with which it is charged has been dealt with under this section; and

(e) the order may be enforced in the same manner as an order of the court.

Where the Inspector is of the opinion that a licensee is —

(a) acting contrary to section 10 (director approval) or fails to provide access to any document under section 11(4) or fails to obtain any information for the purposes of section 14 (related to client records/beneficial owners of IBCs); or

(b) in contravention of this Act or any other law, the Inspector may require him forthwith to take such steps as may be necessary to rectify the matter, and may forthwith suspend the licence.

A suspension shall not exceed a period of thirty days unless extended from time to time by an order of the court on application of the Inspector on the grounds that it is in the public interest that the suspension continue and specifying the duration of such period of further suspension, which shall not itself exceed sixty days each at any one time.

The Inspector may by order, revoke the licence of a licensee —

(a) if the Inspector is of the opinion that the licensee is carrying on his business in a manner detrimental to the public interest, the interest of the companies managed by him or to the reputation of The Bahamas;

(b) if the licensee has ceased to carry on financial and corporate services; or

(c) if the licensee becomes bankrupt or goes into liquidation or is wound up or otherwise dissolved.

An important note to mention here: An appeal under this section *shall not* operate as a suspension of

Under Section 18 any person who carries on the business of financial and corporate services in or from within The Bahamas without obtaining a licence under this Act is liable to criminal penalties. He is liable on summary conviction to a fine of $75,000 and where offence continues post-conviction - $1,000 per day.

Subsection six provides that:

- Whoever assaults or obstructs the Inspector or other person in performance of functions, or commits breach for which no punishment is provided is liable on summary conviction to a fine of $10,000.

19. (1) An appeal lies to the Supreme Court from any decision of the Inspector —

(a) revoking a licence under subsection (1) of section 17; or

(b) suspending a licence under subsection (1) of section 16;

(c) imposing a penalty on the licensee under subsection (1) of section 18A.

(2) An appeal against the decision of the Inspector shall be by motion.

(3) The following procedure applies to appeals from the Inspector —

(a) the appellant within twenty-one days after the day on which the Inspector has given his decision shall serve a notice in writing, signed by the appellant or his attorney, on the Attorney-General of his intention to appeal and of the general grounds of his appeal, except that any person aggrieved by a decision of the Inspector may upon serving notice on the Attorney-General apply to the court within fourteen days after the day on which the Inspector has given his decision for leave to extend the time within which notice of appeal prescribed by this section may be served, and the court upon hearing the application may extend the time prescribed by this section as it deems fit;

(b) the Attorney-General shall within twenty-one days of receiving the notice of appeal obtain a copy of the Inspector's decision and transmit to the Registrar of the Supreme Court without delay a copy thereof together with all papers relating to the appeal, except that the Inspector is not compelled to disclose any information if he considers that the public interest would suffer by such disclosure and a certificate given by the Inspector under the Public Seal is conclusive that disclosure is not in the public interest;

(c) the Registrar of the Supreme Court shall set down the appeal for hearing on such day as is convenient, and shall cause notice of the hearing to be published, in such manner as, the court may direct; and

(d) the court may adjourn the hearing of any appeal and may, upon the hearing thereof, confirm, reverse, vary or modify the decision of the Inspector or remit the matter with the opinion of the court thereon to the Inspector.

(4) An appeal against a decision of the Inspector shall not operate as a suspension of the decision of the Inspector.

CONCLUSION

By now I am certain you will all be glad to know that I've reached the conclusion portion of this presentation.

Some of the key changes in the law were highlighted for you, including enhancements to the information sharing provisions, reorganization of the licensing regime for industry participants, an several new reporting requirements, an updating of the regulatory regime relating to public issuers, and I touched on the new enforcement authority of the Commission.

For those of you working with or as FCSPs, some of the important ongoing reporting requirements were discussed, we provided an overview of the examination process, addressed the legal challenge that was brought against the Act and the Inspector's position regarding the examination of licensees, and took a look at the enforcement process and some of the Inspector's authorities and powers.

I truly hope that each of you appreciates, also, the impact you may have both individually and collectively on the regulatory framework governing the securities and investment funds industries and the capital markets, and the financial and corporate service providers industry. There are a number of consultation papers which may benefit from your input, which will become a part of the regulatory landscape you or your clients will be expected to understand and be in compliance with.

Thanks once again to BICA for another opportunity to speak at one of its engagements.