

DRAFT SECURITIES INDUSTRY ACT, 2008

EXECUTIVE SUMMARY

BACKGROUND

As part of an Offshore Financial Centre mission in October 2002, the International Monetary Fund ("IMF") conducted an assessment of the supervision and regulation of securities markets in The Bahamas and a full assessment of the jurisdiction's adherence to the IOSCO Principles. In November 2004, the IMF conducted a follow-up technical assistance mission and recommended a number of changes to improve the *Securities Industry Act, 1999* ("current Act") in light of international best practices. Given the extensive nature of some of the proposed changes, it was recommended that new legislation for the Securities Commission of The Bahamas (the "Commission") be drafted.

OBJECTIVES

The proposed Securities Industry Act, 2008 ("new Act") was prepared to:

- address the issues identified by the IMF, certain inadequacies in the current Act identified by the Commission and to be consistent with international best practices;
- move to a flexible legislative structure to allow the Commission to respond quickly and effectively as circumstances change;
- strike a balance between stripping out all the details and leaving a sufficient structure in place to reduce the pressure to have full rules in place immediately; and
- reassure market participants that the changes introduced are evolutionary, not revolutionary.

OVERALL STRUCTURE

The new Act has been drafted so that key legal obligations appear in the Act itself, while detailed requirements will be set out in regulations or Commission-made rules.

This structure is increasingly being used for securities legislation owing to the rapid pace of change in the industry. Securities regulators need to be able to respond quickly and with instruments that are legally enforceable.

This format also reassures market participants that the changes introduced are evolutionary, not revolutionary, as the familiar requirements can still be seen. It is also necessary to balance the need for investor protection and efficient markets with the need to encourage further developments of the market itself and not impose an excess burden on market participants.

APPLICATION OF THE NEW ACT TO INVESTMENT FUNDS

The new Act has been drafted to apply in part to investment funds and activities related to investments funds. Those sections that deal with general matters – including the Commission's functions, scope of jurisdiction, specific investigation, inspection and enforcement powers and general rule-making, exemption and recognition authority – apply equally to investment funds and participants in that market. These would include all of the provisions in Parts II [the Commission], III [Assistance to other Regulators], IV [Investigations and Inspections] and XV [Enforcement]. In addition, most of Part XVII [General Provisions] and certain parts of Part XIII

[Market Misconduct], **EXCEPT** the sections that refer to trading in securities of public issuers, also apply to investment funds and other related parties. The provisions in the new Act dealing with licensing and disclosure do not extend to investment funds. Investment funds have been carved out of the rules in the new Act directed at governing public issuers (prospectus and continuous disclosure requirements and civil liability for misrepresentations), as the Commission is largely satisfied with the comparable rules contained in the *Investment Funds Act, 2003* ("IFA"); therefore Parts X [Continuing Obligations of Public Issuers], XI [Governance], XII [Take-over Bids], XIV [Reporting of Shareholders of Public Issuers], and XVI [Civil Liability] by definition do not apply to investment funds.

KEY CHANGES

A. PART I – PRELIMINARY

New Purposes Clause. (section 3) The first significant change in the new Act is the inclusion of a purposes section as recommended in the IMF Report. A purposes clause helps to define the scope of the legislation and provides guidance on interpreting the provisions, particularly where matters of public interest are concerned.

Definitions. (section 4) The definitions section contains a number of new provisions made necessary by the changes made in the rest of the new Act. Where significant changes have been made to existing definitions, or important new definitions have been introduced, they are generally discussed with the Part of the Act where they are most relevant.

Securities and Securities Business. (section 7)

The definition of securities and the activities giving rise to the obligation to register under the Act as set out in the First Schedule have been fundamentally restructured. The categories of registration of firms and individuals will be significantly simplified as a result. Part 1 of the First Schedule sets out the definition of securities. Part 2 of the First Schedule sets out four distinct types of activities that would constitute securities business: dealing, arranging deals (largely corporate finance work or promotional activities), managing securities and advising on securities. Part 3 of the First Schedule exempts a number of activities, such as trading for one's own account or incidental advice as part of a professional's activities, and Part 4 of the First Schedule lists exempt persons, such as receivers, executors or lawyers where the activities are incidental to their professional activities.

Part 1 expands the definition of securities in the current Act dividing it into discrete activities. The overlap in activities present in the current Act has therefore been eliminated. The regulations will specify particular registration requirements that must be met to carry on each activity and the terms attached to a registration will set out the authorized activities.

Carrying On Business In or From The Bahamas. (section 8) A new interpretive provision has been created in the new Act which, sets out the tests for carrying on business in or from the jurisdiction.

