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THE BAHAMAS: A COMPLETE AND COMPELLING CHOICE

*A WealthBriefing mini-series
on The Bahamas financial
services industry*

EDITION 4

*'How First-Class Regulatory
Innovation Can be Crucial To A
Jurisdiction' and 'The Bahamas:
A Fearless But Pragmatic
Financial Centre'*



INTRODUCTION

The Bahamas – where new ideas are more than welcome

When selecting a jurisdiction to set up your business - whether it involves a family office, a private bank, a trust company or a wealth manager - you need to have a good rapport with the regulators. International financial centres are all grappling with new financial ideas and approaches to complex problems, some of which require regulatory support or approval. Bahamian regulators are open to discussing such innovative concepts and approaches, giving them a speedy and deliberate hearing, provided that they do not stray away from international standards. There is earnest commitment to keeping bad actors out of the market.

The Bahamas is among the few international financial centres to have exhibited resilience throughout the worst ravages of the global pandemic and ensuing economic uncertainty from which the world is still recovering. This is partly because no other financial jurisdiction, on a per-capita basis, can match the level of expertise and diversity in offerings that it offers. Moreover, the country is ideally located between the Caribbean and the large population centres of the eastern United States.

In our final mini-report in this year's series, we focus on The Bahamas' very flexible trust laws. Further, we look at the *Investment Funds Act*, which obliges each fund to appoint an investment fund manager, except in some very specific circumstances. Sometimes, if certain safety measures obtain, the fund can appoint a manager in another jurisdiction without the need for licensing in The Bahamas. Each investment fund must appoint a custodian that must be independent of its administrator, manager and operator, unless the fund's operators certify that the fund's structure or the nature of its assets do not require the appointment of a custodian.

In this last instalment, we shine a light on innovation in the sector, examining the ICON fund structure, aimed at the Brazilian market, the regulatory changes that have occurred in the foreign exchange market and the innovative Smart Funds regime. Additionally, the jurisdiction is positioning itself as a digital assets hub, aided by a progressive legislative framework in the form of the *Digital Assets and Registered Exchanges Act*. We also look at the public-private partnership that plays an indispensable part in driving progress along in the financial centre.

The Bahamas adheres to international standards pertaining to economic substance, transparency and cooperation and has removed all preferential exemptions. The *Investment Funds Act* is a good example of how offerings have been enhanced to comply with international standards, as it does with the EU's Alternative Investment Fund Managers Directive (AIFMD). This is underpinned by a genuine commitment to ensuring that the integrity of the jurisdiction is maintained.

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ADVERTISING SUPPLEMENT

HOW FIRST-CLASS REGULATORY INNOVATION CAN BE CRUCIAL TO A JURISDICTION

* by Christina Rolle, the Executive Director of the Securities Commission of The Bahamas

The Bahamas is a swiftly evolving environment for securities and investments and the regulatory body in charge of the process has used its imagination to modernise the rules. Its watchword is pragmatism.



The *Digital Assets and Registered Exchanges Act 2020* – otherwise known as the *DARE Act* – and the *Investment Funds Act* – or *IFA 2019* – have gained international acclaim for their innovative, pragmatic responses to vexing regulatory concerns. Legislative initiatives are opportunities to solve problems but they are also opportunities to innovate. At the Securities

Commission of The Bahamas (SCB), we are deeply committed to coping with regulatory risks pragmatically, taking the view that this will distinguish us from others.

“Legislative initiatives are opportunities to solve problems but they are also opportunities to innovate”

Before 2019, by way of illustration, the legal framework that governed investment funds had not kept pace with international best practices and standards. It had supported The Bahamas’ wealth management industry at the start of the millennium, but a peer review that The Bahamas underwent as part of the International Monetary Funds’ Financial Sector Assessment Programme in 2012 found it to be deficient in several key areas. As for the digital assets space, despite its growing importance to investors and wealth managers there was no body of law in place to provide much-sought-after legal and regulatory clarity.

