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# The Bahamas

## - regulatory overhaul



In association with BFSB

**Regulatory overhaul to increase investment appeal**

**Risk-based approach to fund manager licensing**

**Responding to the changing needs of the global industry**





# The Bahamas prepares risk-based approach to regulatory oversight

By James Williams

Last July, the Securities Commission of The Bahamas (the Commission) embarked on a process to overhaul the Investment Funds Act. The Investment Funds Act 2003 was largely structured to be in line with the operations of fiduciary administrators and did not necessarily account for the appropriate regulation of the various roles within a fund structure. Consequently, the SCB's mission last summer was to address those gaps by asking two major law firms to develop draft legislation and update the Investment Funds Act that would help support institutional, as well as private wealth business.

"In launching the overhaul, it was important to the Commission that we develop best in class legislation from a

regulatory point of view and to enable the jurisdiction to gain ground in the investment funds space, particularly with respect to institutional funds," explains Christina Rolle, Executive Director, Securities Commission of The Bahamas.

Updating the regulatory regime is being proposed to remove and address elements that may cause The Bahamas to be viewed as a less attractive jurisdiction.

There are certainly other elements in play that may not be within the Commission's scope but, as Rolle highlights, it is anticipated that amending the IFA "will accomplish key improvements to the regulatory structure which will enhance The Bahamas' competitive appeal".

### Filling the gaps

Two key changes will be coming down the line with the new funds regime. When the SCB commenced the overhaul, it determined that measures would need to be taken to introduce licensing and/or registration of the fund manager. Also, measures will be taken to increase the oversight of key players in a fund structure, including the fund operator, fund manager, investment manager and custodian. The aim is to arrive at a realignment of the obligations and responsibilities of the various parties to a fund.

It is hoped that by enhancing the regulatory framework, the SCB will have greater oversight of the fiduciary responsibilities of all key players and ensure that they adhere to appropriate ongoing reporting obligations, and in so doing establishing best practices in keeping with global regulatory standards.

Ultimately, the regulatory environment must establish a regime which includes a robust framework for the licencing, ongoing supervision (inclusive of onsite and offsite examinations), investigation and enforcement of regulatory and supervisory requirements for various investment fund participants.

"We are aiming to open the jurisdiction to the global funds industry with the new IFA regime," says Rolle, adding that the new regime will also set to establish clear frameworks for Closed End and Master/ Feeder fund structures.

"We are seeking to extend the regulatory framework to custodial relationships but more importantly, we will provide a formal framework for the regulation of investment managers. We don't have the intention that all investment managers will need to be licensed by the SCB but they will probably need to submit to some sort of registration as opposed to full licensing. Those operating retail funds, for example, will need to be licensed," continues Rolle.

### Manager oversight

With Europe now well down the path to manager-based regulation under AIFMD, and the SEC requiring investment managers to register with the SEC once they exceed USD150 million in AUM, it has become *de rigueur* among global regulators to regulate managers.



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**Christina Rolle, Securities Commission of The Bahamas**

Even offshore jurisdictions have taken steps such as the BVI, which introduced the BVI Approved Fund and BVI Incubator Fund. The Incubator Fund gives start-up managers a two-year easier ride, from a regulatory perspective, where they can test their investment strategy and gain a track record, which can be extended to a third year with regulatory consent, before converting to a BVI Professional Fund.

The Commission sees the value in adopting more of a risk-based approach, with Rolle quick to confirm that there are no plans to create a blanket requirement for the licensing "of all fund managers".

"It is certainly required as a global standard that we have the capability to oversee investment managers," remarks Rolle. "Jurisdictions like the Cayman Islands do it on a risk-based approach. In The Bahamas, we intend to adopt a similar approach. We are considering building some AUM thresholds into the legislation at the fund level."

It is safe to say that in circumstances where there are strong investor protection concerns, for example, where fund managers act on behalf of retail investors, the Commission will propose licensing.

### Striving for excellence

To succeed as an international funds centre requires not just a proactive regulator but a willingness to respond to the changing needs of the global industry. In that regard, The Bahamas became the first independent country in the region with IOSCO "A" Status, which it received on December 27, 2012.

Having a robust regulatory framework in tandem with a commitment to meeting international standards is something that The Bahamas prides itself on. Being viewed as a responsible jurisdiction requires not just committing to global best practices but acting upon it.



This means adhering to, and implementing, the structures to support international cooperation and transparency.

