SECURITIES COMMISSION OF THE BAHAMAS

INVESTMENT FUNDS BILL, 2017

INDUSTRY MEETING

Thursday 7 December, 2:00 p.m.
Andros Salon, Melia, Baha Mar Resort
Nassau, The Bahamas

OPENING REMARKS:

Deputy Prime Minister the Hon. K. Peter Turnquest, MP
Minister of Finance
Commonwealth of The Bahamas

SALUTATION

Thank you, Ms. Allen. I will accept the protocol established. Ladies and gentlemen, good afternoon.

I would like to thank the Securities Commission of The Bahamas for inviting me to open today's industry briefing.

INTRODUCTION

The Securities Commission is one of the principal financial regulators in The Bahamas, and falls under the portfolio of the Ministry of Finance. The Commission is responsible for regulating and overseeing the investment funds, securities and capital markets in The Bahamas *and*, in its capacity as the Inspector of Financial and Corporate Services, it oversees financial and corporate services providers. Its legislated functions include responsibility to advise the Minister on all matters relating to the capital markets and its participants, and to promote conditions that facilitate the orderly development of the capital markets, among others. It is from the Commission's functions, powers and responsibilities—to understand the markets, to regulate and oversee them, to protect investors, to promote positive conditions for market development, to advise the Minister—that we find the foundation for our meeting today. It is my pleasure to open this afternoon's session for discourse on an eagerly anticipated piece of legislation—the Investment Funds Bill, 2017.

The Bill is a piece of legislation with the potential to usher in a new era for investment funds in The Bahamas, with a comprehensive, best-in class regulatory framework designed to overcome regulatory gaps and deficiencies in the prevailing Investment Funds Act, 2003, and create new opportunities for the investment funds industry to develop and flourish. This industry is an increasingly critical component of our broader financial services industry.

The overhaul of the investment funds' legislative framework is coming at a very crucial moment for The

Bahamas. Undoubtedly, offshore jurisdictions, the world over, have a daunting job competing for their share of the global financial services industry. The Bahamas must fight to ensure that financial services, the 'second pillar' of our economy, is strengthened and provides strong, sustainable contributions to the overall economy well into the future. We are moving to improve the ease of doing business, and correct misconceptions about the industry as regard our commitment to compliance with various international efforts to shore-up the financial system from abuse.

Related to this, we are striving to ensure the jurisdiction is renowned for balanced, effective, best-in-class regulation. In this vein, we gather today for an introduction to the Investment Funds Bill, 2017, and for some direct discourse about its provisions and intent.

BACKGROUND

Allow me to provide a little necessary background as we contemplate the events leading to the need for this Bill.

By the 1990s, the offshore arm of the Bahamas' financial services industry was already nearly 60 years old, and fairly well established – particularly the private banking, trust and fiduciary services. In many respects, the jurisdiction was poised to carve out a niche as an offshore private wealth management centre. However, it was lacking a regulated securities industry, and, more specifically, in relation to today's discussion, there was a need to develop regulation to address collective investment schemes, which operate within or from the jurisdiction. Of course, with the vibrant trust and private banking business at the time and the assent of the International Business Companies Act in Parliament in early 1990, there were private clients who needed collective investment schemes. The industry filled this need by creating funds administered by trust companies, and relied on the trust practitioners to act as fund administrators.

The passage of the Securities Board Act, 1995 and the Mutual Funds Act, 1995 answered the need to establish a regulatory regime. Of course, the Securities Board Act established the Securities Commission of The Bahamas. The Mutual Funds Act brought a new level of legitimacy to the industry and laid the foundation for what has been one of the better performing elements of our financial services industry. Strong overall growth in licensed funds and administrators over the years is evidence of the industry's performance. Additionally, the dynamism and innovation that gave birth to the SMART fund and the ICON further establish the outstanding performance of the industry.

Now, let us fast forward fifteen or so years to 2012. The new Securities Industry Act, 2011 is in force and the

Investment Funds Act, 2003, governs the investment funds industry. Globally, regulatory standards and expectations have advanced exponentially since 1990. By 2012, Know-your-client expectations, the global push to combat money laundering, terrorist financing and weapons proliferation, and the concerted effort of various governments to protect or claw-back lost revenue strained Bahamas based financial institutions. There were the OECD's Tax Information Exchange Agreements and blacklisting threats. Several financial crises had come and gone, and the United States had passed the Foreign Account Tax Compliance Act or FATCA in 2010. That same year—2010, the world standard-setter for securities regulation, IOSCO, issued its 38 Principles of Securities Regulation, which included five principles specifically addressing the regulation and oversight of collective investment schemes.

There is another important piece of this picture—assessment of The Bahamas against the International Monetary Fund's Financial Stability Assessment Programme, or FSAP was also underway. Official results of the FSAP released in January 2013, showed that although the securities regulatory regime had performed well generally, with regard to the principles for collective investment schemes, the jurisdiction had missed the mark on four of the five recommendations.

The Mutual Funds Act and its later replacement the Investment Funds Act, 2003, perhaps bespoke to needs of the financial services industry at the time, had lagged significantly behind a sea change in global regulatory standards. Committed to being regarded as an international financial centre girded by effective, balanced regulation, there was no doubt then that the jurisdiction had to address the identified deficiencies. Of course, it was the perfect opportunity to create a growth-friendly legislative framework, unencumbered by unnecessary barriers to entry.