In both instances, the Commission found itself in a position to use its technical expertise to develop legislation and recommend same to the Government of The Bahamas. We looked at the needs of stakeholders, prioritised those needs and then came up with – and carried out – pragmatic, sustainable, best-in-class solutions.

PRAGMATIC LICENSING TRIGGERS FOR INVESTMENT FUNDS

The *IFA 2019* dictates that an investment fund that carries on (or attempts to carry on) business in or from The Bahamas must be

licensed as a Standard, Professional, or Specific Mandate Alternative Regulatory Test (SMART) fund. ‘Carrying on business’ in this context now applies to an investment fund that is incorporated in The Bahamas or offered for sale to non-accredited investors in The Bahamas. An investment fund is therefore required to be licensed based on the activity that it conducts or intends to conduct rather than on whether or not certain service providers to the fund are located or licensed in The Bahamas.

REGULATORY RESPONSIBILITY AMONG RELATED PARTIES

The previous investment fund legislation did not provide for the regulation of investment managers and placed burdensome responsibilities on investment fund administrators for funds licensed in The Bahamas. This may have met the needs of the primary users of investment funds in the early 2000s – private banks and trust companies servicing their clients – but as the funds industry evolved, this misalignment of responsibilities became too onerous for administrators and did not address the lacuna of fiduciary duties which should be the responsibility of the investment manager.

Funds needed flexibility in selecting administrators and non-accredited investors expected to be able to deal with vetted and licensed investment managers. The *IFA 2019* brought these things about by arranging for the licensing and supervision of investment managers.

ADMINISTRATORS FROM PRESCRIBED JURISDICTIONS

A fund based in The Bahamas 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 anywhere in the world. This approach opens the door for international administrators to license funds under the Act.

APPOINTMENT OF INVESTMENT FUND MANAGERS

The *IFA* obliges each fund to appoint an investment fund manager, except in some very specific circumstances. The investment manager must be licensed if the fund is being sold to non-accredited investors but the manager or fund need not be licensed if the fund is being sold

to accredited investors only. Importantly, the fund may appoint an investment manager licensed or registered in a prescribed jurisdiction without the need for licensing in The Bahamas. In such a case, there is a simple registration process.

CUSTODIANS AND OPERATORS

Each investment fund must appoint a custodian that must be independent of its administrator, manager and operator, unless the fund's operators certify that the fund's structure or the nature of its assets do not require the appointment of a custodian. An investment fund's operators are determined based on its legal structure. Operators are responsible for the operation of the fund in compliance with the *IFA*. The operator is subject to an assessment of its fitness and propriety and must be independent of the administrator, unless it is exempted from this requirement, or the fund is structured as an investment condominium.

ACCESS TO EU MARKETS

Finally, the *IFA 2019* is also compliant with the European Union's Alternative Investment Fund Managers Directive, or AIFMD. This allows The Bahamas to qualify for 'passporting' in accordance with the Directive. The law grants a distinct licence to a manager that operates in the European Union or manages funds from the EU.

“The IFA 2019 is also compliant with the European Union’s Alternative Investment Fund Managers Directive”

The *IFA 2019* also addresses the EU's standards for investment funds regarding the regulation of auditors. Every fund that does not submit to a full annual audit is required to receive a certificate every three years from a qualified accountant that states that its books are being maintained in line either with International Financial Reporting Standards or the United States' Generally Accepted Accounting Practices. Auditors must be approved by the Commission if they want to act on behalf of regulated persons.

THE NEED FOR LEGAL CERTAINTY REGARDING DIGITAL ASSET BUSINESS

The SCB's primary objective in developing the *DARE Act* was to bring regulatory certainty to the dynamic, fast-paced and evolving crypto-space. The Commission had already spotted the potential that the space represented for The Bahamas' wealth management industry as the interest of investors in financial technology (fintech) and crypto-assets was increasing globally. The SCB fielded interest from international fintech operators that wanted to operate in a well-regulated, compliant jurisdiction. The Government of The Bahamas had also made it clear that it intended to transform the jurisdiction into a regional fintech hub.

