



The Bahamas 360: The Complete and Compelling Choice

Presented by the Bahamas Financial Services Board

In Partnership with Global Fund Media Group

Tuesday 22 March 2022; 9:20 a.m.

University Club of New York

1 W 54th St., New York

Balancing Innovation with Regulation:

An overview of the SCB's approach to regulation in developing two innovative, modern pieces of legislation: the Investment Funds Act, 2019, and the Digital Assets and Registered Exchanges Act, 2020.

(As prepared)

Presented By:

Ms. Christina Rolle

Executive Director

Securities Commission of The Bahamas



Salutations

Thank you, Gwyn. [Mr. Gwyn Roberts, Moderator]

- Senator the Honourable Michael Halkitis, Minister of Economic Affairs, Commonwealth of The Bahamas
- Ladies and Gentlemen.

Good morning.

I am pleased to be here today to discuss some of the exciting and ground-breaking legislative and regulatory developments in the investment funds and digital assets space over the last few years. Both of these areas are regulated by the Securities Commission of The Bahamas, which also regulates the securities industry, the capital markets, and financial and corporate service providers in The Bahamas.

Introducing the Securities Commission of The Bahamas

Please allow me to quickly introduce you to the Securities Commission of The Bahamas -- in case you are not familiar with us. The Commission has regulated securities, investment funds and the capital markets in The Bahamas since 1995. We became an 'A' signatory to the IOSCO multilateral memorandum of Understanding, or MMoU, in 2012, and by 2018, had so matured in our regulatory capacity and legislative authority that the Commission became the eighth regulator in the world demonstrating the requisite capacity and intent to be successfully accepted to sign onto IOSCO's Enhanced-MMoU.

The Commission is an engaged member of IOSCO, with staff serving on a number of committees and involved in various work streams in recent years. I have the honour of serving as the elected vice chair of the IOSCO's Inter-American Regional Committee, and in this capacity, I currently serve as a member of IOSCO's board. The Commission also serves on IOSCO's Committee 3 regarding Market Intermediaries and Committee 4 with respect to Enforcement and International Cooperation. We are active members of IOSCO's FinTech and ICO networks and have recently been nominated to join IOSCO's Task Force Governing Fintech and Innovation (including Cryptos).

At the 31st of December, 2021, the Commission was responsible for the oversight of:

- 167 securities firms,
- 704 individuals performing registrable securities activities,
- 683 investment funds, approximately
- 376 investment fund managers,
- 45 investment fund administrators,
- 246 financial and corporate service providers, and
- 3 digital assets business.

The Historic Balancing Act

There is one more thing I would mention about the Commission, particularly in the context of this Bahamas 360 Event. Unlike many securities regulators from jurisdictions with mature, well-developed capital markets, the Commission has an expressed mandate to create

and promote conditions that facilitate the orderly development of the capital markets.

This is important, I believe, and impacts the topic under discussion this morning: balancing innovation with regulation. The Commission's approach to regulation, and innovation, were forged in the historic circumstances of the Bahamian financial services industry, and the reality of the vital role the industry plays in our economy, where it represents the second largest contributor after tourism.

A history of innovation

The Commission has been associated with significant innovations in the financial services space for some time. Prior to the two we will discuss this morning, there was the immensely successful introduction in 2003 of the Specific Mandate Alternative Regulatory Test Fund, or SMART Fund as many of you will know it. Currently, SMART Funds account for 65 percent of the investment funds licensed with the Commission, and have certainly established themselves among international wealth managers.

The Commission was also intrinsically involved in the development of the innovative Investment Condominium Act, 2014, which provides an alternative structure for investment funds that wealth managers in civil law jurisdictions may be more familiar with.

There are certain key elements which continue to drive and facilitate the Commission's pragmatic approach to innovation and regulation:

- First, it is an understanding that compliance with international standards and best practices is critical for sustaining the credibility of the jurisdiction and the existence of our wealth management industry,
- We also have a clear understanding of industry demand for access to new opportunities and its vulnerability to regulatory risk,
- We are committed to ensuring that legislation provides appropriate protection mechanisms, particularly for the most vulnerable investors or consumers, and safeguards the financial system from abuse,
- We enjoy High level support from policy-makers and stakeholders, and
- We continuously develop and improve upon our regulatory capacity, which includes the infrastructure, experience, foresight and talent necessary to develop and oversee an appropriately robust, thoughtful and innovative regulatory framework.

