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AT

THE BAHAMAS INSTITUTE OF CHARTERED

ACCOUNTANTS

TWENTY-SEVENTH ANNIVERSARY AS AN INSTITUTE

AND

SEVENTH YEAR OF LEGISLATIVE RECOGNITION

UNDER THE PUBLIC ACCOUNTANTS ACT, 1991

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GOOD MORNING LADIES AND GENTLEMEN:

I am delighted to be here on this very special occasion celebrating your 27th Anniversary as an institute and seventh year of legislative recognition under the Public Accountants Act of 1991.

I want to talk with you about the role of the Regulator, Bica's role in the Securities Market, and how both contribute to the investors' protection with the help of the pending Securities Industry Act.

I contend that securities markets can and do exist without regulations. However, I will equally argue that they will not succeed in achieving their objectives, nor will they stand up to scrutiny from investors, if it is perceived that the markets are subject to fraud and manipulation.

Jurisdictions that have little or no regulations have a higher level of uncertainty associated with their markets consequently investors will be less inclined to invest where the risk/rewards are less favourable, and look to jurisdictions with sound regulatory controls and laws. The role of the Regulator is extremely important. The cornerstones of securities regulation are embodied in three very important principles:

- (1) The protection of investors;**
- (2) Ensuring that markets are fair, efficient and transparent; and**
- (3) The reduction of systemic risk.**

These three principles are closely related and in some respects, overlap. Many of the requirements that help to ensure fair, efficient and transparent markets also provide investor protection and help to reduce systemic risk and those that reduce systemic risk provide protection for investors.

The Role of a Regulator

There are five important principles relating to the regulator, The Securities Commission of The Bahamas.

- (1) The responsibilities of the regulator should be clear and objectively stated.**
- (2) The regulator should be operationally independent and accountable in the exercise of its functions and powers.**
- (3) The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.**
- (4) The regulator must adopt clear and consistent regulatory processes.**
- (5) The staff of the regulators should observe the highest professional standards including appropriate standards of confidentiality.**

Clear Responsibility

The capacity of the regulator to act responsible, fairly, and efficiently will be assisted by:

- **A clear definition of responsibilities, in our case these have been set out in our pending Securities Industry Bill.**
- **Showing cooperation among responsible authorities through appropriate channels, (Those who are responsible for aspects of securities regulations and other law enforcement governmental and regulatory bodies).**

Independence and Accountability

The Securities Commission will be operationally independent from external political or commercial interference in the exercise of its functions and powers and accountable in the use of its powers and resources.

Independence will be enhanced by a stable source of funding for the Securities Commission, (in our case fees from the mutual fund industry and soon from the securities market).

Accountability implies that a regulator should operate independently of sectoral interests; and have a system of public accountability and a system permitting judicial review of decision of the regulator.

The confidential and commercially sensitive nature of much of the information in the possession of the regulator must be respected. Safeguards must be in place to protect such information from inappropriate use or disclosure.

Adequate Powers and Proper Resources

The Securities Commission will have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. In practical terms this means the powers of licensing, supervision, inspection, investigation and enforcement.

The Securities Commission will have comprehensive inspection, investigation and surveillance powers.

It should also have comprehensive enforcement powers.

The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance programme.

Supervision of market intermediaries' conduct through inspection and surveillance helps to ensure the maintenance of high standards and the protection of investors. These preventative programmes are a necessary complement to investigation and enforcement programmes.

The Securities Commission will have the power to require the provision of information or to carry out inspections of business operations whenever it believes it necessary to ensure compliance with relevant standards.

The Mutual Fund Industry is at \$87.8 billion with over 600 registered, but reported as 584 active mutual funds. The Mutual Funds Industry inspections started in July. So far we have inspected the operations of 14 mutual fund administrators, there are 22 left to do. Inspection visits may be rotational or driven by risk assessment or complaint.

Comprehensive Enforcement Powers

The complex character of securities transactions and the sophistication of fraudulent schemes require strong and rigorous enforcement of securities laws. Investors in the securities market are particularly vulnerable to misconduct by intermediaries and others.

