October 2004
IMF Country Report No. 04/318

The Bahamas: Assessment of the Supervision and Regulation of the Financial Sector—Review of Financial Sector Regulation and Supervision

This review of financial sector regulation and supervision in The Bahamas in the context of the offshore financial center assessment program contains technical advice and recommendations given by the staff team of the International Monetary Fund in response to the authorities of The Bahamas's request for technical assistance. It is based on the information available at the time it was completed in April 2004. The views expressed in these documents are those of the staff team and do not necessarily reflect the views of the government of The Bahamas or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623 7430 ● Telefax: (202) 623 7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

ASSESSMENT OF THE SUPERVISION AND REGULATION OF THE FINANCIAL SECTOR

Review of Financial Sector Regulation and Supervision

The Bahamas

APRIL 2004

Contents Page

Glossary 4

Preface....5

Executive Summary 7

Summary of Key Recommendations 10

I. Financial System Overview....11
A. Background 11
B. Financial Institutions and Markets 13
C. Regulatory Framework, Oversight and Market Integrity Arrangements 15

II. Strengths and Vulnerabilities in the Financial Regulatory and Supervisory Arrangements 18
A. Regulatory Structure 18
B. Recommendations 20
C. Cross-Border Cooperation and Information Sharing. 20

III. Observance of Financial Standards and Codes: Summary Assessments....22
A. Basel Core Principles for Effective Banking Supervision 22
B. IOSCO Objectives and Principles of Securities Regulation 30
C. FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism 36

IV. Authorities' response 43

Tables
1. Recommended Action Plan to Improve Compliance with the Basel Core Principles 27
2. Recommended Plan of Action to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation 34
3. Recommended Action Plan to Improve Compliance with the FATF Recommendations 40

Boxes
1. Organizational Structure of the Regulatory and Anti-Money Laundering Framework...17

GLOSSARY

AML	anti-money laundering
BISX	Bahamas International Securities Exchange
BSD	Bank Supervision Department
BTCRA	Banks and Trust Companies Regulation Act
CBB	Central Bank of The Bahamas
CFATF	Caribbean Financial Action Task Force
CFT	combating the financing of terrorism
CP	core principle
FATF	Financial Action Task Force
FIU	financial intelligence unit
FIUA	Financial Intelligence Unit Act
FTRA	Financial Transactions Reporting Act
IBC	international business company
IFCS	Inspector of Financial and Corporate Services
IOSCO	International Organization of Securities Commissioners
KYC	know-your-customer
OFC	offshore financial center
POCA	Proceeds of Crime Act
SCB	Securities Commission of The Bahamas
SIA	Securities Industry Act
STR	suspicious transaction report

PREFACE

In July 2000, the Executive Board approved a program of assessments on the basis of the paper "Offshore Financial Centers—The Role of the IMF." In this context, the Government of The Bahamas invited the IMF to carry out an assessment of the extent to which the regulatory and supervisory arrangements for the financial sector complied with certain internationally accepted standards and measures of good practice. These include the arrangements for combating money laundering and the financing of terrorism.
The substantive assessment took place in the period October 21–November 1, 2002, but followed a preliminary mission in January 2002, which identified some key issues on which the authorities might act in the interim.[1] A separate mission was undertaken by an independent law enforcement expert in late April 2003 to review anti-money laundering issues outside the competence of the Fund mission. The government agreed that the scope should include the banking, securities, and trust and company services sectors, and that it should extend to both the domestic and offshore markets. The insurance sector was not included within the mission's terms of reference because it is a relatively small part of the Bahamian finance industry, and its future development is under review by the authorities. The overall assessment was carried out on the basis of the "Module 2" approach, as described in the abovementioned paper of July 2000. In addition to the long-standing methodologies of the Basel Committee and International Organization of Securities Commissions (IOSCO), the mission employed the new "Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards" (dated October 11, 2002) agreed between the IMF, World Bank and the Financial Action Task Force (FATF).

The mission also took account of the document entitled "Trust and Company Service Providers: Statement of Best Practice" released by the Offshore Group of Banking Supervisors on September 6, 2002. This document, which does not represent an international standard, was being used in a pilot project in which the Bahamian authorities agreed to participate, together with four other jurisdictions. Since the decision was subsequently taken not to extend the review to other jurisdictions, those involved in the pilot were provided with the option of having the reviews included within the final report. In view of the absence of any internationally agreed standards for the regulation of trust and company service providers, the Bahamian authorities decided not to have the review included in this report.

The mission undertook a review of all the relevant legislation, regulations and guidelines, and held discussions with government ministers and officials (from the Attorney General's Chambers, Ministry of Finance and Ministry of Financial Services and Investment), the

[1] These included recommendations to commence a review of the overall regulatory framework; to expedite the promulgation of appropriate regulations and guidelines; to document the internal systems and procedures in the regulatory agencies; to expand the scope of the on-site examination process; to permit the domestic regulators to exchange information on an entirely reciprocal basis; and to enact legislation relating to the financing of terrorism.

regulatory authorities (Central Bank, Securities Commission, Inspector of Financial and Corporate Services (IFCS), and Compliance Commission), the Financial Intelligence Unit (FIU), and a broad cross-section of the private sector practitioners and professional associations. Where appropriate, the mission also reviewed certain draft legislation, regulations, and policy guidelines.

This report is in two parts. The first volume provides background material, discusses the strengths and vulnerabilities of the regulatory framework, and provides summaries of observance of standards and codes. Volume II provides the detailed assessments.

The mission comprised Mr. Richard Chalmers (mission chief, MFD); Ms. Joy Smallwood (LEG); Messrs. Richard Britton, Christopher Cooke, Laurent Ettori, and Ms. Tanya Smith (all consultants, MFD). The independent law enforcement expert for the AML/CFT assessment was Mr. Russell Ursula of the Caribbean Financial Action Task Force (CFATF) Secretariat.

The mission is grateful for the cooperation received from the government ministries and departments, the staff of the regulatory authorities, and a number of private sector organizations and institutions. It is particularly grateful to the Governor and staff of the Central Bank of The Bahamas (CBB) for providing office accommodation, support facilities, and much-needed sustenance throughout the mission's stay.

EXECUTIVE SUMMARY

There has been very substantial progress towards the development of an effective regulatory regime in The Bahamas over the past two years. This has been reflected not only in the body of legislation that was enacted in December 2000, but also in the structural and operational arrangements put in place by the agencies that have been entrusted with supervisory responsibilities. The progress made by the CBB and the Securities Commission has been impressive, due in large part to strong leadership and professional, dedicated staff. This process has placed a considerable burden on both the agencies themselves and on the private sector institutions that they regulate. The majority of the pain of this transformation appears to be over, but there remain a number of issues still to be resolved.

The assessment confirmed the preliminary impression of the earlier Fund mission in January 2002 that the overall regulatory structure in The Bahamas is complex, involves an excessive number of agencies, and places a considerable pressure on limited technical and financial resources. While the respective agencies have worked hard to develop agreements to rationalize the processes as far as possible, there is a need to introduce some specificity into the statutory authority that authorizes the cooperation. Therefore, it is important that the review of the overall regulatory structure, proposed by government, be pursued with some urgency.[2]

However, the mission considers that there are certain elements of the current structure that require attention in the very short term. The arrangement under which some of the regulatory agencies report to the Ministry of Finance, and others to the Ministry of Financial Services and Investments, gives rise to two issues. First, the dual reporting lines do not facilitate effective communication at a time when it is important to bring greater unity to the overall structure; and, second, there is generally regarded to be a conflict of interest in combining regulatory and promotional responsibilities, as is the case with the Ministry of Financial Services and Investments. Therefore, it would be preferable to group all the regulatory functions directly under the Ministry of Finance. This is separate from the question of whether or not there should be some rationalization of the overall regulatory infrastructure.

While accountability to the government, through the relevant ministry, is essential, the extent of the potential influence of government over the Securities Commission is a matter of note. The CBB has very clearly defined independence of direction and operation, but the members of the Securities Commission, including the Executive Director, may be removed forthwith without due cause. This potentially compromises the ability of the Commission to pursue an appropriate professional course of action, when it might not be attractive politically. It would be preferable to circumscribe this power of removal on the basis of specific just cause. The

[2] The Government appointed a Commission in May 2002, under the chairmanship of the Governor of the Central Bank of The Bahamas, to examine the current structure and to make recommendations for possible reform.

mission also noted that the current Executive Director was due to leave her post in less than one month's time, but that no successor had yet been nominated, let alone brought in for a handover period.[3] This poses a threat to the effective operation of the Commission (though none was evident at the time of the assessment), and the mission considers it important to make an appropriate appointment without delay.

There have been major improvements in the past two years to the regulators' ability to obtain information for their own purposes, and to assist overseas regulatory authorities. However, the application of the legal provisions relating to the different agencies sometimes vary for no apparent reason, and it would be helpful for all parties to standardize the requirements and procedures as much as possible.

While the CBB has made very substantial progress in developing a robust regulatory framework in a short period of time, it remains with the legacy of the managed banks[4] that maintain no meaningful physical presence in The Bahamas. Some of these banks pose material risks to the reputation of the jurisdiction and they have been given (through CBB directive) until June 2004 to establish a material presence in the islands or to close. In the meantime, it is important that the CBB should seek to maintain close oversight of these entities in order, as far as possible, to bring supervision towards the standards applied to the rest of the banking sector.

The legislation vests extensive powers in the Governor of the CBB personally, but does not grant the incumbent the same statutory protection against civil and criminal liabilities that is given the CBB 's supervisory staff; nor is such protection provided to the staff of the Securities Commission. It is important that these omissions should be corrected to permit the regulators to undertake their work without fear of personal liability, and to reduce the risk of mischievous or obstructive legal action.

Generally, throughout the regulatory agencies, there is a shortage of staff with the appropriate depth of skills, although the CBB appears to be better placed than the others. This pressure on resources is common to most countries, but is especially acute among small jurisdictions. It will be important for the agencies to establish an environment that makes them as competitive as possible, to attract and retain the skills that are available in the

---

[3] The Secretary to the Commission, Mr. Hillary Deveaux, was formally appointed Acting Executive Director effective December 1, 2002.

[4] Subsequent to the mission, the Basel Committee published a paper, in January 2003, in which it defined "shell" banks as "banks that have no physical presence (i.e., meaningful mind and management) in the country where they are incorporated and licensed, and are not affiliated to any financial services group that is subject to effective consolidated supervision." A number of the managed banks in The Bahamas exhibit the key features identified in this definition.

market. This environment should recognize that the skills in particular short supply are those for which the private sector financial institutions are prepared to pay well.

Finally, with respect to the measures to combat money laundering, the mission noted the extensive provisions introduced since June 2000. These contain some important fundamentals, but they have posed practical difficulties for the financial services industry in view of the extremely detailed and prescriptive nature of many of the provisions. At the same time, there is some ambiguity about certain exceptions to the know-your-customer (KYC) rules that may weaken the overall framework. The mission considers that the industry should be encouraged to develop a more risk-based approach to certain issues, but within an overall framework that demands high standards of customer identification on a very broad basis. On the matter of the financing of terrorism, the mission noted that the Cabinet was in the process of considering a relevant draft bill, which it hoped would be presented to Parliament very shortly.[5]

[5] The Terrorism Bill was tabled in Parliament on June 25, 2003, and was still being debated when this report was finalized. The mission has been unable to review the provisions, but notes the authorities' intention that the legislation should address relevant issues raised in this report.

SUMMARY OF KEY RECOMMENDATIONS

The following table identifies the key, high priority recommendations included within the report. It does not list all the detailed recommendations that are included within Volumes I and II of the report.

Sector	Recommendation
General	Consolidate the reporting lines for the regulatory authorities under the Ministry of Finance.
	Complete the comprehensive review of the overall regulatory framework to determine the most efficient structure for the local environment.
	Introduce statutory protection against civil and criminal liability for all staff of, and official appointees to, the regulatory authorities, while performing their duties in good faith.
Banking	Clarify the extent to which the branches and subsidiaries of foreign banks may pass information to their head office and parent bank for consolidated risk management and supervisory purposes.
	Establish a properly resourced policy unit within the Bank Supervision Department (BSD) and address the issues on which action is required.
Securities	Narrow the powers of the minister to dismiss members of the Securities Commission so that just cause is the grounds for dismissal.
	Complete the work on the draft mutual funds law and on the amendments to the securities legislation and present to parliament as soon as possible.
	Establish a clear policy with respect to the confidentiality declaration required from overseas regulators in order to permit efficient exchanges of information in line with the practice adopted by the CBB .
AML/CFT	Ratify all the relevant international conventions.
	Enact legislation to criminalize and make other provisions in relation to the financing of terrorism.
	Rationalize the legal framework with respect to money laundering in order to reduce the number of highly prescriptive requirements and to permit financial institutions to develop a risk-based approach.
	Reduce the number of exceptions to the high level principle of requiring financial institutions to identify their customers.
	Extend the time permitted to financial institutions to undertake the process of customer identification on pre-2000 Bahamian dollar accounts, and consider introducing a risk-based approach to resolving the outstanding accounts.
	Revise the provisions relating to the obligation to identify beneficial owners/beneficiaries of corporate entities, trusts, partnerships, etc., to ensure that the legal requirements present no exceptions.
	Review the list of countries and institutions that underpin the “eligible introducer” provisions to ensure that they do not weaken the customer identification requirements.