B. PART II – THE COMMISSION

This Part provides for the continuation of the Commission and sets out its functions, powers, constitution and resources. It is proposed that the present framework remain essentially the same as the current Act, but that certain changes are made to provide more comprehensive powers along with greater clarity, independence and accountability.

C. PART III – ASSISTANCE TO DOMESTIC AND FOREIGN REGULATORY AUTHORITIES.

This Part of the new Act contains the powers of the Commission to obtain and share information with other regulatory authorities, both within and outside The Bahamas.

The Commission is given the full range of powers to provide any information already on file and to get information from anyone in the jurisdiction (not just regulated persons) in response to a request from an overseas regulatory authority. The information may also be passed on to another person in the overseas authority's jurisdiction if certain preconditions are met, including those persons being named in the original request and the Commission giving a specific consent to the passage of the information. The powers of the Commission to require a person to provide information are written to overrule the provisions of any other law regarding secrecy. The sections recognize a person's right not to have compelled statements used against them in criminal matters and the right to claim legal privilege on the appropriate documents.

The ability of the Commission to fulfill its obligations under international best practices to assist other regulators is enhanced by provisions in Part IV allowing the Commission to institute an investigation or carry out an inspection to assist an overseas regulatory authority.

D. PART IV - INVESTIGATIONS AND EXAMINATIONS

Investigation Powers. (sections 41-42) The investigation powers under the current Act have been expanded substantially to give the Commission the full range of powers contemplated by the IOSCO Principles and that are present in the securities legislation of many other countries.

Under the new Act, the Commission may initiate an investigation against any person to determine whether the person has contravened, is contravening, or is about to contravene any provision of Bahamian securities laws. An investigation may also be initiated for the administration of Bahamian securities laws or to assist in the administration of the securities laws of another jurisdiction.

The Commission may carry out the investigation directly or appoint another person to act on its behalf. The provisions are drafted to give the Commission full authority to summon witnesses, compel testimony and compel the production of documents. The Commission is also given search and seizure powers.

Inspection Powers - Regulated Persons. (section 44) The current Act provisions have been expanded to allow the Commission to inspect any regulated person (which for the purposes of this Part includes a registrant, registered marketplace or clearing facility, investment fund or party related to an investment fund) whenever the Commission chooses to do so. No notice is required and the Commission does not have to suspect a breach of the Act to carry out the examination. The draft gives the Commission a full range of powers to enter the regulated person's premises, look at data, take copies etc. contemplated by the IOSCO Principles. The section requires the regulated person to pay for an inspection of this type, and provides for the Commission to give an exemption as appropriate. The Commission may also require the regulated person's auditor to review and report on the regulated person's operations (also at the regulated person's expense; see section 45).

Inspection Powers - Other Market Participants. (section 46) The new Act gives the Commission the authority to conduct limited compliance inspections of other market participants beyond regulated persons. This would allow the Commission to order a market participant such as a public issuer to produce documents or other information to ensure that requirements under

securities laws are met. Again, the market participant bears the costs of this review. On-site examinations are not specifically contemplated.

E. PART V – REGULATION OF MARKETPLACES, SELF-REGULATORY ORGANISATIONS, CLEARING FACILITIES AND OTHERS

The sections from the current Act have been substantially rewritten to simplify and clarify the regulatory regime that would govern securities exchanges, clearing facilities and others.

In particular:

- all marketplaces and clearing facilities are required to be registered with the Commission to do business in or from the jurisdiction;
- SROs and ancillary facilities may be registered, but are not required to be, unless the Commission decides it is in the public interest to require registration;
- the application requirements and initial standards to be met (fit and proper personnel and shareholders, satisfactory operational systems and trading rules etc.) will be set out in the regulations or rules;
- the Commission will register an applicant only if all the initial requirements are met and the Commission is of the view that registration is in the public interest; and
- all registrations may be subject to terms and conditions.

F. PART VI – REGISTRATION OF PERSONS CARRYING ON SECURITIES BUSINESS

Categories of Registration. The various current categories of broker-dealer, trader, broker, stockbroker, and securities investment advisor with overlapping permitted activities have been replaced with a single requirement in section 69 that any person carrying on securities business as defined in section 7 of the new Act (and described in Part 2 of the First Schedule to the Act) must be registered with the Commission. The regulations will contain the detailed application requirements and set out the criteria for licensing, including fit and proper tests for key personnel and significant shareholders, initial capital and operational capacities etc. The regulations will also set different initial and on-going requirements for each type of activity the firm is intending to engage in.