The Securities Commission will therefore be provided with comprehensive investigatory and enforcement powers including:

- (1) regulatory and investigative powers to obtain data, information, documents, statements and records from persons involved in the relevant conduct or who may have information relevant to the inquiry;**

- (2) power to seek orders and/or to take other action to ensure compliance with these regulatory, administrative and investigation powers;**
- (3) power to impose administrative sanctions, or to seek orders from courts or tribunals;**
- (4) power to initiate or to refer to matters for criminal prosecution;**
- (5) power to order supervision of trading in securities or to take other appropriate action. Where enforcement action is able to be taken, the power to enter into enforceable settlements and to accept binding undertakings.**

Adequate funding is essential for the regulator to carry out its tasks. Staff must receive ongoing training as required.

Clear and Consistent Regulator Processes

In exercising its powers and discharging its functions the regulator should adopt processes which are:

- (a) consistently applied**
- (b) comprehensive**
- (c) transparent to the public**
- (d) fair and equitable**

In the formulation of policy:

The Securities Commission will have a process for consultation with those who may be affected by the policy. Public disclosure of policy in important operational areas is generally desirable except perhaps in the areas of surveillance and enforcement where consultation and disclosure may be necessary and inappropriate as it may compromise the effective implementation of the policy.

The Conduct of Staff

Staff of the Securities Commission should observe the highest professional standards and be given clear guidance on conduct matters including:

- (a) The avoidance of conflicts of interest (including conditions under which staff may trade in securities).**
- (b) The appropriate use of information obtained in the course of the exercise of powers and discharge of duty.**
- (c) The proper observance of confidentiality and securing provisions and the protection of personal data.**
- (d) The observance of procedural fairness.**

Bica, what about your role in the overall scheme of things in this market?

We will regard the quality of corporate financial reports as essential to the success of our securities market. Financial reporting is about transparency and comparability.

Auditors have a special role and responsibility in our financial system. The auditor is the only independent professional that a company must engage before a public offering of securities and the only professional with a specific responsibility to act independent of management.

The audit opinion provides the markets and investors with confidence in companies' financial statements. That confidence is the cornerstone of our financial markets. Investors absolutely must be able to trust the reliability of the numbers in financial statements. Anything, anything that threatens that confidence would have a very far-reaching and negative impact.

We are relying on auditors to put something like the Good Housekeeping seal of approval on the information investors receive. The integrity of the information must take priority over a desire for cost efficiencies or competitive advantage in the audit process.

Sound markets are the results of fair and rigorous accounting standards. Please do not use the label of '*professional judgement*' to become accommodating to those clients who are being audited. Proper accounting procedures resulting in full disclosure removes the element of uncertainty.

We can not stress enough the importance of companies disclosing information to the market to reduce uncertainty so that the market can

price risk correctly. This reduces the cost of capital. The current real life example of how uncertainty affected the cost of capital is the spectacular decline of Asian currencies and markets.

A suspicion grew that there were unchanged dollar loans on the books of many public and private Indonesian countries. If people knew the extent of the dollar denominated loans, the risk of default or the foreign currency losses could have been priced and the markets could have returned to equilibrium.

We are depending on the members of BICA (Bahamas Institute of Chartered Accountants) through its international accounting standards, to provide a picture of a company's financial position and its results of operations, in such a way that is unbiased and as complete and faithful as possible.

Core standards must constitute a comprehensive generally accepted basis of accounting in our jurisdiction. They must be of high quality and they must be vigorously interpreted and upheld.

According to Chairman Levitt of the Securities Exchange Commission of the United States, the past few years have witnessed a gradual but significant slippage of corporate financial reporting and really undermined the touchstone of financial reporting. Too many corporate managers and analysts are participants in the game of nods and winks.

We are happy to report that, to date, in The Bahamas this is not the case. All participants in the securities market will have to be approved by the Securities Commission.

Remember the need for guaranteeing investor confidence in the independence of auditors and the vital role they play in maintaining the health of the capital markets can not be over-stated.

General Structure of the Pending Act

The Act seeks to provide a regime for the trading in securities in The Bahamas.