THE NEED FOR REGULATORY FLEXIBILITY AS THE MARKET DEVELOPS

Given that the digital assets market or crypto-space is still in its infancy (or, in any event, far from mature), it was clear to the Commission that it needed to establish a legislative framework that was not overly prescriptive. The Act allows the jurisdiction to be nimble

and able to react to new risk-related trends, or market development opportunities, as the evolving landscape demands.

To develop the legislation, the Commission first conducted a benchmarking exercise of 13 select jurisdictions, concentrating on their approaches to regulation and also on global standards and best practices in the business of digital and virtual assets. It reached out to other regulators with relevant experience and consulted the financial industry and other stakeholders.

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

DARE defines salient terms such as digital asset business, digital assets service 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.

The Act defines various types of digital assets and is clear about what is in scope for regulation. It also recognises digital assets or crypto-currencies as members of their own asset class.

By giving the space its own regulatory regime, The Bahamas has removed the narrow question of whether a crypto-currency is a security and has, instead, provided a framework whereby digital assets can be addressed holistically.

THE NEED FOR COMPLIANCE WITH GLOBAL AML/CFT/PF STANDARDS

DARE's approach to global anti-money-laundering standards and standards that counter the financing of terrorism and the proliferation of weapons of mass destruction (AML/CFT/PF) is vitally important. The Commission continues to concentrate on complying with the Financial Action Task Force's Recommendation 15, along with its evolving interpretative notes. In keeping with R15's principles, *DARE* subjects the digital assets business to the primary national AML/CFT/PF legislation of The Bahamas, which includes the *Proceeds of Crime Act 2018*, the *Anti-Terrorism Act 2019* and the *Financial Transactions Reporting Act 2018*. In keeping with the FATF's recommendations, *DARE* focuses AML/CFT/PF supervision and oversight on the digital asset service provider rather than on the new technologies themselves.

“The Government of The Bahamas intends to transform the jurisdiction into a regional fintech hub”

The term 'beneficial owner' in *DARE* is assigned the same meaning as in The Bahamas' *Proceeds of Crime Act*. *DARE* requires financial institutions to perform initial risk assessments prior to launch. The Act requires digital-asset businesses to have systems in place to prevent and detect money laundering, terrorist financing and suspicious transactions and report the reasons for their suspicion to relevant competent authorities. They must also comply with the Securities Commission's rules, policies and guidelines that govern risk management and the prevention of money laundering and terrorist financing.

On 16 March 2022, the Commission published its AML/CFT/PF Rules for *DARE*. These rules are based on the FATF's Recommendation 15 and its interpretative notes. They are supplementary to *DARE* and are also expected to evolve as the market evolves.

“Pragmatism is a key consideration for The Bahamas in its approach to regulation”

A FLEXIBLE JURISDICTION

Pragmatism is a key consideration for The Bahamas in its approach to regulation and the jurisdiction continues to watch as trends indicate a move towards securities and other asset classes becoming

tokenized. We are also mindful of recent emerging risks that came to the fore in the aftermath of the great bear market or “crypto-winter” of 2017-18. These risks must now be addressed in the regulatory framework and clear best practices must be established to protect investors.

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

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ADVERTISING SUPPLEMENT

THE BAHAMAS: A FEARLESS BUT PRAGMATIC FINANCIAL CENTRE

***By Dr Tanya McCartney, the CEO and Executive Director of the Bahamas Financial Services Board**

In this article we hear from the movers and shakers who have been shaping the financial life of The Bahamas in recent years.



The world is emerging from a challenging period. The global pandemic dealt a harsh blow to tourism-dependent economies like The Bahamas' and many questioned whether there would be a domino effect throughout other industries. Although many industries were impacted, financial services – the jurisdiction's second largest industry – proved resilient throughout the

pandemic, staying steady in circumstances affected by rapid changes in service delivery channels and the regulatory landscape. Today, we remain a major global destination for wealth management.

On a per-capita basis, no other country can match the level of expertise that teems within our borders. We have an entire cadre of legal, accountancy, trust, banking and insurance professionals working with and for financial service firms of all sizes and specialisations in the planning, creation and management of our world-class offerings. Our in-country expertise is a major driving force behind our success, serving as the springboard that propels our financial services sector through the best and worst times.