The Investment Funds Act, 2019

A modern approach

As I continue with my remarks this morning, I would first like to give an overview of the Investment Funds Act and then touch upon the Digital Assets and Registered Exchanges Act.

The legislative predecessor to the Investment Funds Act, 2019, had supported The Bahamas' wealth management industry at the turn of the millennium. By the time The Bahamas underwent its peer review under the International Monetary Funds' Financial Sector Assessment Programme in 2012, however, the framework had fallen behind, in terms of compliance with international standards. The jurisdiction received good results for overall compliance in its securities regulation, but the investment funds regime in particular was found to be deficient, and had to be brought into compliance with the majority of IOSCO's core principles specific to investment funds.

The primary reason for this non-compliance was the previous regime's focus around the investment fund administrator. This impacted several elements of regulation as a result, the former framework failed to focus on the regulatory risk posed by funds-related activities. Moreover, it did not appropriately apportion administrative and fiduciary duties amongst the parties related to an investment fund.

The Commission modernized the legal and regulatory framework with the introduction of the Investment Funds Act, 2019, or IFA, to create an internationally compliant regime. Strategically, we used the overhaul as an opportunity to build a more internationally competitive framework.

As a result, the licensing triggers were changed to focus on the conduct of, or intent to conduct, investment fund activity. Investment

fund managers, custodians and operators were properly captured in the legal and regulatory framework. The Act was simultaneously made AIFMD-passport ready, and opened up the funds business in The Bahamas in other notable ways.

Licensing Triggers

The licensing triggers for an investment fund were a key element to address in the new regime. “Carrying on business in or from The Bahamas” now applies to an investment fund that is incorporated in The Bahamas, or offered for sale to non-accredited investors in The Bahamas. Therefore, investment funds are eligible for licensing based on the activity they conduct or intend to conduct and who will be impacted by those activities, and not on whether or not certain service providers to the fund are located or licensed in The Bahamas.

Administrators From Any Prescribed Jurisdiction

As a result, a Bahamas based fund is no longer required to appoint an investment fund administrator in The Bahamas to provide its principal office. Investment fund administrators for Bahamian investment funds may be licensed under the Investment Funds Act, or licensed and operating in any prescribed jurisdiction throughout the world. This is a competitive advancement, as it opened the door for international administrators to license funds under the Act.

The key change for administrators, however, was the rationalization and correct apportioning of the administrative and fiduciary duties among the parties related to an investment fund.

Investment Fund Managers

Under the IFA, funds must appoint an investment fund manager, except in some very specific circumstances. Importantly, investment funds may appoint investment fund managers licensed or registered in prescribed jurisdictions without the need for licensing of the fund manager in The Bahamas. There is a simple registration process.

On this subject, note that the fund manager must be licensed if the fund is sold to non-accredited investors, but does not need to be licensed if the fund is being sold to accredited investors only.

Custodians and Operators

Funds must appoint a custodian, who must be independent of the administrator, manager, and operator of the investment fund, and is obliged to segregate the cash and other assets of the fund from those of the custodian itself.

Funds are also required to appoint operators, based on how the fund is structured. Operators have responsibility for the operation of the fund in compliance with the Act, and the fund's constitutive documents. They are subject to fit and proper assessment, and must be independent of the administrator unless exempted from this requirement, or structured as an investment condominium.

EU, AIFMD & Audits

Finally, the Act is also compliant with the European Union's Alternative Investment Fund Managers Directive, or AIFMD. This

allows The Bahamas to qualify for passporting under the Directive. The framework grants a distinct license for managers operating in the European Union or managing funds from the EU.

The current investment funds regulatory regime also addresses the EU's standards for investment funds regarding the regulation of auditors. Under the framework, all funds which do not submit to a full annual audit are required to receive a certification, every three years, from a qualified accountant that its books are being maintained within IFRS or U.S. GAAP standards. Auditors must be approved by the Commission to act on behalf of regulated persons.

Digital Assets and Registered Exchanges Act, 2020

Drivers of the DARE

I would like now to pivot, if I may, I talk a little bit about DARE

--

Our primary objective in developing the Digital Assets and Registered Exchanges Act, 2020, or DARE as it is becoming increasingly known, was to bring regulatory certainty to a dynamic, fast paced and evolving space. The Commission had observed the potential the space represented for our wealth management industry with increasing investor interest in fintech and crypto assets globally. We also fielded interest from international fintech operators seeking to operate in a well-regulated, compliant jurisdiction. Enveloping

these opportunities, the government had also made clear its intention to transform the jurisdiction into a regional fintech hub.