PART 1: Preliminary

The main focal point of Part I is the Interpretation provisions of the Act. It is in this section that you will see terms and phrases that, until now, were foreign to The Bahamas or at the most used very infrequently. It is this section that the Commission will refer to when it is deciding whether or not a person is subject to regulation under the Act. For example, whether a person is a broker, a dealer or a securities investment advisor, or whether a company is conducting business as a Securities Exchange or is dealing in securities. These and other terms are all defined in this section and provide the Commission with a starting point with respect to who should be subject to regulation under the Act. But the most important definition in this Part is the definition of the word security. That definition is quite extensive and was written to cover the whole gamete of financial instruments that could

conceivably be construed as a security. It also leaves the door open for the Commission to designate any financial instrument as a security, because in this business if somebody wants something...anything, then that item whatever it is, can be sold at a certain price and thereby potentially creating security interests. The Commission, therefore, must be in a position to react to these new products or instruments, and to say that they are in fact securities which are subject to regulation under the Act, and consequently, subject to the reporting and disclosure requirements contained in the Act which I will talk about later.

Part II: Securities Commission

This part should be very familiar to many of you, as it is essentially provisions from the Securities Board Act, 1995. It was decided that the Securities Board Act should be amalgamated into the Securities Industry Act, because of the importance of this piece of legislation and the fact that this will be the primary function of the Commission in the future.

This section will officially change the name of the "Securities Board" to its new name, the "Securities Commission of The Bahamas". This was done primarily for recognition purposes, and to come into conformity with the rest of the world.

The original provision of the Securities Board Act, will remain essentially the same, except for a refinement of the functions of the Commission. Therefore, once the Act becomes law the functions of the Commission will be:

- (a) To formulate principles to regulate and govern mutual funds, securities and capital markets;**
- (b) To maintain surveillance over mutual funds, securities and capital markets ensuring orderly, fair and equitable dealings;**
- (c) To create and promote conditions to ensure the orderly growth and development of the capital markets;**
- (d) To advise the Minister generally regarding mutual funds, securities and capital markets; and**
- (e) To do such other things as may be prescribed by this Act or by any other written law.**

Part III: Regulation of Securities Exchanges and Market Participants

Part III is where we begin to talk about the different players in the market, we refer to these persons as "Market Participants". In this Part, depending on the type of business or transactions an individual or firm is involved in, will dictate the type and level of registration or approval that will be required by the Act.

I will briefly introduce the different market participants and how they will operate in the market.

Registration of "Securities Exchanges"

First, any company that wants to operate as a Securities Exchange must first be approved and registered by the Commission. By law, a Securities Exchange must be a company incorporated under the Companies Act, 1992.

This was done to firmly cement the jurisdiction of the Commission over any company that establishes itself or conducts the business of trading on a Securities Exchange.

Recognition of "Foreign Securities Exchanges"

The Commission also has the power to recognize exchanges in other jurisdictions for the purpose of allowing securities listed on those exchanges to be listed on any Bahamian exchange.

This will become very important as our market develops, because as we attract more listings on the Exchange, the profitability of the Exchange will increase and this will inevitably filter to the economy of The Bahamas. But also, the prestige and prominence that will come from increased listings will have the added benefit of increasing investor confidence in our capital markets.

Registration of "Facilities"

Companies wishing to provide services that facilitate or are ancillary to the operation of a Securities Exchange, for example, clearing, settlement,

depository or custody services must be approved and registered by the Commission. Such companies will officially be known as "facilities" and will either be a company incorporated or registered under the Companies Act, 1992.

Registration of "Broker-Dealer" Firms

Any company that wants to buy and sell securities, either for itself (as a dealer) or for others (as a broker) on a Securities Exchange must be registered as a broker-dealer. This is a prerequisite for any company wishing to become a member of a Securities Exchange. These are the firms that will hold seats on a Securities Exchange. They are usually the most active in the market in terms of trading securities and are usually the focus of day-to-day regulation and supervision by the Commission or the Exchange upon which they are members.

You will note that this Part contains no penalty for violating this requirement. However, we have addressed the violation of this requirement in a different manner because of the two step process involved.

Let me explain, the Commission must first register a company that wants to become a member of a Securities Exchange. That company will then take that registration certificate to the Exchange seeking membership. Automatically, the Exchange will contact the Commission to verify whether the registration of that particular company is in good standing before even considering it for membership. Therefore, prior to any company

becoming a member of an Exchange there are certain checks and balances that must be satisfied. This, therefore, protects the Exchange.