With that in mind, the Commission's aim is to ensure that The Bahamas has all the tools necessary to ensure that it is – and will remain – a competitive jurisdiction. Pragmatism is the name of the game and while The Bahamas does not want to overregulate, it does want to be respected for best in class regulation.

“It is our view that good fund promoters and good businesses want to be in jurisdictions that are considered best in class for regulation. Anything we can do to ensure a legislative environment that complies with latest global standards can only bode well for The Bahamas,” opines Rolle.

Over the years, The Bahamas has shown its commitment by establishing robust AML and KYC regimes, not to mention the fact that it has now entered into 33 Tax Information Exchange Agreements (TIEAs) to meet international standards on transparency and tax co-operation.

On 3rd November 2014, The Bahamas and the US signed their Agreement to Improve International Tax Compliance (the Agreement) and to Implement FATCA based on the Model I IGA. As an IGA partner jurisdiction, Bahamas-based Financial Institutions will not be subject to a 30 per cent withholding tax on US source income, unless they fail to meet the requirements set out in the IGA and in Bahamas domestic implementing legislation.

The Bahamas has also built upon its FATCA platform to bring itself in line with Common Reporting Standards ('CRS').

### **Widening the scope of administration services**

Rolle is keen to stress that more can always be done, no matter what the jurisdiction. She says that the Commission is looking to enhance the legislative framework by making key changes to the current funds regime, particularly, by introducing oversight of investment managers for certain funds where investor protection is an issue and also by addressing other key gaps, for example oversight of custodial relationships.

“We certainly want to be up to date with what's going on in Europe and are taking



a proactive approach to ensure AIFMD requirements are met.

“Moreover, we are looking to open the jurisdiction to allow administration to take place from anywhere in the world and also to rationalise the responsibilities of each of the fund's operators. Both of these points are important.

“I think it would certainly put us ‘best in class’ from a regulatory point of view and it would also remove any barriers people might have when it comes to selecting a jurisdiction that might previously have prevented them from selecting The Bahamas,” says Rolle.

This point about widening out administration services is key and should go some way to making the jurisdiction more attractive to fund managers who may already have longstanding relationships with Europe-based fund administrators, for example.

Asked what the SCB would need to do to get comfortable with Bahamian funds using non-local administrators, Rolle responds: “We would prescribe a list of jurisdictions that licensed fund administrators could operate from. The main jurisdictions in the world will likely be on such a list. For a jurisdiction that is not, we would need to be comfortable with the regulatory environment. Places like Ireland would fit into that category easily.”

### **Enhancing Financial and Corporate Service Providers Act**

Aside from filling the gaps by overhauling the Investment Funds Act, The Bahamas is also



currently working to overhaul the Financial and Corporate Service Providers Act.

Specifically, the SCB wishes to enhance its regulatory and supervisory powers and to bring definition and clarity to the range of activities that fall within the scope of the Act.

It is looking to develop Rules for each specific activity, and to build a licensing and supervisory structure that is centred around each activity, as opposed to the broad, 'one size fits all' licensing/supervisory regime that presently exists.

Rolle explains this as follows: "For example, at the moment we have one broad Financial & Corporate Service Providers license. Going forward, we intend to have different categories of licenses.

"Someone who is providing corporate services would have a corporate services license, someone else providing escrow services would have an escrow services license and so on. Whatever activity they are engaged in, provided it is covered under the Act that is the license they will receive. Also, it will be possible for the license to extend to more than one activity."

This will allow the SCB to move away from blanket regulation that treats all service providers the same. With these changes, they will be regulated in a way that reflects their activities in the market. In other words, it will be a more considered, tailored approach.

Rolle confirms that the Commission is in the process of finalising the Act, which should be completed within the next couple of months.

As for engaging with the local financial services industry, the Financial and Corporate Service Providers Bill has already gone out for public consultation and feedback has been duly received for the Commission's consideration.

Proposed changes to the IFA regime, as highlighted above, are due to go out for public consultation in the coming weeks.

With independent directors playing a key role in providing proper governance and oversight to the way funds operate, jurisdictions like the Cayman Islands have taken strong measures to ensure that greater transparency and accountability are achieved.

As part of Cayman's drive to enhance its corporate governance environment, the Directors Registration and Licensing Law (2014) was introduced. Part of the rationale for doing this was to provide CIMA with greater transparency in respect of directors of Cayman funds. Although this has not made any significant change to how funds operate or who may act for funds, CIMA is increasingly proactive in its collation of information and active regulation of funds.