I. Financial System Overview

A. Background

Government and economy

1. The Commonwealth of The Bahamas is an archipelago of approximately 700 islands and cays, covering nearly 100,000 square miles of the Atlantic Ocean. From its westernmost island, which lies approximately 50 miles east of Florida, The Bahamas stretch 750 miles in a southeasterly direction to within 50 miles of Haiti and Cuba. The population is approximately 300,000, most of which is concentrated on New Providence (on which the capital, Nassau, is located) and Grand Bahamas.

2. The Bahamas, which was formerly a British colonial territory, became an independent, self-governing nation within the British Commonwealth on July 10, 1973. The political system is based on the British Westminster model with a Governor General, a Prime Minister and a bicameral Parliament. The Bahamas have enjoyed political stability since independence. The two primary political parties are the Progressive Liberal Party, which in the general election held in May 2002, was elected to a five-year term in office, winning 29 of 40 seats, and the Free National Movement, which governed between 1992 and 2002.

3. The Bahamian economy is highly dependent upon tourism and international financial services. These two sectors of the economy together account for approximately 55 percent of GDP. Tourism represents an estimated 40 percent of GDP and employs, directly and indirectly, over half of the workforce. In 2001, The Bahamas attracted nearly 4.2 million visitors, who spent in excess of US$1.8 billion. More than 80 percent of these visitors were from the United States and Canada. Over the past ten years, the Government has intensified efforts to improve the competitiveness of the tourism sector, principally by promoting new investment in hotels and other facilities, encouraging wage constraint, and expanding marketing efforts.

4. The financial services sector of the economy accounts for an estimated 15 percent of GDP, although there is undoubtedly a further hidden contribution in the form of high value tourism associated with business visitors to the islands (e.g., accompanying spouses and post-business stayovers). The Bahamas has, over the past fifty years, been an attractive location for the domicile of offshore financial services. In response to international concerns regarding the potential for money laundering and other illicit activities and weaknesses in the regulatory regime, at the end of 2000, the government enacted far reaching measures to strengthen the regulatory and supervisory regimes, as well as allow for easier cooperation with foreign regulators. These measures, while requiring a significant adjustment on the part of sector participants, are expected by the authorities to enhance the long-term attractiveness of The Bahamas as an international financial services center.

5. Real GDP of The Bahamas is estimated by international agencies to have grown at an average annual rate of 4.3 percent during the period 1996 through 2000. Fund estimates show

that a contraction of 2 percent was experienced in 2001, and the growth of activity was subdued in 2002 and early 2003. The recent weak economic performance reflects the general recessionary conditions in the United States, the primary market for visitors, exacerbated by the impact of September 11, 2001. During the period 1992–2001, The Bahamas experienced an annual average inflation rate of 2.06 percent per annum. The workforce at end 2001 comprised 164,675 persons and the unemployment rate was 6.9 percent.

6. The broad economic strategy, as articulated by the new government, aimed at continuing to promote long-term development by maintaining fiscal prudence and encouraging foreign direct investment, while at the same time ensuring that lower and middle income families have increased access to the economic benefits derived from development. The key elements of this strategy include: (i) further emphasizing domestic economic activity, by encouraging development in agriculture, fisheries, and manufacturing, through closer integration with the tourism and other sectors; (ii) increasing the competitiveness of the tourism industry; (iii) broadening the scope of the international services sector of the economy; (iv) pursuing privatization of government-owned corporations where feasible; and (v) increasing and enhancing the efficiency and effectiveness of services generally.

The offshore center

7. The Bahamas is generally regarded as one of the preeminent OFCs in terms of development, size, and market share. It is ranked among the world's top five OFCs in relation to banking assets and assets under management, but is not a significant player in the offshore insurance market or in some of the more innovative products developed in other major centers. The financial services sector, broadly defined, employs some 14,000 persons. Activity within the sector is linked very much to the Latin American, North American and (to a lesser extent) the European markets, and the business cycle is particularly defined by economic developments in the United States

8. The country's competitive edge is seen to lie in the fact that it is a stable, English-speaking democracy within the Commonwealth, lies within the same time zone as New York, is geographically close to the United States eastern seaboard, enjoys a relatively developed infrastructure, and has a substantial, well-educated workforce. The availability of the skilled workforce, in particular, has permitted the development of some of the more labor-intensive financial services that have been denied to The Bahamas' smaller island competitors in the region and elsewhere. On the other hand, the very high cost of telecommunications has undoubtedly constrained the growth potential of some aspects of the industry (e.g., dealing and back office functions).

9. The origins of the center date back to the mid-1960s with the enactment of legislation to provide the basis primarily for offshore banking and trust activities. The suite of offshore legislation has been expanded progressively over the years (with particular focus on development of the securities and mutual funds industry), but The Bahamas remains recognized as a leading center for private banking and asset management. While legislation covering offshore insurance has long been on the statute books, this sector has seen little

development, and the government is looking to introduce new legislation to make the jurisdiction a more competitive environment. Similarly, the existing legal framework has lagged behind other OFCs that have developed niche markets in, for example, special purpose vehicles, protected cell companies, and e-commerce.[6]

10. The financial services market in The Bahamas has undergone some fundamental changes in the past two years since the inclusion of the jurisdiction on the FATF's list of Non-Cooperative Countries and Territories (NCCTs) in June 2000. This led to the introduction of eleven new or revised laws in December 2000, which restructured the regulatory environment and broke down some of the bases on which the OFC had long thrived (e.g., a very high level of confidentiality, a relative lack of "intrusive" regulation, and a liberal licensing policy). These changes resulted in The Bahamas' removal from the NCCT list in June 2001, but have sparked some legal challenges from the private sector, particularly on the grounds that some of the key measures are unconstitutional and are contrary to the interests of the Bahamian people. One challenge, relating to the powers of the FIU to freeze funds by administrative order, has been successfully appealed by the government. However, another more omnibus action challenging the whole basis upon which the package of legislation was introduced, brought by local attorneys, is currently awaiting a substantive hearing before the courts.[7] As with the previous case, the plaintiffs' statement of claim seeks to address a number of constitutional issues.

B. Financial Institutions and Markets

Banks and trust companies

11. Historically, the banking and trust company sectors have been the dominant feature of the Bahamian OFC. At mid-October 2002, there were 310 licensed institutions, of which 123 held combined banking and trust licenses, 80 held only a banking license, and 107 were authorized solely to undertake trust business. In total, 198 institutions were entitled to conduct a wide range of business under a public license, while the remainder were either restricted to varying degrees in the scope of their activities under the terms of the license or were inactive.

12. The domestic commercial banking sector currently comprises nine institutions (including both locally and foreign owned entities) with total deposit liabilities of about US$22 billion, of which only US$3.7 billion are due to residents of The Bahamas. In terms of their purely domestic business, the banks provide typical commercial services to their personal

[6] The government subsequently passed three e-commerce enabling Acts in April 2003: The Electronic Communications and Transactions Act, the Computer Misuse Act, and the Data Protection (privacy of Personal Information) Act. With the exception of the Data Protection (POPI) Act, these Acts came into force on June 16, 2003.

[7] The date for hearing of this matter has been set for February 2004.

and corporate customers. However, they are also engaged in significant levels of offshore activity, primarily through interbank transactions with group entities. The trend in recent years has been for a contraction in the number of institutions providing local retail facilities.

13. The focus of the offshore sector has traditionally been wholesale euro-currency business, private banking, and asset management. Total external assets of the banking system at end-2001 were US$258 billion, with funds under management totaling approximately US$1 trillion, the latter figure being based on estimates from the industry. The industry has representation from a broad spectrum of jurisdictions, but with a particularly strong presence by Swiss, North American, and British-based banks. While the euro-currency operations (largely interbank transactions) have typically brought little "value-added" in the form of downstream economic activity, The Bahamas has been able to develop a market lead in the provision of private banking and asset management by drawing on the local pool of well-trained personnel. These activities are seen to provide the greatest potential for continued development of the banking and trust sector, and for the maintenance of The Bahamas' competitive position in the offshore market. This focus helps explain the predominance of Swiss banks on the Bahamian register.

14. The offshore banking sector has witnessed significant adjustments to its structure over recent years. In line with trends elsewhere, there has been a rationalization of the market in The Bahamas, as institutions have merged or reorganized to meet the challenges of the global markets and to operate in a more cost-effective manner. There has also been a pronounced move towards withdrawing from non-core activities. Within the local context, these general changes have been compounded by the banks' response to the adjustments to the regulatory framework introduced since June 2000. Key among those was the decision to require all banks and trust companies to establish a physical presence in the islands by June 2004, involving the appointment of resident senior personnel and the maintenance of comprehensive books and records in the jurisdiction. To date, a majority of the euro-currency branches are managed, or "booking," branches that have appointed a resident managing agent in The Bahamas (primarily for the service of legal notice and to act as a contact person for regulatory and customer service purposes), while conducting the business through offices elsewhere, primarily in New York.

15. Approximately two-thirds of the offshore banks currently maintain a substantive physical presence in the islands. While many of those without such presence plan to comply with the new requirements, several have indicated, or have already acted on, their intention either to move their operations to other OFCs or to repatriate the business to their domestic money centers. The authorities realistically expect that by June 2004 the number of licensed banks and trust companies will have declined to about 250 institutions from just over 400 at end-2000.

Securities and mutual funds

16. The local securities market in The Bahamas is extremely thin. There are only 16 stocks traded on the Bahamas International Securities Exchange (BISX), with market

capitalization of less than US$2 billion and a current average of about 10 trades per day. The exchange has only three members. As a result of this low level of activity, the BISX, which is privately owned, is facing severe financial difficulties, and commentators have suggested that it is in need of the support of public monies in order to continue in operation.

17. The offshore sector is dominated by the mutual funds industry. At end-June 2002, there were 60 licensed fund administrators handling 706 mutual funds with total assets under management of US$97 billion. About 200 of these funds are classified as "exempt"[8] on the basis that they are either overseas funds established in one of a list of approved jurisdictions, or are local funds targeted at 15 or fewer investors. Approximately one-half of the total value of funds under management is administered by a single firm that has a dominant role in the industry. As is typical of offshore markets, the role of the local administrators does not generally extend to making investment decisions or to formulating strategy. These functions are almost always performed in the major money centers on shore.

Company service providers

18. Historically, The Bahamas has been one of the major centers for the incorporation of international business companies (IBCs). Such companies are typically established (for a variety of reasons) by nonresidents of The Bahamas, as vehicles to hold financial or real assets. Following the inclusion of The Bahamas on the FATF's list of non-cooperative jurisdictions, the government introduced certain legislative amendments to address the concerns that IBCs were particularly vulnerable to abuse for the purposes of money laundering. Key among these amendments were the abolition of bearer shares and the imposition of an obligation on the company formation agents to maintain certain books and records in the jurisdiction. The impact on the IBC sector was immediate, with the number of registered companies declining from approximately 117,000 at end-2000 to 47,100 in June 2002.

C. Regulatory Framework, Oversight and Market Integrity Arrangements

19. The basic regulatory framework in The Bahamas (within the scope of this report) is formulated in the following legislation (as amended) and associated regulations:

[8] The funds are exempt from section 3(1) of the Mutual Funds Act 1995, which, among other things, requires a mutual fund to hold a license issued either by the SCB or by a Mutual Fund Administrator that itself holds an unrestricted mutual fund administrator's license. All funds presently categorized as "exempt" will be regulated under the Investment Funds Act 2003, which has been passed in both Houses of Parliament and is awaiting an appointed date notice for enforcement.

- Central Bank of The Bahamas Act, 2000;
- Banks and Trust Companies Regulation Act, 2000;
- The Securities Industry Act, 1999;
- Mutual Funds Act, 1995;
- Financial and Corporate Service Providers Act, 2000;
- Proceeds of Crime Act, 2000;
- Financial Transactions Reporting Act, 2000;
- Financial Intelligence Unit Act, 2000.