Investors are also protected, because any company that holds itself out as being a registered broker-dealer and attempts to engage in securities transactions will be in violation of one of the offences in the Act which prohibits the use of any deceptive devices with the intention to defraud, deceive or mislead.

All of the companies I have indicated that must be registered with the Commission, i.e. Securities Exchanges, facilitates and broker-dealers must satisfy some basic requirements prior to registration. For example, the companies must file with the Commission all material information about their directors, officers and substantial shareholders, as well as a statement of their operational capabilities. In addition, the Commission must be satisfied that the different companies meet any special requirements that accrue to them as a result of their particular business. (A good example of a special requirement would be the Securities Exchange having to supply the Commission with details about a compensation fund which member firms will pay into to defray the cost to investors and other member firms if any member firm becomes bankrupt or goes out of business).

Registration of Individuals as "Stockbrokers", "Dealers", "Traders" or "Associated Persons"

There is also a requirement that the Commission register individuals, if they are working for a broker-dealer, and that broker-dealer has gained

membership on a Securities Exchange. These individuals will be registered as stockbrokers, dealers or traders depending on the work they are performing for the broker-dealer.

Also, persons that are a step below stockbrokers, dealers or traders and are a step above performing clerical or non-securities related functions, and who are employed by a broker-dealer or a facility must be approved by a Securities Exchange as an "associated person". These are essentially your back office professional staff.

So the net effect of this complete registration process as it relates to a Securities Exchange is to document each and every individual or company operating in the market and to allow access to that information at any given time by anyone who wants it. This is a cornerstone or key ingredient of proper securities regulation and lends itself to achieving a high level of transparency, which is one of our ultimate goals. Through this process investors will know who in the market is (1) permitted to deal in securities transactions on a particular Securities Exchange and (2) who is capable of dealing in securities.

I indicated that the Commission would register stockbrokers, dealers or traders, but this function will be delegated to a Securities Exchange once one becomes operational.

Registration of "Securities Investment Advisors:

We have also addressed those individuals and companies that engage in securities transactions in or from The Bahamas who or which have not gained membership on a Securities Exchange and indeed, have no intention of seeking such a membership. These are persons who simply do business in or from The Bahamas and either advise investors about buying and selling securities or trade securities through international brokers around the world.

Such persons will be required to register solely with the Commission as a “securities investment advisor” in order to engage in such activities.

Exemptions from Registration

However, there is an exemption from registering as a securities investment advisor, but only in a specific instance. Bear in mind, that a securities investment advisor is any person that deals or trades in securities or provides securities investment advice for a fee or other reward, who is not a broker-dealer that has gained membership on a Securities Exchange. Therefore, the exemption applies to the following persons where they offer to provide or are providing securities investment advice, and such advice is only incidental to their principal business or occupation:

- (a) Financial institutions including banks and trust companies licensed under the Banks and Trust Companies Regulation Act and insurance companies registered under the Insurance Act;**

- (b) Mutual fund administrators licensed or exempt under the provisions of the Mutual Funds Act, 1995;**
- (c) Counsel and attorneys and accountants qualified to practice in The Bahamas; and**
- (d) Publishers and writers of newspapers and other publications in general circulation in The Bahamas or elsewhere who give advice only through such publications and have no interest either directly or indirectly in any of the securities upon which the advice is given and receives no commission or other consideration for giving the advice.**

Part IV: Regulatory Authority of the Commission

This part sets out the depth and breath of the regulatory authority of the Commission with the securities market in The Bahamas. The goal of this Part is to provide the Commission with the tools to identify potentially impacting developments within the securities market, and then to allow the Commission to respond to those developments in the swiftest manner possible to promote fairness, efficiency and transparency within the market.

Power to delegate

The Commission also has the power to delegate certain duties to a Securities Exchange or other bodies that are registered under this Act. This is an important feature of the Act because it creates the possibility of having

what are known as “Self Regulatory Organizations” or SROs. The primary example of an SRO will be the Securities Exchange once it becomes operational. What that means is that the Exchange will be responsible for regulating itself and its members, with the Commission maintaining ultimate oversight authority. Therefore, the Exchange will be able to establish amongst other things, rules of operation, patterns and types of reporting, listing requirements, sanctions and codes of conduct for its members and listed companies. But in all instances, the Exchange or any other SRO must adhere to the minimum thresholds established by the Act or regulations, and the Commission will approve or review any rules, policies or procedures prior to their enactment.