“Financial services – the jurisdiction’s second largest industry – proved resilient throughout the pandemic”

Over the years, despite multiple economic shocks and a rapidly-evolving global market in financial services market and regulatory landscape, The Bahamas continues to lead the way. You will find secure anchorage for your financial services and investments within our borders. We refer to our approach as measured innovation; each step we take is well-planned and strategic and balances the preservation of our historical strengths with the need to evolve and lead the way constantly.

REGULATORS WHO INNOVATE

A prime example of measured innovation at work is to be found in our securities sector. “The Bahamas has done and continues to do substantial work to ensure that we reset the outdated and

inaccurate ‘tax haven,’ ‘non-compliant’ narrative,” said Christina Rolle, the Executive Director of the Securities Commission of The Bahamas. “It is important to us that the jurisdiction not only keeps pace with, but anticipates, international best practices and is viewed globally as best-in-class with respect to our regulatory framework. This also is a big part of our story and the evolution and innovation you see in our financial services industry.”

Executive Director Rolle explained her strategy for balancing innovation with regulation further.

“If you take The Bahamas’ approach and positioning concerning the enactment of the *Digital Assets and Registered Exchanges Act 2020* as an example, you can see that we, as regulators, took the time to speak with industry, to understand the needs of operators and, more importantly, to understand where regulation can play a much-needed role for the protection of consumers and investors. In designing the legislation, we took a pragmatic approach that would enable us to address the space with robust authority but also with flexibility as it evolves. This is always the approach in The Bahamas – where regulators study the markets and take into consideration the needs and feedback from stakeholders.”

Wendy Warren from Caystone Solutions echoed these sentiments.

“I think The Bahamas has been fearless in its confidence that we can strike the right balance. If we think or perceive there’s a need to tweak, we will tweak, but we will not stand still, we will always be responsive and reflect the needs of our clients and our partners.”

A CULTURE OF INNOVATION

Alexander Christie, a partner at the law firm of McKinney, Bancroft & Hughes, reflected on the culture of innovation that the jurisdiction has created over the years.

“The Bahamas historically has been very proactive in seeking out what is needed in the market. Let me give you a few specific examples. The Bahamas has very flexible trust legislation in terms of giving settlors certain retained powers. We also have the *Foundations Act*, which is really a civil law structure, but that was integrated into our common-law regime in The Bahamas to attract a different type of investor. Or look at our ICON fund structure, which was targeted specifically for the Brazilian market. We were quite innovative with the Smart Funds regime, which was really tailored for investors to allocate different risks to satisfy a very particular investor.”

As the second-largest contributor to our GDP after tourism, the financial services industry is a central pillar of the Bahamian economy. Successive administrations have demonstrated their commitment to sustained innovation and success in this sector. The Government remains committed to avoiding adverse listings, harnessing the potential of niches old and new and ensuring that our financial services regime continues to provide market-responsive wealth management vehicles.

CONSISTENCY, STABILITY AND SECURITY

As a result of the investment of a tremendous amount of resources, you will not find The Bahamas on any existing blacklists. We have met and exceeded global standards for anti-money laundering and counter-terrorism financing measures and established the highest standards of tax transparency and compliance. Investors can expect consistency, stability and security within the confines of the financial services sector.

We have responded to and adopted the standards of the European Union that pertain to economic substance, ensuring that entities in The Bahamas are managed and conducting adequate business and removing all preferential exemptions for local entities operating commercially outside the country. We embrace change as an opportunity for growth.

Greater transparency for mandatory disclosures and the arrival of global minimum corporate taxes are issues that we are prepared to address in the near future. You can be sure that our response to these looming concerns will be thoughtful and that our resultant policies will be balanced and articulated clearly. Our Number One priority, as always, is to protect the interests of our investors, clients and other key stakeholder groups.

“Our Number One priority, as always, is to protect the interests of our investors”

You can expect to see sustained jurisdictional excellence and world-leading innovation from our financial services sector. This is increasingly important because the world is grappling with inflation and economists have begun warning of an impending recession. Savvy investors are positioning themselves to secure their assets and future while taking advantage of a re-opened global economy.