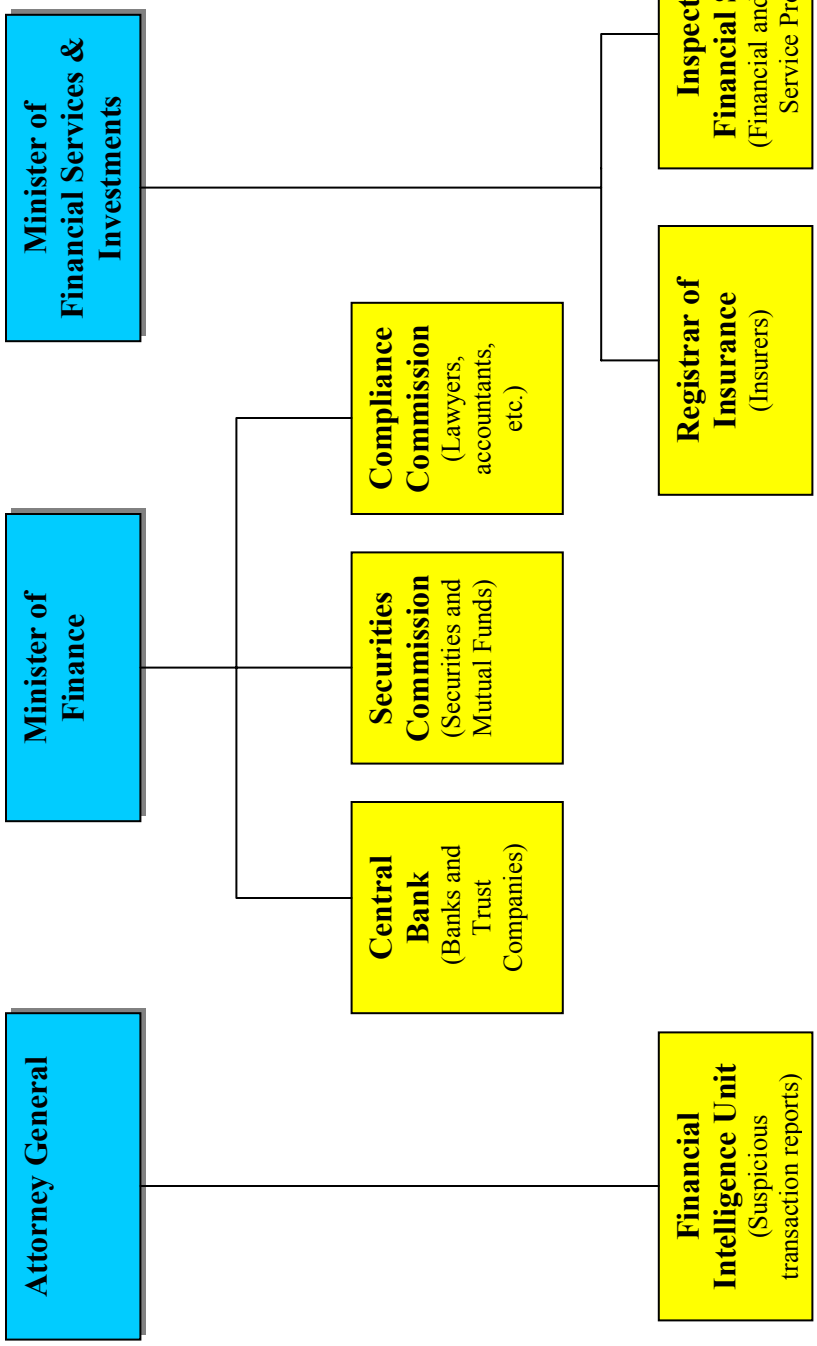
20. The company service providers sector (other than services being provided by licensed banks or trust companies which are regulated by the CBB) is the most recent to be brought under regulation in The Bahamas, following the enactment of the Financial and Corporate Service Providers Act in December 2000. This legislation requires the licensing of any person (other than a licensed bank or trust company) who, among other things, offers services for the registration and management of IBCs, and the provision of directors and nominee shareholders for such companies. Those firms that were already engaged in the relevant business prior to the introduction of the legislation were granted a three-month window in which to apply for a license. At the time of the mission's visit, the IFCS Providers had issued 165 licenses.

21. The overall structure of the supervisory arrangements is relatively complex. There are currently five agencies that perform some type of regulatory function with respect to the financial sector, some of which have closely interrelated, and sometimes overlapping, functions. The responsibilities and reporting lines of each of the agencies are shown in Box 1 overleaf.

22. In summary, the Central Bank of The Bahamas (CBB) licenses and supervises the banks and trust companies, while the Securities Commission of The Bahamas (SCB) oversees the securities and mutual funds industry. Company managers and related service providers are the responsibility of the IFCS, the insurance industry falls to the Registrar of Insurance, with the Compliance Commission being tasked primarily to ensure compliance with the AML obligations imposed on those businesses that are not otherwise subject to prudential supervision. Where applicable, all the respective agencies supervise activities in both the domestic and offshore sectors under a general legal and regulatory framework that does not apply differential regimes between the two sectors.

23. The Financial Intelligence Unit (FIU) was established in early 2001 to receive, analyze, and pass for investigation the suspicious transactions reports (STRs) submitted by the financial institutions and others under the provisions of the Financial Transactions Reporting Act. The FIU, which is a member of the Egmont Group, has a staff of 16 comprising police officers and analysts.

Box 1. Organizational Structure of the Regulatory and Anti-Money Laundering Framework



II. Strengths and Vulnerabilities in the Financial Regulatory and Supervisory Arrangements

A. Regulatory Structure

24. Although this demarcation of functions appears straightforward in principle, the structure of the market poses some serious challenges to minimizing the risk of regulatory overlap. For example, many banks and trust companies are registered by the Securities Commission as broker-dealers and are equally engaged, directly or through subsidiary operations, in the incorporation and management of offshore companies. In addition, the scope of the Compliance Commission's remit is defined by statute in terms of activities that also include some of the normal business of financial institutions subject to regulation by other bodies. It appears also to be the case that some company service providers and trust companies are engaged in very similar activities, but are supervised under quite different regimes.[9]

25. While the reporting line for the CBB , the Securities Commission, and the Compliance Commission is to the Minister of Finance, the IFCS and the Registrar of Insurance report to the Minister of Financial Services and Investments. The portfolio of the latter ministry is primarily directed towards business development and external marketing and promotion, rather than regulation.

26. The earlier Fund mission that took place in January 2002 raised questions not only about the efficiency of the regulatory structure, but also about the pressure that it placed on the pool of skilled resources to staff the various agencies. The mission recommended that a review of the structure be undertaken by the authorities as soon as possible to establish whether this was the most suitable regulatory model for The Bahamas. Subsequently, a consultant retained by the Fund visited Nassau for preliminary discussions with the authorities and a commission was appointed by the minister of finance in May 2002 with the mandate to develop a strategy for the rationalization of the activities of the several regulatory agencies. The membership of the commission comprises the head of the FIU and the heads of the other regulatory agencies. The commission is chaired by the governor of the CBB and has a secretariat based in the ministry of finance. The commission received the consultant's report in June 2002.

---

[9] As discussed later, in order to minimize regulatory overlap, the regulators have executed an MOU which recognizes a primary regulator that has responsibility for AML supervision of its licensees. In the case of the financial and corporate service providers and the insurance sector, the Compliance Commission supervises AML compliance on behalf of both the Registrar of Insurance and the Inspector of Financial and Corporate Service Providers.

27. In the meantime, the Group of Financial Services Regulators,[10] established in 2001 with a six-month revolving chairmanship and terms of reference to ensure greater harmonization of the existing system of regulation, has focused on the implementation of certain of the recommendations of the Fund consultant that call for a unitary approach to a number of regulatory matters within the existing structure. This group has made substantial progress in rationalizing the overall approach to supervision and reducing the risk of an excessive regulatory burden being imposed on the industry. The CBB and the SCB have agreed on a program of joint examinations of institutions in which they have a common interest, while the CBB has agreed with the IFCS to assume responsibility for overseeing the corporate service activities of the banks and trust companies, where such activities are undertaken through separately licensed subsidiaries. In turn, the IFCS and the Compliance Commission have agreed on a framework for sharing responsibilities with respect to inspections, since both organizations are faced with similar resource limitations and have a significantly overlapping constituency. On October 16, 2002, the five agencies (excluding the FIU) signed a memorandum of understanding (MOU) that addresses issues relating to the sharing of information, joint examination procedures, the identification of a principal or "lead" regulator, and routine coordination in processing license applications reflective of recommendations contained in the Fund consultant's report. There is a project to create a database that identifies all institutions in which there are multi-agency interests.

28. The creation of this group of financial services regulators and the development of the MOU are very positive steps towards making the overall regulatory regime more efficient. In due course, it is expected that this work will be accelerated by the Commission appointed by government to consider the advantages of moving formally towards a more unified regulatory system, possibly leading to the creation of a single regulator.

29. The availability of resources to the different agencies varies considerably, although all face the common challenge of having to compete with private sector institutions for staff with specialist skills that are in short supply. The CBB currently has a total of 53 staff in the BSD, having gone through a period of rapid expansion in the last two years. While it is able to recruit a suitable number of inexperienced junior staff (especially in the current market conditions), it faces a continuous problem of retaining their services once the recruits have been trained and have gained even a modest degree of practical experience. It is recognized within the CBB that adjustments may be necessary to its salary structure in order to retain experienced staff at all levels, and it is in the relatively fortunate position of having an independent source of funding (through its central banking functions) upon which to draw.

30. The other agencies do not enjoy the same funding position, but face an equal need for skilled resources. The SCB has a total staff of 31, most of whom are well-trained and relatively experienced professionals, but it is constrained in its growth by the fact that it is

[10] This group comprises the central bank, the Securities Commission, the Inspector of Financial Services, the Registrar of Insurance and the Compliance Commission.

not entirely self-financed and is dependent for a significant proportion of its budgetary needs on direct funding from government. There are plans to expand the scope of the license fees to provide the SCB with sufficient direct income to support its activities, and it is considered that this can be achieved without jeopardizing the jurisdiction's competitiveness.

31. By comparison, the IFCS and the Compliance Commission, both of which are relatively new creations, having emerged from the legislation enacted in December 2000, appear poorly resourced in numbers, if not in individual technical competence. This is particularly the case with the IFSC, which has a total of 4 staff that is also tasked (within the office of the Registrar General) with having to undertake many of the routine functions of the company registry. In the case of both agencies, they intend to rely extensively on the use of external accountants to undertake on-site examination work on their behalf, but they retain the ultimate responsibility for the analysis of, and response to, the resulting reports. As the first round of examinations is still in its very early stages, there is currently no experience of the actual pressure that these tasks will place on the agency staff, but it can be expected to be considerable.

B. Recommendations

32. With respect to the overall regulatory structure within The Bahamas, the mission offers two specific recommendations:

33. First, the mission strongly supports the undertaking of the proposed review of the regulatory framework at the earliest opportunity, since it continues to believe that the current structure gives rise to the risk of duplication of process, and puts an unnecessary strain on the authorities' limited resources. In addition, the detailed assessment has highlighted some disparity in the regulatory approach to different institutions conducting similar business; and, in general, there would be distinct advantages in implementing any material changes before the existing agencies expand and consolidate their operations to any great extent. At the same time, it is recognized that it may take some years to implement fully any decisions to restructure the system, in view of the need to prepare and enact appropriate legislation, and to effect any integration and/or harmonization of the agencies' systems, procedures, and staff.

34. Second, there is generally considered to be a significant potential conflict of interests between the promotional and regulatory functions, and the mission recommends that the reporting lines for all the regulatory agencies be consolidated under the ministry of finance, in line with common international practice.

C. Cross-Border Cooperation and Information Sharing.

35. Information sharing with overseas regulatory authorities is covered in several pieces of legislation. The Central Bank of The Bahamas Act, the SIA, the Financial and Corporate Service Providers Act, the FTRA, and the Mutual Funds Act address the conditions under which information may be shared. These conditions are the same in all five Acts. They permit the Bahamian regulators to pass to an overseas regulatory authority any 'information necessary to enable that authority to exercise regulatory functions including the conduct of civil or administrative investigations and proceedings to enforce laws, regulations, and rules

administered by that authority." An "overseas regulatory authority" is not defined identically in each Act, but is broadly deemed to be an agency that fulfils the same functions as the respective Bahamian authority. However, the CBB (unlike the SCB) has the discretion to extend the range of corresponding functions to include "any additional regulatory function in relation to companies or financial services as the bank may specify by order."