Powers of investigation

Another important feature of the authority vested in the Commission is the power to conduct investigations and regulatory hearings into matters relevant to the securities market, which violate or may violate provisions in the Act, or any regulations or rules made under the Act.

To bolster this power vested in the Commission the Act gives the Commission the power to impose sanctions or other relief upon persons regulated under this Act following a regulatory hearing. Most notably, the Commission may fine a regulated person up to a maximum of three hundred thousand dollars, as well as, order the disgorgement of profits or other unjust enrichment plus a penalty of up to twice the amount of such profits or unjust enrichment. In all instances, where the Commission issues an order, such an order will be subject to appeal to the Supreme Court.

Part V: Financial Requirements Broker-Dealers

This Part establishes some basic financial requirements for broker-dealers. However, this Part is instructive in that it shows you what to expect with respect to the financial requirements of other market participants.

For example, broker-dealers will have to maintain a certain level of issued and paid up capital, known as a capital adequacy requirement. The amount of capital that a broker-dealer, or any other market participant, will be required to maintain on a day-to-day basis, will be calculated based on the types of transactions they are involved in. Therefore, a broker-dealer which holds client accounts will have a far greater capital adequacy requirement than a broker-dealer which simply advises investors and holds no client accounts.

Quarterly reporting

Broker-dealers will also be required to prepare and submit quarterly unaudited financial reports, as well as an annual audited financial report to the Commission. This requirement allows the Commission to have a more proactive role in the securities market by requiring one of its most active constituents to file timely reports about their financial condition.

Part VI: The Issue of Securities to the General Public: Prospectus

Part VI is the heart of the Securities Industry Act, all other provisions are built around the prospectus requirements and are designed to support this fundamental principal of securities regulation.

This Part sets out the procedures to be followed when a company seeks to raise capital by accessing public funds through the issuance of securities. This procedure requires the production of a prospectus, which is a detailed analysis of a company's business or proposed business enterprise.

A prospectus essentially serves two main purposes.

- 1) It is simply a marketing tool used by the issuer to sell its securities; and**
- 2) It is a legal document, which will be required to be filed with the Commission.**

Once a prospectus is filed with the Commission, the Act requires that the Commission review it for compliance with the provisions Act and regulations, and if all of the requirements have been met the Commission will register the prospectus, which can then be published by the issuer to the public.

One critical issue, however, that securities regulators face world-wide is the perception of the public with respect to a prospectus that it registers. The perception is that if the regulators register a prospectus then it must be a good investment for me to put my money into. This is not the message we wish to convey.

But, despite the fact that the review by the Commission employs slight elements of merit review, the Act requires that every prospectus state prominently on its face that registration of the prospectus by the Commission does not mean approval of the contents of the prospectus, nor does it create any liability on the part of the Commission nor the Government.

Civil and criminal liability for misstatements

The overall purpose of filing a prospectus is to ensure that all material facts relating to an issue, which could potentially affect an investors ability to make an informed investment decision, are disclosed. Consequently, the Act permits both civil and criminal actions to be commenced against anyone associated with the publication of a prospectus containing untrue statements.

Civil actions may be through individual or class action suits to recoup any loss or damage that came about as a result of any untrue statement in a prospectus. And any person found criminally liable for untrue statements made in a prospectus would be liable on summary conviction to a fine of thirty thousand dollars or to imprisonment for six months or to both. OR, on conviction upon information to a fine of seventy-five thousand dollars or to imprisonment for one year or to both.

Definition of a private company

This Part also establishes a new definition of a private company. This is very important because companies run the risk of being considered a public company without ever intending to. In The Bahamas, companies will either be private or public, there is no in-between status.

In order for a company to be considered a private company, it must through its Articles:

- (1) Restrict the right to transfer its shares;
 - (2) Limit the number of its members to no more than 50 beneficial owners;
- and

(3) Prohibit invitations to the public to subscribe for any shares, debentures or other securities of the company.

Transitional provisions

In order to allow companies to adjust to this new regulatory environment the Act contains a set of transitional provisions which should give companies enough time to get their affairs in order.