A GENUINE PUBLIC-PRIVATE PARTNERSHIP

One of the critical elements of the infrastructure of The Bahamas is a robust public-private partnership, where communication is open and frank among all three of the participants involved with this agenda: the Government, the regulators and the private sector. This public-private dialogue facilitates our engagement in creating and investing in our wealth management pedigree.

Chris Illing of ActivTrades Corp commented on the positive impact of this partnership.

“In foreign exchange, we had major regulatory changes last year and I just love the dialogue that you can have with the regulators. They were looking for real input from our industry, how we can kind of make it more compliant and safer, but don’t hinder the growth and

still give us a flexibility that other jurisdictions don’t have. Our dialogue was positive. It’s like the old paradigm of onshore and offshore jurisdictions disappearing and that in a sense we’ve become a bit like midshore now, so not offshore any more.”

To many in The Bahamas, the onshore-offshore debate has been fuelled by misunderstanding or ignorance about the true essence of such a jurisdiction. Caystone’s Ms. Warren added: “I will be a little bit provocative and say I think there was never an onshore and an offshore. We know many places in major economies provide similar features just like The Bahamas provides. We perhaps were ahead of the curve, *vis-à-vis* these other ‘onshore’ locations in terms of our movement towards transparency, towards accountability, towards regulation. It was easy to look at a small country and label it as offshore, but the reality is that we’ve always operated in a manner that was consistent with what was happening onshore.”

“I just love the dialogue that you can have with the regulators”

The defining turning point for this transition was in 2000, when there was considerable pressure on many jurisdictions, including The Bahamas, to increase their regulation and transparency. Christel Sands-Feaste of Higgs & Johnson noted this.

“We have done that and now operate at a blue chip-level in terms of our regulation. We provide financial services in a way that is regulated, responsible and consistent with international best practices. Despite encountering considerable headwinds, we continue to retool, re-adjust and elevate the standard of the offerings and the jurisdiction. When The Bahamas was made an IOSCO Category A signatory, that was a huge win in the investment funds space, particularly considering the country’s marketing focus on Latin America. Even in the digital assets space, where the regulatory framework is fairly new, the policymakers have indicated there are some refinements that need to be made and their commitment to effecting those changes as soon as possible.”

THE GATEWAY TO AMERICA

As a jurisdiction, we lean into our geopolitical advantages as a global transshipment hub – a gateway to the Americas – and as a politically, economically and socially stable nation with a strong international standing. While global markets and economies remain in flux, The Bahamas’ financial services sector remains a bulwark of strength, stability and consistency. This is not by chance. Through the strategic development of the industry, we have created optimal conditions for our financial services stakeholders to grow and protect their economic interests.

This is why leaders in the world’s FinTech industry, for example, are now making moves to establish footholds in The Bahamas. Valdez Russell from FTX, a blue-chip digital assets exchange which has established its global headquarters in Nassau, said that there were many reasons for this optimism – not only at FinTech companies but in other areas of business.

“As we build our global headquarters here in Nassau, we have our teams from around the world come in and out. We are seeing more people visit the jurisdiction to understand what is attractive. We are seeing the strength of our democracy, we’re seeing our modern

infrastructure and access to talent as all being incredibly attractive, added to the fact that we're in a good time zone which may differ from other jurisdictions. We should see more entities being in The Bahamas in such a way that other jurisdictions will want to know what it is that we're doing.

ANCHORAGE IN A SAFE HARBOUR

"We just so happen to be a good country and a great place to raise a family, to consider retirement and to invest in. And while jurisdictions have other competitive advantages, it is our people who genuinely make the difference real."

During these uncertain times, it is more crucial than ever for investments to be anchored in a safe harbour. The track record of our financial services industry speaks for itself. We have weathered storm after storm.

The Bahamas will continue to maintain its position as a global destination of choice for wealth management and wealth generation. We are committed to keeping our status as the complete and compelling choice for financial services for years to come.

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