36. The sections set out factors that the Bahamian regulators **may** take into account when deciding whether to disclose information, and factors about which they **must** be satisfied before disclosing. These latter include either the provision by the requesting authority of an undertaking on confidentiality sufficient for the Bahamian supervisor to satisfy itself that the requesting authority is subject to 'adequate legal restrictions on further disclosure,' or the provision by the requesting authority of an undertaking not to disclose the information provided without the prior consent of the donor. In addition, the Bahamian authority must be satisfied that the information will not be used in criminal proceedings against the person providing the information.

37. It appears that the principles of the laws have not been applied evenly among the Bahamian regulatory agencies. The SCB appears to hold requests for information to a standard that is difficult to achieve (see "Supervision of the Securities and Mutual Funds Sector" in Section III B). As a result, the amount of nonpublic information that has been shared with other supervisory authorities is limited. The CBB, however, has focused on reasonable assurances that the information will be protected. When the information is provided to the overseas jurisdiction, the CBB notes that the information has been provided with the understanding that it will be kept confidential and not disclosed further without prior approval of the CBB. The CBB has responded to approximately 200 requests for information since December 2000.

38. The CBB has an additional powerful tool not available to the other regulators. Under its Act of establishment, the CBB has been granted "compulsory powers," whereby, at the request of an overseas regulatory authority, it may require any person, who might reasonably be believed to hold relevant information, to provide that information to the CBB for onward transmission to the overseas authority. The conditions for onward disclosure remain those indicated above. The use of this power is not restricted to entities subject to supervision by the CBB and it is an offense not to comply with the CBB's direction.

39. Neither the CBB nor the SCB is required to have a bilateral MOU with an overseas regulator before information can be shared. This facilitates efficient exchanges of regulatory information. However, both agencies have received several requests from overseas counterparts to enter into more formal arrangements. The CBB is in the process of negotiating with six overseas authorities, but resource constraints at the SCB have delayed progress in meeting requests from several of its counterparts.

40. At the level of the financial institutions, there are significant legal impediments to sharing of nominative customer information with the head office of a branch, the parent bank of a Bahamian subsidiary, and also with home country supervisory authorities. Section 15 of

the BTCRA states that no person "shall, without the express or implied consent of the customer concerned, disclose to any person any such information relating to the identity, assets, liabilities, transactions, or accounts of a customer." This extends to any customer, not simply a depositor. The exceptions to this rule, beyond customer consent, primarily allow the CBB itself to perform ancillary duties. The law also allows information to be passed on, but only if it is for collating or synthesis purposes.

41. The mission found that gateways have developed within the industry to allow sharing of information with the head office. There was general agreement that information cannot be passed routinely to the head office, but the industry did indicate that, for specific requests, they could find ways to share the information. In some cases, this is because they require their clients to sign a general confidentiality waiver at the time of the account opening. There are some who believe that this procedure does not avoid the constraint on disclosure because the customer has not given consent on specific occasions and in relation to specific information.

42. As regards judicial authorities, there are mechanisms to secure the passage of relevant information. The Bahamas has treaties with Canada and the United States on Mutual Assistance in Criminal Matters and an agreement with the United Kingdom "Concerning the Investigation of Drug Trafficking and Confiscation of the Proceeds of Drug Trafficking." Domestic legislation provides further gateways through the "Criminal Justice (International Cooperation) Act 2000" and the "Evidence (Proceedings in Other Jurisdictions) Act 2000."

43. Finally, the FIU was established in early 2001 to receive, analyze, and pass for investigation the suspicious transaction reports (STRs) submitted by the financial institutions and others under the provisions of the Financial Transactions Reporting Act (FTRA). It is a member of the Egmont Group. The FIU has a staff of 16 comprising experienced police officers and analysts.

III. Observance of Financial Standards and Codes: Summary Assessments

A. Basel Core Principles for Effective Banking Supervision[11]

General

44. The assessment was based on the CBB's self-assessment of compliance with the Core Principles (CP); a review of relevant laws, regulations and prudential guidelines; and discussions with the governor and staff of the CBB (including the General Counsel, the Inspector of Banks and members of the BSD), industry groups (including the Association of International Banks and Trusts, the Association of Compliance Officers and the Institute of Bankers), and representatives of individual financial institutions. In addition, examination

[11] The assessment was undertaken by Messrs. Tanya Smith (Office for the Comptroller of Currency) and Laurent Ettori (French Commission Bancaire).

templates, operations manuals, and off-site examination returns were reviewed in order to gain a comprehensive understanding of the supervisory program in The Bahamas. The primary laws reviewed for the detailed assessment were the Banks and Trust Companies Regulation Act, 2000 (BTCRA) and the Central Bank of The Bahamas Act, 2000.

Institutional and macroprudential setting, market structure—Overview

45. At the time of the assessment, there were 310 bank and trust licensees in The Bahamas, of which 300 were active. Licensees with bank and trust, or solely bank licenses, totaled 203; the remainder were trust or nominee trust licenses. There were 209 licensees with physical presence in the jurisdiction, the remainder being managed licensees, including 36 stand-alone, or "shell," banks. The Bahamas has a substantive role as a host jurisdiction for a large number of subsidiaries and branches of foreign banks emanating from a wide array of countries including Switzerland, the United States, the United Kingdom, Canada, France, and Brazil. A decision in 2001 to require substantially all banks to establish a physical presence by June 2004 is expected to result in the surrender of up to 100 licensees.

46. The primary business for many licensees is private wealth management and related trust business. There are no clear estimates of assets under management in the system, although the industry considers the total to be above $1 trillion. Total external banking assets approximated $258 billion at year-end 2001.

47. The supervisory program of the CBB has changed very substantially since December 2000, when much of the existing legislation was passed. A fundamental development was the introduction of on-site examinations in January 2001 to supplement the traditional off-site processes. This change has prompted improvements in prudential standards and resulted in a greater understanding of the licensees and the risks in the banking system. The focus of the on-site work has gradually expanded from a review of AML compliance to include risk management, corporate governance, and financial soundness issues. The CBB has also devoted much effort to the production of a range of prudential regulations and guidelines.

General preconditions for effective banking supervision

48. The Bahamas is a stable democracy with sound economic policies, although it is particularly vulnerable to fluctuations in external demand, especially from North America. There are enforceable property rights, an effective bankruptcy law, and appropriate measures to resolve problem banks. In September 1999, the Government passed The Protection of Depositors Act. The deposit insurance fund established under the Act provides a maximum coverage of B$50,000 to each Bahamian dollar deposit held by member institutions. The jurisdiction has highly professional legal and accountancy services and a well-developed and independent judicial system.

Main findings

49. The assessment of the banking supervision framework reveals that there is compliance with many of the Core Principles. The legal and regulatory framework is in place

to give the CBB appropriate authority to license and supervise banks. The framework applies equally to on-shore and off-shore licensees, although there remains an issue about the process applied to the remaining stand-alone managed licensees and booking branches. Compliance was less robust in areas related to prudential regulations and requirements, as many of these are still in the early stages of development.

50. **Objectives, autonomy, powers, and resources (CP 1):** Overall, the legal framework provides a suitable base for an effective regulatory process. The law sets out the responsibilities of the supervisor, provides a range of specific and general powers, and grants the CBB an appropriate level of operational independence. It provides protection to the Inspector (and designees) against civil and criminal liabilities, but the governor, who exercises some regulatory functions in his own right, is not afforded that same protection, although he is indemnified against the cost of any legal action taken against him. The supervisory function is funded from the CBB's own internal resources that are generated from its central banking functions. However, the human resources available in some key areas (for example, policy development and legal advice) are fewer than the sharply increasing workload demands. The CBB has had trouble recruiting and retaining skilled employees primarily because of competition from the private sector. This is particularly true with respect to the recruitment of senior officials, and the CBB must continue its efforts to ensure that remuneration packages are competitive.

51. **Licensing and structure (CPs 2–5)**: The legislation identifies the conduct of banking business as a regulated activity, and only institutions granted a license may include the word "bank" in their name. The application requirements are defined in some detail, and the CBB is required to have regard to fitness and propriety, financial resources, the business plan, and track record. For foreign bank applicants a statement of "no objection" is required from the home country supervisor. The law does not provide for the concept of significant ownership or control of a bank, but instead requires that no shares in any licensed institution may be issued, transferred or otherwise disposed of without the prior approval of the CBB. Provisions are made for an exemption to be granted in undefined circumstances. While the CBB has granted limited exemptions to the domestic banks with publicly traded shares, no such exemptions appear to have been made in respect of the foreign banks operating through branches in The Bahamas, resulting in such banks with publicly-traded shares being in technical breach of the law. There are no regulations that require licensees to obtain prior approval from the CBB for major investments or acquisitions (except the establishment of foreign subsidiaries). However, regulations have been drafted to address investments and acquisitions by licensees. Additionally, provisions exist for monitoring this area in the licensing process. As a condition of licensing, all licensees are advised in the licensing letter that "There should be no establishment of a branch, subsidiary or representative office of the bank, or its participation in any other financial institutions without the prior approval of The Central Bank." The CBB's prudential norms reinforce this statement.

52. **Prudential regulations and requirements (CPs 6–15):** The formalization of prudential regulations and requirements are in various stages of completion. The CBB has focused on transforming the limited-scope statement of prudential norms, which has long

been issued to every licensee, into more robust standards that require a greater depth of risk management. The KYC and AML areas have received the greatest attention over the past two years, and this has resulted in the creation of a relatively comprehensive program of compliance testing. However, prudential regulations and policies are still being considered and drafted in several areas, and additional, dedicated resources are required to complete this work within a reasonable timeframe.

53. The application of the Basel Capital Accord framework is set in statute, although the CBB currently applies a dual minimum level of capitalization, based on either 8 percent of risk assets or 5 percent of total assets, whichever is higher. The CBB has sought to address connected lending in its draft large exposures regulation, which indicates that lending to "related parties" is subject to various requirements, including arm's length dealing. The CBB has not yet formalized its position on credit, market, country, and transfer risks, although credit and country risks are assessed through both the on-site and off-site examination processes. Technical assistance may be required in developing appropriate regulations and guidelines with respect to market risk, as in-house expertise is currently not available.

54. **Methods of ongoing supervision (CP 16–20):** The CBB has developed a combination of on-site and off-site supervisory procedures that result in a reasonable understanding of the position of the banks. The off-site program, based on the submission by banks of a range of quarterly prudential returns, has been in existence for many years, and this has been supplemented by an on-site examination program since 2001. The CBB has made efforts to integrate the skills by instituting a cross-training system, whereby the off-site analysts participate in the examinations in order to improve their overall understanding of the institutions. Originally, the on-site program focused solely on AML, but this has gradually been expanded to look at a variety of prudential banking risks. There is, however, much more work to be done, as several risks have still to be addressed in a structured form. Moreover, the continued, but time-limited, existence of "managed" licensees without a physical presence in the jurisdiction poses a serious obstacle to a comprehensive on-site program and to regular contact with bank management.

55. Supervisory information is primarily validated through the on-site examination procedures, but the CBB does have the option, which it has used in practice, of requiring a review to be undertaken by independent accountants. There is currently no established policy on whether to incorporate random or comprehensive reviews within the scope of the auditors' work. The CBB has no formal consolidated reporting system for domestic financial services groups, but this is being developed within a new off-site system. In practice, the CBB is a party to a domestic inter-agency MOU, which provides for a lead regulator for groups that span more than one agency.

56. **Information requirements (CP 21):** Banks are required by statute to submit an annual report prepared by an approved external auditor, and this must be accompanied by a certificate signed by management verifying that the accounts are true and correct. The appointment of all auditors is subject to approval (which may be withdrawn) by the Governor of the CBB, but there is no single national accounting standard to which auditors must

adhere. While the CBB prefers the use of IAS, other standards are permitted, subject to notification to the CBB, provided that they are recognized as having broad international acceptance. The CBB has the legal authority to request additional information from the auditors and to require that they conduct procedures in line with the CBB's instructions.

57. **Formal powers of supervisors (CP 22):** The statute defines a limited number of specific remedial actions at the CBB's disposal (including the power to impose conditions on a license at any stage); but this is supplemented by a very broad power to take whatever corrective measures it deems appropriate, if it determines that a licensee is not complying with relevant rules, regulations, accounting procedures, or prudential norms. The CBB has responded to this general authority by developing a ladder of intervention, which provides an extensive listing of the types of actions that it might take to respond to problems in a licensee. The ladder is not a public document, but its publication would assist considerably in improving the transparency of the techniques that the CBB might wish to employ.