DEFICIENCIES

Let us look, briefly, then at the substantive legislative gaps, which the Bill sets out to fill.

Among the more fundamental is transitioning from the older, exclusively rules or disclosure based approach to regulation of investment funds, to a modern approach that considers the conduct of industry participants, and includes appropriate prudential assessments. IOSCO's Principle 24 of securities regulation, with regard to investment funds, requires the regulatory system to "set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme." The assessment found that only the fund administrator was subject to full assessment of its governance, organization and operational conduct, whereas this comprehensive level of assessment should also be in place for the operators, managers/advisers, promoters, and custodians to investment funds. Further, the Report calls for related parties to an investment fund present in the jurisdiction to be subject appropriate ongoing oversight.

According to Principle 25, "the regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets." In this regard, the FSAP report noted that specific requirements concerning segregation of client assets and the operational conduct of the custodian were absent from the prevailing funds legislation. It further indicated that the absence of such requirements would likely be 'problematic' in the event of losses or insolvency of the fund operator.

Now, you may recall, earlier I said the jurisdiction received an acceptable assessment in one of the five principles specific to collective investment schemes. That was Principle 26, which says, "Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme." Well, as a disclosure based Act, the Commission met the requirement here, although the report indicated that some of the disclosure requirements still fell short of the *specificity* required by IOSCO.

The basis for asset valuation and the pricing and redemption of units of a collective investment scheme were also identified as areas of deficiency as, according to Principle 27, regulation ought to ensure these are both proper, and disclosed. The report indicated these were not in place. Further, the mechanisms and process used needed to be verifiable by the Commission, which the report indicates was not the case.

Finally, Principle 28 requires regulation to ensure that hedge funds and/or hedge fund managers are subject to appropriate oversight. As regards this Principle, the recommendation was that the Securities Commission "keep the size, asset composition and trading strategies of its professional and SMART funds under review with the objective of determining whether by virtue of size, leverage, etcetera any would fall within the broad category of hedge fund for which enhanced supervision is required."

OPPORTUNITIES

We can see, just from the nature of the regulatory deficiencies the new legislation will address, that the new framework must be substantively different from the existing one. Just as in the mid-90's, when establishing a regulatory framework undergirded the investment funds industry's credibility and set the foundation for its growth and development, today's challenges present similar, though significantly greater, opportunities.

We are serious about having, and being recognised as having, Best-In-Class regulation, and understand that by addressing some of the regulatory deficiencies in the prevailing legislation, we are fostering the industry's growth potential. For example, by appropriately aligning the respective duties, responsibilities, and hence, risk between the relevant parties to a fund, the industry may be able to attract funds business it was not able to before. Additionally, by bringing investment managers, custodians, promoters and other parties to an investment fund under comprehensive and appropriate regulatory oversight, this proposed legislation will enhance the legitimacy of the sector.

The Commission, I am advised, took great care to present a Bill, which considers the European Union's

Alternative Investment Fund Managers Directive, and the passporting process, to allow managing and marketing of alternative investment funds in the European Union, subject to the conditions of the Directive.

We trust the innovation continues, and that the financial services industry will find new and creative ways to use the proposed framework to support the financial services sector's value proposition, as occurred with SMART funds and the Investment Condominium. There are two final thoughts I wish to leave you with this afternoon. The first comes from PriceWaterhouseCoopers' recent report, "Asset & Wealth Management Revolution: Embracing Exponential Change", released October 31st.

Allow me to share some extracts from the report:

- "By 2025, AuMs will have almost doubled – rising by 6.2% a year, from US$84.9 trillion in 2016 to US$145.4 trillion in 2025, with the fastest growth seen in the developing markets of Latin America and Asia Pacific.

- -"Alternative asset classes – in particular, real assets, private equity and private debt – will more than double in size, reaching $21.1 trillion by 2025, accounting for 15% of global AuM.
- "There is a 'great divide' between asset and wealth managers who have acted to ensure they are fit for growth, and those who have not.
- "The industry's involvement in niche areas such as trade finance, peer-to-peer lending and infrastructure will dramatically increase."

…

To quote PwC's Global Asset & Wealth Management Leader, Olwyn Alexander, "Asset managers can take advantage of this massive global growth opportunity *if they're innovative*. But it's do or die, and there will be a 'great divide' between few have's and many have not's. As a result, things will look very different in five to ten years' time and we expect to see fewer firms managing far more assets significantly more cheaply."

…

The second thought is: The Bill which will determine the lay-of-the-land, and allow for the necessary innovation, *or not* allow for it, and signal to the world that the funds industry is regulated to international best practice standards, *or not*, is now in the public domain.

Now is the time to get this right, and it needs your sincere and best efforts in reviewing it, in raising queries, in challenging yourselves and the Commission, with ensuring the long term sustainability of the investment funds industry and greatest overall benefit to the jurisdiction being of paramount importance.

I wish you a productive meeting today – one that leads to an Investment Funds Act that speaks to your professionalism, dedication, creativity, innovation, and understanding of this space.

Thank you.