I will briefly go over the different transitional provisions with respect to three categories:

- (1) Public Companies,**
- (2) Companies with 19 or less members; and**
- (3) Companies with 51 or more members**

When the Act becomes law all companies incorporated in The Bahamas under the Companies Act, 1992 or the International Business Companies Act, 1989, will have to take note of the following:

Public Companies

- 1. If a company plans to go public or has already gone public and has shares outstanding, it shall be required to comply with the reporting and continuous disclosure requirements contained in the Securities Industry Act which relate to all public companies.**

All companies with 19 or less members

2. Companies that have 19 or less members will be deemed to be private companies. Therefore, such a company will be deemed by law to have in its Articles of Association the provisions of a private company which require a company to:

- (a) restrict the right to transfer its shares, limit the number of its members to no more than fifty beneficial owners, and**
- (b) prohibit invitations to the public to subscribe for any shares, debentures or other securities of the company.**

All companies with 51 or more members

3. Companies that do not fall into one of the categories above (i.e. not public or has less than 20 members) will be deemed to be private companies for a period of one (1) year from the commencement of the Act.

NOTE:

- Therefore, companies that have between 20 and 50 members must amend their Articles of Association to conform to the provisions of the Securities Industry Act which define a private company, or else they will become public companies one (1) year from the commencement of the Act for failing to satisfy the requirements of a private company. These companies, therefore, will be required to comply with the onerous reporting and continuous disclosure requirements contained**

in the Act applicable to all public companies regardless of their intention otherwise.

- **Companies with 51 or more members must take the necessary steps to reduce their membership to less than 51 members. Failure to do so will result in such a company automatically becoming a public company one (1) year from the commencement of the Act. The company would become a public company even if it changed its Articles of Association to conform to the definition of a private company, because private companies are limited to a membership of 50 or less beneficial owners.**

So to summarize, one year from the commencement of the Securities Industry Act, the Commission will look at all companies incorporated in The Bahamas, and

- **If a company has up to 19 members, the law requires that company to be a private company and incorporate the provisions of a private company in its articles;**
- **If a company has between 20 and 50 members, that company must have in its articles the provisions of a private company, and must adhere to them, or else it will be treated like a public company; and**
- **If a company has 51 or more members, that company will be treated automatically as a public company.**

Part VII: Reporting Requirements

In this Part public companies are required to file with the Commission reports of any material changes that occur or may occur in their day-to-day affairs. The term “material change” is defined in the Act, but essentially, it is any information that a reasonable investor would consider important when deciding to purchase the securities of a public company. This information will be required to be published in newspapers circulating generally in The Bahamas. However, the company will be able to approach the Commission with a request to delay the publication of such information, if it feels that the release of such information would detrimentally impact the company. Ultimately, the Commission will have the authority to release any information if it feels that such a disclosure is in the public’s interest. The goal of the Commission in this respect is to err on the side of more information being release to the public in a timely fashion rather than leaving the public in the dark with no information to judge or evaluate for themselves.

Part VIII: Conduct of Security Business

Some of the most important provisions in this Part are those creating criminal liability for persons engaging in certain prohibited business practices or activities within the securities market.

Those offences that are the most prevalent are the employment of deceptive devices, the use of confidential information and insider trading.

If anyone commits one of these offences they could be liable to a fine up to one hundred and fifty thousand dollars, or to imprisonment for two years, or to both.

The principal behind having fines and jail sentences of this amount and duration respectively, is to act as a deterrent to would be criminals who look at the emerging securities market of The Bahamas as fertile ground to conduct their fraudulent and deceitful practices.

Part IX: Interest in Securities of Public and Listed Companies

One of the basic principals of securities regulation, is the requirement that persons who could potentially affect the operations of a public company must disclose what security interests they hold in that public company.

The Act gives effect to this basic principal by requiring directors, officers, substantial shareholders and other insiders to disclose publicly what interests they hold in their respective public companies, as well as any securities transactions engaged in by these persons with respect to the securities they hold.

Part X: Miscellaneous

And finally, Part X gives the Minister the power to make regulations. These regulations will address all regulatory aspects of the securities market and provide support and instruction to the enabling provisions of the Act.

Overall, the Act goes to great lengths to be as progressive as possible by providing the Commission with the necessary regulatory tools to effectively regulate the securities industry in the Bahamas.