"We are currently considering our own register of approved directors and we are looking into the implementation of this in line with other jurisdictions," confirms Rolle.

### Europe still on radar

As well as addressing the custodian and fund manager opportunities, another catalyst for overhauling the Investment Funds Act, 2003 is the European Union's Alternative Investment Fund Managers Directive (AIFMD).

The Directive has been up and running for several years, following its implementation and incorporation into the national laws of individual Member States, the rules of which became applicable to AIFMs from 22 July 2013.

As AIFMD also applies to non-EU AIFMs that manage or market AIFs in the EU, Bahamian investment managers to EU funds are subject to the impact and requirements of the Directive. The Commission has already engaged with and executed 27 Memoranda of Understanding with counterpart regulators in EU Member states, in order to facilitate participation in their respective countries but

there are still two outstanding, which it is working to finalise: one with Germany, the other with Italy.

Europe is a key market for fund managers wishing to raise capital so it is understandably vital that those operating Bahamian funds have the confidence, and the imprimatur, to continue marketing them into individual EU Member States through national private placement rules; hence the importance of establishing MoUs.

Updating the regulatory regime will go a long way towards maintaining The Bahamas' competitive appeal and satisfy EU regulators that the necessary controls and best practices are in place, in keeping with a progressive offshore jurisdiction.

"The Commission has reached out to ESMA requesting to be included in the next round of assessments to be done by them for purposes of the AIFMD passport. Although things aren't moving that quickly, we are continuing to dialogue with ESMA with respect to that process.

"In the meantime, we are writing the legislation that will enable us to be ready for passporting under AIFMD," says Rolle, who rightly points out that Europe is "too large a market" for any serious jurisdiction to ignore.

In the Cayman Islands, the Mutual Funds Law has been revised primarily to introduce the concept of an "EU Connected Fund" to give such funds the option to be registered or licensed under the Mutual Funds Law. When the AIFMD Like Regime is formally introduced, Cayman promoters will have the opportunity to have a registered EU Connected Fund or become an EU Connected Manager.

"We aren't looking to go that route. Rather, we will be updating our licensing regime, making additional requirements which will meet AIFMD standards," confirms Rolle.

### What's on the horizon?

Looking ahead to 2018, The Commission is in the final stages of developing legislation to address crowdfunding and over the counter capital raising. It is also looking to make some key amendments to the Securities Industry Act early next year.

With respect to equity crowdfunding, new legislation is being drafted that will make it easier for smaller businesses and

entrepreneurs to raise small amounts of capital under new Business Capital Rules.

In an interview with Tribune Business\*, Keith Davies, chief executive of the Bahamas International Securities Exchange's (BISX) said the exchange had completed internal drafts of market models for both crowdfunding and small business listing platforms, to boost capital access for Bahamian entrepreneurs and small and medium-sized businesses (SMEs).

"The idea is designed to support those who want to raise say, USD1 million in a crowdfunding scenario, up to USD3 million in an over-the-counter scenario. Instead of having to meet the full-blown requirements of an IPO, the new rules will be lighter touch and enable entrepreneurs to more easily raise capital in the marketplace," states Rolle.

Another key regulatory initiative identified by the Commission is the development and implementation of a risk based supervisory framework (referred to earlier) for all Bahamian registrants and licensees. At the moment, the Commission takes a rules-based, compliance-based approach.

"We are currently looking to implement a risk-based approach which would mean collecting much more data than we do today: data on AUM, data on the funds' activities, AML data; a whole host of things. We would then need to establish a set of parameters on risk criteria that would be of concern to the SCB. The next step would then be to risk weight those parameters to provide a risk score on each licensee.

"Finally, according to the risk score, we would determine the level of monitoring that we would need to conduct on the licensee. We are at the initial stages of this," concludes Rolle.

With a host of regulatory initiatives and updates underway, there are clear signs that The Bahamas is committed to building a funds jurisdiction that is more transparent, more streamlined and more focused in how it oversees different fund activities and operations. With global jurisdictions under the microscope more than ever, being able to demonstrate best practices in its regulatory regime should mean The Bahamas is well placed for further continued growth. ■

\*<http://www.tribune242.com/news/2017/jul/20/banking-limitations-restrict-bisx-model-for/>