58. Suspension of a license is one of the remediation measures that the CBB may apply, and this is seen by the CBB as an important tool in being able to act immediately to take control of a situation without having to go through the pre-notification procedures for revocation. However, the law does not define the term "suspension" and there is no discussion of its effect on the institution. The CBB interprets it to mean that all activities (taking loan payments and deposits, paying employees and other bills, etc.) must cease from the date of the order. That description seems to confirm that there would be little left to resuscitate if the suspension were removed, and this is consistent with the fact that all suspensions have subsequently resulted in revocation. It is important that this process should be more clearly defined in law if it is to continue to be a key instrument of enforcement.

59. **Cross-border banking (CP 23–25):** The legal framework draws no distinction between foreign and domestic institutions for the supervisory and regulatory process. In practice, the vast majority of Bahamian licensees are subsidiaries or branches of foreign banks. As a result, the CBB has focused extensively on setting a framework in place to provide for its role as a host supervisor. However, there remain material concerns about the extent of effective supervision over the managed banks that maintain no physical presence in The Bahamas. These include both the booking branches of established international banks, and the higher risk, independent banks that have no affiliation with another regulated institution. While all licensees are subject to the same off-site supervisory program, the on-site regime for these institutions is necessarily far more circumscribed than for banks with a physical presence. There is a need to establish a program to resolve this issue and extend the on-site program to all licensees. The CBB is requiring that the unaffiliated managed banks be phased out by June 2004, although booking branches based in Basel Committee member countries are being permitted to stay, provided that they meet certain criteria. With respect to the CBB's powers as home supervisor, the law requires banks to obtain prior approval from the CBB to establish a branch, subsidiary, agency, or representative office overseas. The CBB has not yet extended its on-site program to any overseas offices.

60. Since December 2000, the CBB has had a range of powers to cooperate with, and assist overseas regulatory authorities. Although exchanges of information are not dependent upon an MOU, the CBB is undertaking negotiations for such agreements with several overseas regulators for which The Bahamas is a significant host jurisdiction. In addition to responding to enquiries, the CBB has shared information spontaneously with home country authorities in instances where there have been significant concerns about the Bahamian licensee. There is provision for on-site examination of branches and subsidiaries in The Bahamas by overseas regulatory authorities or their agents, and some examinations have taken place. Direct access to certain customer records is prohibited, but the CBB has instituted arrangements whereby it would be able to obtain (and sanitize, if necessary) relevant information on behalf of the overseas authority.

Table 1. Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action	Authorities' Response
CP 1(2): Resources	Establish a policy unit within the BSD with dedicated resources, and create an additional position of legal adviser to the BSD.	**Agreed and in progress**. The BSD is in the process of restructuring. The restructured department will include an integrated on- and off-site function and a fully resourced policy unit under the direct supervision of the Inspector. The Bank has already engaged additional legal resources which will increase those legal resources dedicated to the BSD.
CP 1(5): Legal Protection.	Grant the Governor of the CBB the same protections afforded the members of the banking supervisory team.	**Agreed**. The Banks and Trust Companies Act, 2000 is being reviewed and the necessary amendments will be recommended.
CP 5: Investments.	Finalize the existing draft regulations.	**Agreed and in progress.** The draft Regulations on Acquisitions and Investments have been finalized and is under review by the Attorney General's Office. These Regulations should be released in late 2003.

Reference Principle	Recommended Action	Authorities' Response
CP 10: Connected Lending	Finalize and publish the draft regulations.	**Agreed and substantially completed.** We have drafted the Large Exposures regulations and guidelines with particular reference to the definition of "related parties" as discussed with the Mission. We are confident that the amended Guidelines and Regulations are 'compliant' and once implemented, will be recognized accordingly. We appreciate the onsite guidance given by the Mission in this regard. The Guidelines and Regulations are expected to be finalized by January 2004.
CP 13: Other Risks.	Continue to review the status of all the existing, in-process and prospective regulations and identify the priorities for action. Assess where additional specialized skills will be needed to complete the task of developing the required regulations and guidelines.	**Agreed and in progress**. The CBB has already prioritized the areas of policy development based on its Basel Core Principles self assessment in 2001. Additionally, the CBB reassesses its policy needs on a regular basis and adjusts its policy priorities accordingly. The Policy Unit has made considerable progress in the development of Regulations and Guidelines. Additional resources have been identified to adequately staff the Unit. Market risk has been identified as an area for additional training and external assistance.

Reference Principle	Recommended Action	Authorities' Response
CP 22: Remedial Measures.	Publish the "ladder of intervention" to inform the industry of the manner in which the CBB intends to use its broad powers. Review the existing laws and internal policies regarding suspension of a license to clarify the value of the objective and the procedures adopted.	**Agreed.** The CBB will be publishing its ladder of intervention as part of a document entitled, "The Regulatory Framework of Bank and Trust Supervision in The Bahamas." The Bank is comfortable with this provision as it gives the CBB time, in certain circumstances, to decide on alternative courses of action, such as whether to allow an institution to be taken over by another or placed into receivership.

Authorities' response

61. The Central Bank began the process of preparing for its IMF Module 2 assessment in late 2001. Although resource consuming, the Central Bank has benefited tremendously from this exercise. It has enabled the Bank to assess its compliance with the established supervisory standards and to identify its strengths and take steps to address its weaknesses. The CBB is pleased with the results of the assessment and generally agrees with the recommendations of the IMF assessors. The Bank has commenced the necessary actions to move towards full compliance with all Core Principles.

62. The Central Bank has also begun the process of identifying its technical assistance needs. We have identified additional training and focused seminars in specialized areas such as market risk and onsite examination as important areas for technical assistance. With respect to market risk, there is also a need to engage external expertise for a three to six months period to augment existing in-house resources and to facilitate the transfer of skills in this area. The IMF may also assist by encouraging supervisory agencies in countries which monitor market risk and test market risk models to provide cross-training opportunities for Central Bank staff. The Central Bank expects to develop a framework for the monitoring of market risk, consistent with the Basel Capital Accord (1996 amendment) by late 2004.

B. IOSCO Objectives and Principles of Securities Regulation[12]

General

63. The assessment of compliance with the IOSCO Objectives and Principles of Securities Regulation was carried out on the SCB and the legislation from which it derives its responsibilities and power. The relevant legislation is the Securities Industry Act 1999 (SIA) (as amended) and its associated regulations, and the Mutual Funds Act 1995 (as amended) and its associated regulations. The assessment took note of a self-assessment report prepared by the SCB. The SCB's overall procedures, including those relating to the inspection process, were reviewed, as were its rules and guidelines, both published and unpublished. The SCB has a clear and informative web site, which was employed as a source of information.

64. Meetings were held with a variety of public and private organizations including the Executive Director and senior staff of the SCB, the Attorney General and his staff, the governor and senior staff of the central bank, practitioner members of the Bahamas Association of Compliance Officers and the Association of Mutual Fund Administrators and Broker-Dealers and the acting CEO and Chief Legal and Compliance Officer of the Stock Exchange.

Regulatory and institutional framework

65. The securities market and the mutual fund industry are supervised by the SCB. There are no formally recognized self-regulatory organizations, although the SCB has registered the BISX as a stock exchange, and has delegated to it certain of its powers. The domestic securities market is extremely thin. There are only 16 stocks traded on the BISX, with market capitalization of less than US$2 billion, and a current average of about 10 trades per day. The exchange has only three members. The offshore sector is the main focus of market interest, and is dominated by the mutual funds industry. At end-June 2002, there were 60 licensed fund administrators handling 706 mutual funds with total assets under management of US$97 billion.

General preconditions for effective securities regulation

66. The Bahamas is a stable democracy with sound economic policies, enforceable property rights, and an effective bankruptcy law. It has highly professional legal and accountancy professions and an effective judicial system. The state encourages new entrants to its securities and mutual fund industries and seeks to ensure that regulatory costs are distributed proportionately.

---

[12] This assessment was undertaken by Mr. Richard Britton (consultant, MFD, formerly UK Securities and Investment Board).

Summary principle-by-principle assessment

67. **Regulator (principles 1–5):** The SCB is a quasi-governmental agency with a staff of 31. It reports to the minister of finance who has wide and unspecified powers both to direct the SCB to take action, and to dismiss Commissioners without apparent proper cause. These powers have not been used to date. Legal protection against civil liability is not provided either to members of the Commission or to the staff when carrying out their duties in good faith. The SCB is partly self-funded (from license fees, etc.), but is also dependent on financial support from the government. The legal responsibilities of the SCB are clear and objectively stated. Of the 80 broker dealers and securities investment advisors registered with the SCB, 48 are also licensed in respect of their bank and trust business by the CBB. An MOU provides for information sharing and cooperation between domestic regulators, who meet monthly within a structured framework. It has been agreed that, for the 48 entities jointly regulated by the SCB and the CBB, the latter is to act as the principal regulator.

68. **Self-regulatory organizations (principles 6–7):** Legislation does not formally recognize SROs, as such, and principles 6 and 7 are therefore not applicable. However, the SCB has the power to approve and register a company as a stock exchange under the SIA and to delegate any of the powers conferred on it by the Act. In practice, the SCB has registered the BISX as a stock exchange and has delegated to it the powers of oversight of trading on the exchange; supervision of its members and enforcement of its rules on them; monitoring of companies listed on the exchange for compliance with the SIA and enforcement of the exchange's timely disclosure and other listing rules. The SCB retains extensive powers over BISX and trading on the exchange, and may withdraw, add or vary any delegated powers as it deems necessary.

69. **Enforcement (principles 8–10):** The SCB has comprehensive investigation powers, and, with the exception of a power to wind up unlicensed mutual funds, comprehensive enforcement powers. The current legislation does not give the SCB specific authority to conduct routine inspections of investment firms, although that has not prevented the SCB from so doing, nor has the SCB's practice in this regard been challenged. As regards mutual funds and their administrators, draft legislation is intended to close these loopholes. The explicit power to conduct inspections of all registrants awaits amendment to the SIA.

70. **Cooperation (principles 11–13):** The SCB has authority to share public and nonpublic information with domestic counterparts, and there appear to be no problems in practice. However, a key issue concerns the sharing of information with foreign counterparties. The legislation permits the SCB to pass to an overseas regulatory authority information necessary to enable that authority to exercise regulatory functions, including the conduct of civil or administrative investigations and proceedings to enforce laws, regulations and rules administered by that authority. A requesting authority must provide either an undertaking on confidentiality sufficient for the SCB to satisfy itself that the requesting authority is subject to 'adequate legal restrictions on further disclosure,' or an undertaking 'not to disclose the information provided without the consent of the Commission.' It appears that the SCB is reluctant to give its consent to a requesting authority to pass information it

has received to its judicial authorities or to other bodies (such as parliamentary committees), even when the recipient is legally obliged to pass on such information. To insist on an undertaking to maintain confidentiality in all circumstances may have the effect of obstructing transfers of nonpublic information, on the basis that no overseas agency could provide a blanket assurance.

71. The SCB has not signed any bilateral MOUs with foreign regulatory counterparts, although it has received requests to do so from Canada, Japan, the United Kingdom and the United States. The conclusion of such MOUs may assist in clarifying the procedures for effective information exchanges.

72. **Issuers (principles 14–16):** There is an absence of any mechanism, whether in law or enforceable codes of practice, governing the practice and aftermath of takeover bids and other changes in corporate control, and the treatment of shareholders in this process. The SCB has power under the SIA to make rules for tender offers, mergers, and other issues of corporate control and acquisition involving any public company, but has yet to implement appropriate mechanisms. The time period in which public companies are legally obliged under the SIA to release price-sensitive information (five days) is excessive, and varies from the more appropriate requirement under the Stock Exchange rules ("without delay").

73. **Collective investment schemes (principles 17–20):** The current licensing and exemption requirements in the Mutual Funds Act are complex and confusing. The proposed enactment of new legislation (the preparation of which is well advanced) is to be used as an opportunity to simplify and clarify, as well as to ensure that the SCB's oversight powers are logical and complete. In particular, although the exempt fund provisions do not appear to have raised investor protection issues in practice, the current provision, whereby such funds file their documentation voluntarily with the SCB, will be replaced with a mandatory obligation. Most funds currently exempt will also require a license.