Development

To develop the legislation, the Securities Commission initially conducted a benchmarking exercise of 13 select jurisdictions, honing-in on regulatory approaches, global standards and best practices in the digital or virtual assets space. We reached out to other regulators with relevant experience, and consulted with industry and other stakeholders to develop the legal framework.

The DARE Act came into effect on the 14th of December 2020. It provided sought-after clarity, and successfully established a Bahamian legal and regulatory framework for the registration of digital token exchanges and for the issuance of digital tokens via initial token offerings.

DARE provides key legal definitions for salient terms including digital asset business, digital assets services provider, digital token, non-fungible token, utility token and virtual currency token, among others. It intentionally does not set out to answer the question of whether a digital asset is a security or not, which I will speak more to in a moment.

On a related note, you may be aware that the Central Bank of The Bahamas successfully introduced the world's first Central Bank Digital Currency. I note that digital fiat currency distributed by or approved for distribution by the Central Bank of The Bahamas is

excluded and not subject to regulation under DARE. Non-fungible tokens and security tokens are also excluded or exempted from DARE.

Our Pragmatic approach

The digital assets or crypto space is still in its infancy, or in any event, far from its maturity, so it was clear to the Commission that we needed to establish a legislative framework that was not overly prescriptive. This allows us to be nimble and able to react to new risk trends, or market development opportunities, as the evolving landscape demands.

An excellent example of this manifests with the Commission's approach to determining if a crypto/digital asset was a security or not. Through the Act, although various types of digital assets are clearly defined and we are clear about what is in scope for regulation, digital assets or cryptos are recognised as its own asset class and by giving the space its own regulatory regime, we have removed this narrow question, and its inherent uncertainty, of whether a crypto is a security and provided a framework whereby digital assets can be addressed holistically.

Pragmatism is a key consideration in our approach to regulation and we continue to watch as trends indicate a move toward securities and other asset classes becoming tokenized.

AML/CFT/PF Focus

How DARE seeks to address global AML/CFT standards such as the Financial Action Task Force's Recommendations, in particular,

Recommendation 15, is vitally important and I would like to touch on this area as well. Recommendation 15 and its explanatory notes are fairly involved, so this is a very high level look at our approach.

Under DARE, digital assets business is subject to the primary national AML/CFT legislation, including the Proceeds of Crime Act, 2018, the Anti-Terrorism Act, 2019 and the Financial Transactions Reporting Act, 2018.

DARE requires financial institutions to perform initial risk assessments prior to launch. The Act requires digital assets businesses to have systems in place to prevent, detect and disclose money laundering, terrorist financing and suspicious transactions. They must also comply with the Commission's rules, policies, and guidelines on risk management and the prevention of money laundering and terrorist financing.

The term 'beneficial owner' in DARE is assigned the same meaning as in The Bahamas' Proceeds of Crime Act, harmonizing the definition with this key piece of legislation.

DARE focuses AML/CFT supervision and oversight on the digital asset service provider, rather than trying to regulate new technologies themselves.

Finally, I note that the Act provides the Commission with appropriate administrative sanctions to punish and deter misconduct, including powers to ban registrants, suspend managers,

and remove directors, officers and other senior managers or general partners.

Conclusion

In developing DARE, we set out to establish The Bahamas as a leader in the crypto asset space. There is a journey still ahead of us to get there, but we are not daunted from that objective. Managers and staff are eagerly embracing high-level capacity building opportunities with world-leading education programs, such as MIT, Wharton and Cambridge's Judge School of Business. We are engaged with the industry through the Global FinTech Network and other opportunities and position ourselves to be on the cutting edge of regulatory developments coming out of IOSCO, the FATF and other pertinent standards setters.

If you know anything about The Bahamas, you know we do not view our size as a handicap, but a reality we can leverage to our benefit. The close access that we as regulators have to industry players and regulatory addressees, policy makers, and the consumers and investors we aim to protect allows us to identify and act on urgent matters, and to be innovative in providing solutions to regulatory concerns.

We are applying these approaches and principles to decentralized finance, and you will see it manifested as we roll-out the new Securities Industry Bill for consultation later this year.

Ladies and gentlemen, there is a lot more I could tell you about, but I won't take any more of your time this morning.

I hope to get to meet many of you and answer questions later. I look forward to continuing this process of learning from each other and to explore opportunities to develop and grow the financial services industry in The Bahamas.

With that, I thank you for your time and attention. I will join the panel later and look forward to your questions.