Registration of Individuals. The registration regime does not contemplate an individual being registered other than in association with a registered firm. The new Act makes it clear that upon ceasing to be employed by the firm, that individual's licence is automatically suspended (section 69(6)). It can be reinstated upon employment with a new firm and the criteria for transfers or reinstatements of registration of individuals should be set out in the regulations. As in the current Act, all individuals acting for a firm in carrying out securities activities must be registered, other than ones carrying out strictly administrative tasks. The regulations will set out the detailed criteria to be met, which may differ depending on the role the person plays in the firm and the activities to be carried on. For example, more experience may be required of someone registering as a director or officer of a firm or as someone who is proposing to manage portfolios on a discretionary basis for the firm's clients, than for a retail salesperson.

G. PART VII – CONDUCT OF SECURITIES BUSINESS.

General Duties of Registrants. The sections of the current Act and regulations governing the conduct of a registrant's business have been clarified and expanded to include several of the key

provisions from the BISX rules, such as the duties to act (a) honestly and fairly in conducting its business activities in the best interests of its clients and the integrity of the market; and (b) with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

H. PART VIII – COMPENSATION FUND

Given that under current practices all customer cash must be held in a trust account, all trades on the exchange are settled on a delivery against payment basis and the securities are generally held in non-certificated form at the central depository, the risks to investors on a failure of a dealer should be minimal, so the establishment of a fund is not an immediate priority in The Bahamas.

I. PART IX – DISTRIBUTIONS AND PROSPECTUSES

The sections from the current Act are largely in compliance with international standards; however have been substantially rewritten to be less confusing and more consistent. The prospectus disclosure regime would now be triggered by the nature of the transaction being undertaken, rather than the behaviour of the parties involved. No prospectus would be required unless a person were carrying out a distribution, which primarily means a primary offering of securities from the issuer's treasury.

Preliminary Prospectus. The new Act introduces a requirement for a preliminary prospectus that must be delivered to anyone who has been solicited to purchase the securities prior to the issue of the receipt for the prospectus in final form (sections 85 to 92). The preliminary prospectus is essentially the draft prospectus as presently filed with the Commission. The form requirements are the same as a prospectus, except certain details (such as the price of the securities) may be omitted. The preliminary prospectus must contain a prominent statement on its face that no securities commission has reviewed the information in the document and it is subject to change. The Commission has the right during the review period to order the issuer and its agents to stop soliciting purchases using the preliminary prospectus and to require changes be made to the document before any further solicitations are made (section 87). In addition, paragraph 138(1) (p) gives the Commission the authority to order a distribution to cease and all subscription funds to be repaid.

The current Act says no solicitations are permitted to take place until the receipt for the prospectus is issued. Experience suggests that this prohibition is not followed in practice, leaving the Commission with both enforcement issues and no control over what sort of information is being used to sell the securities. The preliminary prospectus process recognizes that the solicitation activities are going to take place and seeks to protect investors by mandating the delivery of a document containing specified information.

J. PART X – CONTINUING OBLIGATIONS OF PUBLIC ISSUERS¹

All public issuers would be subject to the same disclosure requirements; continuous disclosure obligations would be extended from listed companies to all public issuers. The regime introduced in the new Act incorporates the continuous disclosure requirements for listed companies from the BISX rules and applies these requirements to all public companies. General standards for disclosure, fair treatment of shareholders and the fiduciary duties of officers and directors of public issuers are also mandated as recommended in the IMF Report (see section 98). These standards are followed by detailed requirements on disclosure of material changes, provision of annual and interim financial statements, annual reports and on proxy solicitation. The draft also introduces a requirement that public issuers send financial statements and annual reports to their securityholders, as this is best practices under both securities and corporate legislation.

K. PART XI – GOVERNANCE AND OTHER REQUIREMENTS

There are a number of regulatory initiatives underway in the major jurisdictions to upgrade the requirements for corporate governance at public issuers. The most high profile legislation is the *Sarbanes-Oxley Act* in the US. However, as yet, there is no international consensus on best practices in this area. The new Act prescribes that the specific requirements (**section 106**), will be set out in the regulations.

L. PART XII – TAKE-OVER BIDS

One of the acknowledged gaps in the regulatory regime in The Bahamas is the lack of a regime to govern take-over bids that ensures all securityholders are treated in a fair and equitable manner on a change of control or similar transaction with respect to the public issuer. The new Act sets out an overarching requirement that take-over bids be carried out in compliance with the law and prescribe that the specific requirements (**section 107**), will be set out in detail in a separate regulation or code.