74. There are two practical problems with the regulation of collective investment schemes. First, the rules and regulations do not adequately address issues concerning stock lending by a fund. This is a legitimate practice for increasing the income of a fund, but which, if not subject to adequate controls, can expose the fund to significant risk. Second, the Mutual Fund Regulations 1995 state that a unit trust does not have to have a custodian who is independent of the mutual fund administrator, "if not less than 80 percent of the equity capital of the fund is listed on a recognized stock exchange," or, in the case of a unit trust or an investment company, "if the mutual fund administrator meets certain capital requirements," which are likely, in most cases, to be very low in relation to the assets of the funds it administers.

75. **Market intermediaries (principles 21–24):** It is important that the SCB should create and test a contingency plan to deal with the failure of an investment firm. While most of the necessary elements in terms of information flows, domestic inter-regulator cooperation arrangements and statutory powers appear to be in place, it is not clear currently whether there are any procedural or legislative gaps that need to be filled.

76. The licensing and supervisory procedures adopted by the SCB appear to work well and there are no obvious gaps, although, as noted above, while routine inspections are carried out, they are not supported by specific powers. The legislation also needs updating to reflect current business practices by removing overlap in the registration process between certain categories of firms. Similarly, the SCB informally requires all broker-dealers and securities investment advisers to comply with the conduct of business rules of the BISX when those go beyond the SCB's own rules (for example, 'best execution'). Only three broker-dealers out of 54 are members of the exchange.

77. **Secondary market (principles 25–30):** The BISX is the only stock exchange in The Bahamas. There are no other mechanisms for matching buyers and sellers, which might fall within a generally accepted definition of a trading system. The power of the SCB to regulate the latter is not beyond doubt.

78. The SIA empowers the Commission to supervise and regulate the operations and duties of a securities exchange. As the SCB recognizes, its mandated function of 'ensuring orderly, fair and equitable dealings' is particularly relevant to its supervision and regulation of the exchange. To that end, the SIA authorizes the Commission to 'review, approve, reverse or vary any rules, regulations, interpretations, decisions, actions or orders of the exchange.' In light of this authority it has been the practice of BISX to seek the approval of the SCB prior to the adoption or variation of any rules. BISX is required to file a monthly report with the SCB specifying for the previous month its income statement, cash flows, tangible net worth, trading statistics, etc. The SCB also carries out on-site inspections of BISX on a bi-annual basis. The exchange opened in 2000 and so only one inspection has been carried out to date.

79. The volume of trading on BISX has been very low since launch, and the exchange appears to be in urgent need of additional funding from either existing or new shareholders, or the government. The SCB should be satisfied that it is in a position to manage an orderly wind-down of the exchange if that should prove necessary. In practice, the risk to investors is small given the low level of trading and settlement occurring on a T+3 basis. The main source of risk probably lies in the security of the system for recording ownership of those shares that have been dematerialized.

80. The SIA contains provisions to deter market manipulation and other unfair trading. Specifically, topics addressed, and which are subject to criminal sanctions (including fines and imprisonment), are the creation of false markets, market rigging transactions, employment of deceptive devices, misuse of confidential information and insider dealing. In the last case, the SIA also provides a mechanism for those who have suffered loss as a result of an insider's actions to seek compensation.

81. IOSCO Principle 29 requires that regulation should aim to ensure the proper management of large exposures, default risk, and market disruption. It should be noted that, in the current state of development of the market, the occurrence of a market disruption is unlikely, and the risk of significant losses arising from the default of a broker-dealer or

securities investment advisor is small. On the other hand, the SCB has not undertaken a review of the interaction of securities law and the general law of insolvency to establish, for example, whether the law adequately protects a customer's trades or positions in the event of a market intermediary's default.

Table 2. Recommended Plan of Action to Improve Implementation of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action	Authorities' Response
Principles Relating to the Regulator (P 1–5)	Narrow the Minister's power to give directions to the SCB. Restrict the Minister's power to dismiss Commissioners to proper cause, such as bankruptcy or fraud. Provide the Commissioners and staff with immunity against liability. Introduce the draft Mutual Fund Bill into Parliament to secure the improvements in the powers of the SCB including the power to raise additional fees.	Narrowing the Minister's power to give directions to the SCB has been addressed in the Investment Funds Bill and will also be addressed through amendments to the SIA. Restricting the Minister's power to dismiss Commissioners and provide the Commissioners and staff with immunity against liability will be addressed in amendments to the SIA. The SCB notes that the Investment Funds Bill has been tabled and passed by both Houses of Parliament and awaits an appointed date to become law. The appointed date is being reserved until the Regulations are completed so that we can have contemporaneous enforcement.
Principles of Self-Regulation (P 6–7)	No recommendations	
Principles for the Enforcement of Securities Regulation (P 8–10)	Apply the resources necessary to accelerate drafting of further amendment to the SIA to correct existing deficiencies as identified by the SCB.	The SCB notes the Missions comments.
Principles for Cooperation in Regulation (P 11–13)	Recognize in the legislation that most overseas regulatory authorities cannot give an absolute guarantee to preserve the confidentiality of information received. Commence bilateral negotiations with one or more key jurisdictions with a view to signing bilateral MOUs.	With respect to the nonability of overseas regulators to give an absolute guarantee to preserve the confidentiality of information, the SCB confirms that our consent will be given for the further release of nonpublic information onto judicial authorities or other bodies such as parliamentary committees of the requesting authority. With respect to the Mission's comment on commencing bilateral negotiations with one or more key jurisdictions with a view to signing bilateral MOUs, the SCB notes that

Reference Principle	Recommended Action	Authorities' Response
		the IOSCO MOU is presently being considered for adoption.
Principles for Issuers (P 14–16)	Replicate in legislation the BISX requirement that public companies disclose material change information to the public without delay. Make rules to ensure that in takeovers and similar situations all shareholders are treated fairly and equitably.	With respect to including in legislation the BISX requirement that public companies disclose material change information to the public without delay, the SCB notes that this will be addressed in amendments to the SIA. The SCB notes that the making of rules for takeovers and similar situations is imperative and to this end we intend to make a request to the IMF for technical assistance.

Authorities' response

82. **Cooperation (principles 11–13):** The SCB reiterates its position that its consent will be given for the further passing on of information by a requesting authority to its judicial authorities or to other bodies such as parliamentary committees. The SCB's consent in this regard will be given from the outset requesting only that we be notified when the information has been further passed on by the requesting authority to its judicial authorities or other bodies such as parliamentary committees.

83. **Collective investment schemes (principles 17–20):** At the end of the first paragraph the Mission notes that "Most funds currently exempt will also require a license." The SCB notes that all funds will fall under the purview of the SCB and will either have to be licensed or registered.

84. With respect to the second paragraph and the Mission's comments that there are two practical problems with the regulation of investment schemes the SCB notes that the first problem identified by the Mission, that is, that the rules and regulations do not adequately address issues concerning stock lending by a fund, is presently being researched by the SCB with a rule to be developed as soon as is practicable. In the case of the second problem identified by the Mission, that is, the ability for unit trusts and collective investment schemes to not have a custodian independent of the mutual fund administrator, this has been addressed by the new Investment Funds Bill whereby this 'exception' no longer exists.

C. FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism

Introduction

85. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations Combating the Financing of Terrorism* was prepared by a team composed of staff of the International Monetary Fund, outside experts under the supervision of Fund staff, and a further expert not under the supervision of Fund staff who was selected from a roster of experts in the assessment of criminal law enforcement.[13]

86. The report provides a summary of the level of observance with the FATF 40+8 Recommendations, and provides recommendations to strengthen observance. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the government of The Bahamas or the Board of the IMF.

Information and methodology used for the assessment

87. In preparing the detailed assessment, the mission reviewed the relevant AML/CFT laws and regulations, and supervisory and regulatory systems in place to deter money laundering and financing of terrorism among prudentially regulated financial institutions. In addition, the mission reviewed the regulatory systems in place for non-prudentially regulated sectors that are macro-relevant, specifically trust and company service providers. The capacity and implementation of criminal law enforcement systems was also reviewed. The assessment is based on the information available at the time the missions were completed, in October 2002 (for the main mission) and April 2003 (for the independent law enforcement expert only).

Main findings

88. The Bahamas has made important progress with respect to the measures to combat money laundering. The mission noted the extensive provisions introduced since June 2000. These contain important fundamentals, but they have posed some practical difficulties for the financial services industry in view of the extremely detailed and prescriptive nature of many of the provisions. At the same time, they offer the potential for significant exemptions to the

---

[13] The assessment was undertaken by Mr. Richard Chalmers (mission chief, MFD); Ms. Joy Smallwood (LEG); Messrs. Richard Britton, Christopher Cooke, Laurent Ettori, and Ms. Tanya Smith (all consultants, MFD). The independent law enforcement expert for the AML/CFT assessment was Mr. Russell Ursula of the Caribbean Financial Action Task Force (CFATF) Secretariat.

general principles, for example, in relation to identifying the beneficiaries of trusts. While the mission considers that the industry should be encouraged to develop a more risk-based approach to certain issues, this should only be within an overall framework that demands high standards of customer identification on a very broad basis.

89. On the matter of the financing of terrorism, the mission noted that the Cabinet was in the process of considering a relevant draft bill, which it was hoped would be presented to Parliament very shortly.[14]

Criminal justice measures and international cooperation

(a) Criminalization of ML and FT

90. Money laundering is criminalized as an indictable offense, extends to all proceeds of criminal conduct, and is consistent with the definitions set out in the Vienna Convention, Palermo Convention, and the FATF 40 recommendations. With respect to criminal offenses, both individuals and corporate entities are subject to criminal laws relating to money laundering, including unlimited fines and imprisonment of up to 20 years for "conviction on information" also known as an indictable offence. FT is not criminalized. The Bahamas should also ratify both the International Convention for the Suppression of Financing of Terrorism (1999) and the UN Convention Against Transnational Organized Crime (Palermo Convention); and should fully implement the UN Resolutions on the prevention and suppression of the financing of terrorist acts, particularly UN Security Council Resolution No.1373.

(b) Confiscation of proceeds of crime or property used to finance terrorism

91. Provisional measures may be taken to seize, freeze, or restrain a person from dealing with any cash related to the proceeds of crime. Under the Proceeds of Crime Act (POCA), the court may also issue restraint orders to prohibit any person dealing with realizable property. Restraint orders will be issued on an ex-parte basis by a Judge in chambers. Realizable property is defined as property held by the defendant or any property held by another to whom the defendant has made a gift caught by the POCA. Property is defined as money and all other property, movable and immovable, including things in action and other intangible or incorporeal property. Confiscation of assets of equivalent value is permissible after conviction.

92. No provisions are in place for identifying and tracing assets suspected of being used for the financing of terrorism. Laws do not provide for the freezing of funds or other property of terrorists in accordance with the UN resolutions. Instrumentalities, except in respect of drug-trafficking offences under section 33 of the DDA, are not covered by current legislation. Provisions are in place with regard to AML and proceeds of crime and may be

[14] The Terrorism Bill was tabled in Parliament on June 25, 2003.

expanded upon at a later date to be used in freezing funds or other property of terrorists, but competent authorities do not currently have the power to identify and freeze the property of suspected terrorists, those who finance terrorism or terrorist organizations.

(c) The FIU and the process for receiving, analyzing, and disseminating intelligence

93. A FIU was established in The Bahamas in December 2000 and is a member of the Egmont Group.[15] It has responsibility for receiving STRs. The Royal Bahamas Police Force also has jurisdiction in this area. The FIU has independence and autonomy, although, under Section 5 of the Financial Intelligence Unit Act, the Minister, in this case the Attorney General, may give the FIU directions in writing of a general nature as to the policy to be followed in the public interest. In practice, the Director of the FIU deals with day-to-day matters. He meets with the Attorney General as and when the need arises and keeps the Attorney General apprised of matters by a formal annual report.

94. Persons, other than financial institutions, may discharge their obligation to report suspicions under the AML legislation by contacting either the police or the FIU, but there is no obvious requirement for the police to keep the FIU apprised of any STRs it may receive. Furthermore, auditors may report to any member of the police, which allows a wide scope of reporting and would include police located anywhere in The Bahamas. In cases where time was of the essence, there could be a delay in the information arriving at the FIU, which could compromise the spirit of the regulatory structure.

(d) Law enforcement and prosecution authorities, powers and duties

95. Police may execute warrants to search and seize by making application to a magistrate. Any magistrate who, on an application, is satisfied that there are reasonable grounds to do so, may issue a search warrant in the prescribed form, to a member of the Police. Separately, there is authority under Section 6(4) of the MLAA for the Royal Bahamas Police to execute a warrant in order to assist in a request for legal assistance from abroad. Further, Sections 19(2)(c), 22(d)(i) and 22(d)(iii) of the FTRA allow disclosure of information to the Attorney General's office for purposes of the administration of the Mutual Legal Assistance Treaty process.

---

[15] The Egmont Group defines a FIU as: "a central, national agency responsible for receiving (and, as permitted, requesting), analyzing, and disseminating to the competent authorities disclosures of financial information (i) concerning suspected proceeds of crime, or (ii) required by national legislation or regulation, in order to counter money laundering." See www.fatf-gafi.org "Other Initiatives."

(e) International cooperation

96. There are laws and procedures for mutual legal assistance in money laundering regarding the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in investigations and criminal proceedings. There are also laws and procedures to provide effective mutual legal assistance in money laundering matters by making an application to the Attorney General. There is a dual criminality test for international cooperation under a bilateral treaty. Under the CJA, used by non-treaty countries, the Attorney General has broad powers to grant assistance without the need for dual criminality or reciprocity. International cooperation is supported through bilateral and multilateral treaties.

97. Extradition is possible from The Bahamas. The Extradition Act, 1994 is not a list offense Act, but a dual criminality and minimum sentence Act. Specifically, a person can be extradited from The Bahamas where the alleged crime carries a minimum sentence of two years for Commonwealth countries. For other countries, bilateral treaties are required. In those treaties, a person can be extradited where the alleged offense is one year (see article 2 of U.S./Bahamas treaty on extradition). Treaties have been signed with the countries listed in schedule 1 of the Extradition Act. The Bahamas will extradite their own nationals. There is nothing explicit in the Extradition Act, in other legislation or in the Constitution of The Bahamas that forbids this. In practice, according to the authorities, The Bahamas have extradited their own nationals on numerous occasions.

Preventive measures for financial institutions

98. The CBB licenses and supervises the banks and trust companies, while the SCB oversees the securities and mutual funds industry. Company managers and related service providers are the responsibility of the IFCS, with the Compliance Commission being tasked primarily to ensure compliance with the AML obligations imposed on those businesses that are not otherwise subject to prudential supervision. Where applicable, all the respective agencies supervise activities in both the domestic and offshore sectors under a general legal and regulatory framework that does not apply differential regimes between the two sectors.

(a) Prudentially regulated sectors

99. Supervision and Enforcement: While the CBB has made very substantial progress in developing a robust regulatory framework in a short period of time, it remains with the legacy of the managed banks that maintain no meaningful physical presence in The Bahamas. Some of these banks pose material risks to the reputation of the jurisdiction and they have been given (through CBB directive) until June 2004 to establish a presence in the islands or to close. In the meantime, it is important that the CBB should seek to enhance its oversight of these entities in order, as far as possible, to bring supervision towards the standards applied to the rest of the banking sector.

100. Generally, throughout the regulatory agencies there is a shortage of staff with the appropriate depth of skills, although the CBB appears to be better placed than the others.

This pressure on resources is common among jurisdictions. It will be important for the agencies to establish an environment that makes them as competitive as possible, to attract and retain the skills that are available in the market. This environment should recognize that the skills in particular short supply are those for which the private sector financial institutions are prepared to pay well.

101. Preventative Measures: All the AML/CFT provisions are contained in the POCA, the FTRA, the FTRR or in the FIUA, FIUR or FIU guidelines. Breach of the law is considered a criminal offence rather than an administrative matter. The mandatory regulations require the regulated entities to have procedures on customer identification, record keeping, reporting of suspicious transactions, and appropriate training regarding suspicious transactions, which comply with international standards. Tipping off is penalized and persons furnishing information to the competent authorities are protected from claims for breach of confidentiality. Certain specified exceptions in customer identification (e.g., for non vested beneficiaries in a trust) should be more narrowly tailored to avoid putting the AML/CFT framework at risk.

(b) Non-prudentially regulated sectors that are macro relevant

102. Supervision and Enforcement: The overall regime applied to the corporate service providers regulated by the Inspector of Financial and Corporate Service Providers gives rise to a number of structural issues. However, the AML supervision for the sector is based uniformly on the FTRA. While the IFCS has the licensing and enforcement authority over the corporate services providers, an agreement has been reached for the Compliance Commission to monitor compliance with AML obligations in this sector.

Table 3. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
40 Recommendations for AML	
General framework of the Recommendations (FATF 1–3)	Revise confidentiality provisions to ensure that the authorities can share information at both the domestic and international level.
Scope of the criminal offense of money laundering (FATF 4–6)	Amend POCA to specifically reflect the intentional element of these offences may be inferred from objective factual circumstances.
Provisional measures and confiscation (FATF 7)	Amend POCA to specifically allow for the forfeiture of property of corresponding value.
General role of financial system in combating ML (FATF 8–9)	

Reference FATF Recommendation	Recommended Action
Customer identification and record-keeping rules (FATF 10–13)	Reduce or eliminate the exception from identification requirements applicable to transactions made by or through other financial institutions or through eligible introducers. Prohibit the establishment of anonymous or fictitious accounts by tightening up provisions in POCA regarding beneficial ownership of accounts, particularly trusts. Require liquidated companies or dissolved partnerships to retain records, for five years so that compliance with FATF 12 is achieved.
Increased diligence of financial institutions (FATF 14–19)	Create an obligation to monitor, detect and analyze unusual and complex transactions. Financial Institutions should then implement these requirements.
Measures to cope with countries with insufficient AML measures (FATF 20–21)	Enact regulations that require banks to have a routine for testing compliance against both and host country KYC standards. Enact regulations that recommend that a group policy be followed to the extent that all overseas branches and subsidiaries ensure that verification of identity and record keeping practices are undertaken at least to the standards required under Bahamian law or, if the standards in the host country are considered or deemed more rigorous, to those higher standards. Currently this requirement is only in guidance. Furthermore, enact provision in law or regulation to request financial institutions pay special attention to transactions with countries with deficient AML/CFT provisions.
Other measures (FATF 22–25)	
Implementation & role of regulatory and other administrative authorities (FATF 26–29)	Provide all regulatory authorities with the resources necessary to develop adequate on site and off site supervision of compliance at financial institutions. Adopt a consistency of approach across all regulators regarding powers of information sharing with overseas regulators to create effective international cooperation.
Administrative Cooperation – Exchange of general information (FATF 30–31)	The regulatory authorities should discuss a common interpretation of their respective provisions with respect to confidentiality and the exchange of information, and the interpretation should be a reasonable one in determining a practical reading of what represents “adequate” assurances of confidentiality from overseas authorities. A strict interpretation of the current law could lead to very limited exchange of information.
Administrative Cooperation – Exchange of information relating to suspicious transactions (FATF 32)	
Other forms of cooperation – Basis &means of cooperation in confiscation, mutual assistance, and extradition (FATF 33–35)	*The Bahamas should consider expanding staff at the Attorney General’s Office and the Tracing and Forfeiture/ML Investigation Section of RBPF in order to continue responding promptly and fully to requests for assistance received from other countries.*

Reference FATF Recommendation	Recommended Action
Other forms of cooperation – Focus of improved mutual assistance on money laundering issues (FATF 36–40)	
8 Special recommendations on terrorist financing	
I. Ratification and implementation of UN Instruments	The Bahamas should ratify and fully implement the 1999 United Nations International Convention for the Suppression of the Financing of Terrorism. The Bahamas should implement the UN resolutions relating to the prevention and suppression of the financing of terrorist acts, particularly UN Security Council Resolution No.1373.
II. Criminalizing the financing of terrorism and associated money laundering	The Bahamas should criminalize the financing of terrorism and terrorist organizations.
III. Freezing and confiscating terrorist assets	The Bahamas should criminalize the financing of terrorism as soon as possible.
IV. Reporting suspicious transactions related to terrorism	Amendments to relevant legislation required.
V. International Cooperation	Under treaties with other countries, including the USA and Canada, dual criminality is required before assistance can be rendered. The Bahamas has not yet criminalized the financing of terrorism.
VI. Alternative remittance	
VII. Wire transfers	Regulation 8 of the FTRR does not require financial institutions to include the name, address and account number of the originator in the wire transfer that should remain with the transfer or related message through the payment chain. It only requires them to maintain and keep records of such information. Although this uses similar language of FATF Special recommendation VII, it is not detailed enough and should be amended to meet the requirements of FATF Special Recommendation VII.
VIII. Nonprofit organizations	No legal provisions, no supervision or monitoring of nonprofit organizations. These measures should be placed in law and implemented.

IV. AUTHORITIES' RESPONSE

Central bank's response

103. The Central Bank was generally pleased with the assessment of the IMF Mission of the AML/CFT framework in the banking and trust sectors. Subsequent to the assessment and the issuance of the revised FATF 40 Recommendations, a Legislative Committee has been constituted comprising the Financial Services Regulators, private sector participants and industry associations to review the FTRA, FTRR and the AML-KYC Guidelines and to recommend amendments to the Government.

Our response to specific concerns of the mission is set out below.

General framework

(a) C-43 (Transfer of nominative information between branches and head office)

The Central Bank notes the concerns of the mission with respect to the ability of branches to transfer nominative information to the head office.

In this regard, we advise that the construction of section 15(2) of the BTCRA does permit the Inspector to give general approval for the systematic transfer of certain classes of information between a licensee, its head office, a branch or a subsidiary. In practice, where the Central Bank licensees have requested the passage of nominative information (e.g., for the purpose of the consolidated monitoring of large exposures), such permission has been given.

From a practical standpoint, the transfer of nominative information within Groups is frequently supported by "shared client agreements," signed by the client, that permit the sharing of client information among entities (i.e., corporate parent) in different jurisdictions. The Central Bank, during onsite examination, is increasingly seeing this approach.

(b) Confidentiality provisions

The Mission *expressed concern that the confidentiality provisions of section 15 of the BTCRA do not bind licensees but only their directors, officers and employees.*

The Central Bank is of the view that the reference in section 15(1)(a) to the directors and employees of a licensee by necessary inference binds the licensee itself with respect to the confidentiality provisions of Section 15, because the licensee is operated by the very persons referred to in section 15(1)(a), viz., its directors, officers, employees and agents.

(c) Risk-based approach

The Central Bank notes the concern of the mission over the detailed and prescriptive approach of the FTRR.

The Legislative Committee has submitted to the Government, draft amendments to the existing legislation which would adjust the current basis on which customer due diligence is conducted, and move to a more risk-based approach to customer identification in accordance with the revised FATF 40 Recommendations.

(d) Consistency in information sharing arrangements between regulators

A review of the interpretation and application of the information sharing provisions of the applicable statutes is currently being undertaken by the Attorney General's Office together with the financial service regulators with a view to addressing these issues.

Customer identification

(a) C-45 Prohibition of numbered or anonymous accounts

The Central Bank notes the mission's statement that *"there is no explicit prohibition of* numbered *or anonymous accounts in the law."*

However, we advise that Regulation 3(2) of the FTRR addresses the concerns under C-45. Under the FTRR all facility holders are verified using a consistently high KYC standard. Further, via the onsite examination process for Central Bank licensees, examiners verify that details provided by the client include a declaration that he is the beneficial owner. In those cases where the client is not the beneficial owner, the identity of the beneficial owner must be verified.

The Central Bank is of the view that compliance with FATF 10 may be achieved by the imposition of either a positive or a negative obligation. The provisions of the FTRA comply with FATF 10 by imposing a positive obligation on financial institutions to establish and/ or verify the identities of their customers as well as beneficial owners of accounts. We believe this approach to be equally as effective in law as the imposition of a negative obligation (expressly prohibiting anonymous or fictitious accounts) to prevent the use of anonymous or fictitious accounts.

(b) C-46 Identification of beneficial owners

The Central Bank notes the Mission's statement that "While the FTRA aims to require identification *of all customers, there are gaps in the legislation, with regard to beneficial owners of accounts."*

We advise that the legislative framework requiring compliance with FATF Recommendation 11 is in place. Financial institutions are required to obtain information about the true identity of a person on whose behalf an account is opened or for whom a transaction is conducted whenever there are reasonable grounds for believing that a customer is acting on behalf of another or whenever there are doubts as to whether customers are acting on their own behalf.

Additionally, the Central Bank advises that the onsite examination covers the Process of Control over AML activities as well as confirming, through representative sampling, that the required documentation is in place at each licensee. When assessing the adequacy of the Process of Control the examiners consider the adequacy of policies and procedures as well as the quality of personnel responsible for the administration of the policies and procedures. The examiners carry out substantive and compliance testing to ensure that the transaction is in accordance with established criteria.