M. PART XIII – MARKET MISCONDUCT

Prohibited Acts. The full range of market misconduct offences have been included in the new Act, including market manipulation, market rigging by creating artificial prices or artificial activity, misleading or deceptive conduct, issuing false or misleading statements, improperly inducing persons to deal, general dishonest conduct and the making of prohibited representation (**sections 107 - 118**). The provisions governing trading on undisclosed information ‘insider trading prohibitions’ (**section 119**) have been clarified and the related concept of ‘front running’ has been introduced (**section 120**). In addition to direct trading by the person with material undisclosed information, encouraging someone else to do so or passing the information on to a third party, other than as required in the course of business ‘tipping’ are also offences (**sections 119 (3) 120 (2)(c) and (d)**).

¹ As investment funds are not going to be public issuers under the new Act, this Part implicitly does not apply to these issuers.

N. PART XIV – REPORTING BY SECURITYHOLDERS OF PUBLIC ISSUERS

As in the current Act, this Part of the new Act covers two distinct sets of reporting requirements: reporting by insiders (officers, directors and significant securityholders, etc.) of a public issuer and the ability of issuers to obtain information about their beneficial security holders. Both sets of requirements have been simplified and clarified. Any necessary forms and timing requirements would be set out in the regulations.

O. PART XV – ENFORCEMENT

Enforcement Orders. (sections 132 - 138) The sanction provisions in the current Act are extensive, but not comprehensive. Additions made in the new Act include issuing compliance orders or cease trade orders against an issuer or any person, withdrawing exemptions, prohibiting someone from acting as a director, officer, auditor or consultant to any market participant, requiring or prohibiting publication of information, and appointing a person to assume control of a registrant or advise a market participant on the proper conduct of its business. All of these can be imposed after a hearing or on a settlement with a party and the Commission authority to take action extends to investment funds and their related parties. The Commission has also been given the authority to freeze assets on a temporary basis, both for domestic reasons or to assist in the administration of the laws of another jurisdiction.²

Appointment of Receiver. An analogous power has been given to the Commission to appoint a controller for a regulated person³ (section 140(1) (m)). There is no reference to requiring a court order, but the temporary order/prompt hearing requirement (discussed below) would apply.

Administrative Penalty. (section 135) The new Act contains the power for the Commission to impose monetary penalties for breaches of the Act. This is stated to be subject to the right to a prior hearing.

Hearing Requirement. The IOSCO Principles and the rules of natural justice generally require that no sanction be imposed before the person is given an opportunity to be heard. However, best international practice recognizes that the public interest may demand that the regulator act quickly, and without holding a hearing. Accordingly, the enforcement provisions, as drafted, allow the Commission to apply many of the sanctions without holding a hearing, but only for a maximum of 15 days (subsections 133(3)-(6)). A notice of hearing must accompany the temporary order.

Hearing Process. The Commission has been given the authority under paragraph 32(5) (b) to determine its own hearing process. The elaborate disciplinary process set out in the current Act has been deleted.

Costs. (section 137) The provisions on costs say that that the Commission shall require a person to pay investigation and hearing costs. These costs also may include the costs of a monitor, advisor or controller appointed under an order of the Commission. The Commission retains the discretion to grant an exemption from the requirement to pay costs.

² The language in this section 138 parallels that of subsection 4(2) of the Financial Intelligence Unit Act, 2000.

³ Regulated person is defined in section 4 as including a person registered under Part V [Marketplace etc.], a registrant, an investment fund or an investment fund administrator.

P. PART XVI – CIVIL LIABILITY FOR MISREPRESENTATIONS.⁴

This Part of the new Act addresses civil liability and the rights of investors where there has been a misrepresentation in a prospectus. The existing provision in the current Act has been rewritten to clarify an investor's rights of action against the various parties involved and to introduce the remedy of rescission as an alternative to taking action for damages.

Q. PART XVII – GENERAL PROVISIONS

This Part contains the Commission's rulemaking authority, provisions governing some administrative proceedings and appeal processes and sets out the Commission's authority to make orders in some detail. It also contains the power to recognize foreign securities exchanges and foreign jurisdictions for various purposes under securities laws. This Part also contains procedural provisions for appeals of decisions of the Executive Director, reviews of decisions by a regulated person – principally BISX – and the appeals of Commission decisions to the Supreme Court.

Public Availability of Documents. Section 158 imposes a new obligation on the Commission to make all documents "filed" with it available to the public, subject to an exemption where the disclosure would not be in the public interest. From a policy perspective, this disclosure requirement is aimed at raising the level of information available to the securities markets thereby increasing transparency, efficiency and fairness. Filings can be made available through direct access at the Commission offices or by posting the documents to its website. This is in accordance with international best practices in the area.

⁴ As investment funds are not going to be public issuers under the new Act, this Part implicitly does not apply to these issuers.