The Central Bank believes that the above process complements the legislation and regulations and also provides the jurisdiction with reasonable assurance that each licensee has in place sufficient processes "to verify the capacity of the person who is conducting the transaction on behalf of the listed entities." There are other related examination techniques and practices that are applied during each examination. Large dollar items are sample tested for validity and regular verifications as are nostro account reconciliations to ensure that any unusual items are identified by staff and are elevated to senior management for approval or otherwise.

We have noted the mission's comments with respect to Section 9 of the FTRA and will give consideration to this issue.

(c) C-48 (wire transfers)

The Central Bank notes the mission's concern that the FTRR does not specifically require institutions *to include the name, address and account numbers of the originator in the wire transfer.*

This matter is under consideration by the Legislative Committee. Additionally, although there are currently recommendations concerning originator information under the Guidelines, the legal requirement concerning wire transfers has been addressed by the Legislative Committee in the *draft Customer Due Diligence Regulations* which have been submitted to the Government.

In practice, however, in accordance with paragraphs 100 and 101 of the KYC-AML Guidelines, financial institutions routinely populate wire transfer payment fields as to beneficiary, account and originator. As part of the onsite examination process, the process of control surrounding incoming and outgoing wire payments is tested through the use of a template entitled *Review of Internal Controls for Wire Transfers and Other Payments* that includes processes for AML oversight. Also wire activity is included in the processes whereby financial institutions are required to monitor accounts and transactions.

(d) Gradated customer acceptance policies (general recommendation)

The Central Bank notes the mission's concerns that there is no specific guidance to banks to develop gradated customer acceptance policies and procedures that require extensive due diligence for higher risk customers.

The Central Bank advises that the Legislative Committee has recommended to the Government the implementation of a risk-based customer acceptance system and has submitted to the Government draft amendments to the FTRA and FTRR which would facilitate this approach.

Additionally, the Central Bank has issued Guidance Notes on Accounting and Other Records and Internal Control Systems and Corporate Governance Guidelines. Both of these documents speak to the issues of risk management and internal controls, including the documentation of policies and procedures. In practice, financial institutions have documented risk-based client acceptance policies and procedures, including authorization levels. This area is examined during the on-site examination process, through the use of a template entitled *Acceptance of New Business and Maintenance of Existing Client Relationships*.

(e) Trusts

We note the Mission's concern regarding potential gaps in the legislation relating to exemptions of banks under the FTRA from identifying beneficiaries of trusts in certain circumstances. Section 10 provides an exemption only in the case of beneficiaries who do not have any vested interest in a trust. Whenever the interest of the beneficiary becomes vested, there is a duty on financial institutions to verify the identity of the beneficiary pursuant to FTRR 3(2).

The Central Bank does not agree with the Mission's statement that the FTRA is ambiguous in this regard. Provisions regarding trusts are in our view adequate. The identities of vested beneficiaries must be verified. The FTRA clearly covers legal or corporate entities. There is in our view no need to include a specific definition of person to include corporate entities as this definition is provided by the Interpretation and General Clauses Act.

(f) Corporate entities

The purpose of the requirement for the written confirmation in the FTRR is to rule out the possibility that an account may be operated on behalf of undisclosed principals. The requirement to obtain information on the identity of the true owner complies with FATF 10 which requires financial institutions to verify the legal existence and structure of a customer such as an IBC or other corporate entity, and inter alia information concerning the customer's name, legal form, address, directors, etc. Also required by FATF 40 is verification that any person acting on behalf of a customer has authority to do so. There is no requirement to verify the identities of the beneficial owners of IBC's in the FATF 40 or in the Basle CDD paper. The Bahamas legislation meets the FATF and Basel standard.

(g) Politically exposed persons (PEPs)

With respect to the development of policies concerning the treatment of PEPs, banks are required by the Central Bank's Corporate Governance Guidelines to develop policies and procedures to manage reputation and other risks associated with all or any of their customers.

Licensees are required to establish policies and procedures for acceptance of customers, including PEPs.

(h) Identification of beneficial owners

The FTRA requires the verification of facility holders as well as persons on whose behalf they are acting, both in respect of opening of accounts (Section 6 and FTRR Reg. 3 (2)) and the conduct of occasional transactions (see Sections 7, 8, 9, and 10). FATF 11 requires verification of the person on whose behalf an account is opened where a financial institution has doubts as to whether the account holder is acting on his own behalf. The FTRA meets this standard under section 6(4).

Ongoing monitoring of accounts and transactions: C-49, C-50

The Central Bank notes the recommendation of the mission that regulations or guidelines should be developed to encourage banks to apply enhanced due diligence to certain classes *of transactions.*

We confirm that the legislation has been reviewed by the Legislative Committee who has proposed, to the Government, amendments to the FTRR to address the need for ongoing risk-based account activity monitoring. Heightened scrutiny would be expected for PEPs, business relations (including financial institutions) domiciled in higher risk jurisdictions, relationships that have been refused by other financial institutions or facility holders who have complex or unusually large transactions.

The on-site examination process would indicate that the majority of financial institutions have already developed and applied appropriate methodologies to extend heightened scrutiny to the described higher risk relationships.

Recordkeeping C-53 (continued AML monitoring for liquidated or dissolved companies)

The Central Bank notes the recommendation of the mission that a provision should be made that would require the archiving of customer records for companies which have been dissolved or liquidated. This matter is under consideration.

Internal controls, compliance and audit C-61 (routine testing for compliance against home and host KYC standards)

The Central Bank notes the mission's observation concerning routine compliance testing for financial institutions against home and host country KYC standards.

We advise that we will consider incorporating the current requirement which is in the FIU Guidelines into specific Regulations. These Regulations will require that all licensees test their compliance and the compliance of their foreign branches and subsidiaries against the higher of the home or host country AML/CFT standards.

Additionally, however, it appears that the mission has misunderstood the applicability of the current FIU Guidelines for banks and trust companies in this regard. The Guidelines are applied to all Bahamian licensees and their foreign branches and subsidiaries. These Guidelines recommend that the higher of Bahamian or host country STR/AML standards are implemented.

Integrity standards—C-63 (standards for charitable and non-profit organizations)

The Central Bank notes the mission's observations that, apart from the FIU Guidelines, there are no measures in place to prevent unlawful use of entities identified as vulnerable *as conduits for criminal proceeds or FT, such as charitable or nonprofit organizations.*

The Central Bank advises that, in addition to the FIU Guidelines, under the FTRR all facility holders, including charitable and nonprofit organizations are verified using a common KYC standard.

Enforcement powers and sanctions

The Central Bank notes the mission's observations that there are no specific provisions that empower the Central Bank to require a bank to close down an establishment in a foreign jurisdiction where there are insurmountable legal impediments for the host supervisory in carrying out onsite inspections, and where there are no satisfactory arrangement that can be put in place.

The Central Bank advises that Section 14(1)(g) of the BTCRA empowers the Governor to require a licensee to take any such action as the Governor considers necessary. This may include the closure of an establishment in a foreign jurisdiction. The recommendation that the Governor imposes fines on banks which do not comply with AML legal framework is under consideration.

The Central Bank intends to proceed with the institution of fines in instances where licensees do not comply with the requirements of the AML framework.

Securities commission's response

Table 2

General framework

The SCB is of the view that there is no difference between the SCB and the CBB approach on the exchange of information to overseas regulators.

Cooperation between supervisors and other competent authorities:

The SCB notes that the IOSCO MOU is presently being considered for adoption.

Table 3

Implementation & role of regulatory and other administrative authorities and Administrative Cooperation—Exchange of general information:

The SCB notes that specific provisions regarding inspections have been included in the Investment Funds Act. With respect to registrants and licensees under the SIA, this will be addressed through amendments to the SIA.

The SCB reiterates its view that there is no difference between the SCB and the CBB's approaches on the exchange of information to overseas regulators.

Ongoing monitoring of accounts and transactions:

BISX conduct of business rules are approved by the SCB and the SCB has no objection in developing these as guidelines or rules.

Internal Controls, Compliance and audit and Integrity standards:

With respect to amending the SIA and SIR to change their applicability from only Broker Dealers to all registered firms, the SCB notes that this will be addressed through amendments to the SIA.

Cooperation between supervisors and other competent authorities

With respect to on-site inspections, the SCB notes that specific provisions regarding inspections have been addressed in the Investment Funds Bill. With respect to the SIA, specific provisions regarding inspections will be addressed through amendments to the SIA.

Exchange of information

The Commission adheres to the law with respect to sharing information based on an undertaking from the requesting authority; however, the SCB is well aware and has often relied on the alternative basis for sharing information of satisfying itself that the requesting authority has similar provision in its laws for the sharing of information. Moreover, the SCB has never refused a request to share information on the basis of not having received the required undertaking and cannot see that it will unless there is an obvious void between the laws of the requesting authority and our own confidentiality provisions. The SCB notes that our consent will be granted for the further release of nonpublic information onto judicial authorities or other bodies such as parliamentary committees of the requesting authority.

The SCB further notes, for the period January 2000 – September 2003, the SCB received 19 requests from overseas authorities for assistance with respect to nonpublic information. The SCB responded to 16 of these requests and three matters are still pending.

Summary of authorities' general comments supplemental to the regulators'

Combating terrorist financing

On June 25, 2003, the Terrorism Bill was tabled in the House of Assembly, it is presently in Committee Stage. Once passed, this Act will fully implement UN Security Council Resolution No. 1373 and all outstanding commitments to ratify the relevant international conventions on terrorism financing. In the meantime the International Obligations (Economic and Ancillary Measures-Afghanistan) Order 2001 has been employed for freezing of accounts suspected to be associated with Osama Bin Laden and the Al-Qaeda Organization.

Information sharing with overseas regulators

The Authority does not agree that there is any difference in the interpretation and application of the legal provisions by its domestic regulators regarding information sharing with overseas regulatory authorities. The Authority maintains that with respect to cooperation between like regulators i.e., Central Bank to overseas Central Bank or Securities Commission to overseas Securities Commission the application of the relevant enabling provisions for information sharing are applied consistently by domestic regulators. However, in those cases where the Central Bank has sought to accommodate requests for cooperation from non-bank regulators from abroad, issues on the further disclosure of the information released have arisen. The Central Bank is urgently working on an appropriate resolution of this matter.

Exceptions to customer verification obligation

The law as implemented by the domestic regulators is set out below. Where there is any breach of the requirements imposed by the regulators the financial institution faces consequences for violating the obligation.

The FTRA imposes an obligation on all financial institutions to verify clients called "facility holders" under FTRA before establishing the account/facility. This verification must be in accordance and to the standard imposed by the FTRR.

This obligation also exists with respect to the beneficial owners of the accounts where the facility holder is not the only beneficial owner.

In addition, the law places an obligation on financial institutions to verify the identity of any person (A) seeking to engage in a large cash transaction (called an "occasional transaction" under the Act) and to verify the identity of anybody else (B) on whose behalf the transactor may be acting. In this latter case the law does allow the financial institution (with which the transaction is being conducted) to rely on a verification of the person on whose behalf the transactor is acting (person B), that has been carried out by an eligible introducer.

With respect to the exemption in Section 10 to the FTRA, this only occurs where the trustee presents to conduct a large cash transaction and it is being done in relation to the trust and in respect of the beneficiaries under the trust, one or more are contingent beneficiaries for

whom the contingency has not materialized. Where a financial institution holds an account for a trust, it is already required to maintain information on the beneficiaries for the trust. However if a trustee approaches a financial institution with which he does not have an established facility for the trust to conduct a large cash transaction, clearly he would be required to establish to the satisfaction of this institution (a) that he is acting as a trustee; (b) that the cash is not for his personal benefit; (c) the existence of the trust; and (d) the identity of the beneficiaries to the extent that these are known.

Similarly Section 9 deals with imposing a primary obligation on persons who use their own accounts or facilities to conduct transactions on behalf of others, to provide the financial institution holding the account/facility with verification details on any person on whose behalf the account is used to carry out a large cash transaction. Again exceptions to this strict obligation are provided in cases where the holder of the account is a designated eligible introducer under the FTRA.

Section 8 of the FTRA deals with those situations where someone approaches another financial institution to conduct a large cash transaction on behalf of another person.

The Authority does not agree that significant exceptions exist to the high level principle to verify, but has noted the several recommendations that may serve to reinforce the principle.

In this regard, amendments to the FTRA are being considered: (1) to introduce a more risk-based approach to customer verification; and (2) to specifically require verification where suspicion is aroused irrespective of the amount involved.

4. Reconciliation of STR reporting to the Police and FIU.

The recommendation to introduce a mechanism that would ensure that all STRs are received by the FIU on a timely basis is being considered.