

Relaxation of Exchange Controls in The Bahamas and Future Developments



Seminar on Exchange Controls

by

Governor John Rolle

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Outline

- What makes the existing regime “effective”
- Aspects of the current regime & recent developments
- Requirements for continued liberalisation
 - Financial liberalisation
 - Longterm investments and administrative reforms
- Conclusions



Purpose of Existing Exchange Controls:

- Safeguards the fixed exchange rate: ensure that B\$1.00 =US1.00.
- Prioritise access to foreign exchange payments for international trade transactions (current account): goods and services interest and profits on investments and remittances
 - Only limited flexibility offered on capital flows
- Strong bias for private direct investment inflows
- Forex supplied at a premium for investments outside The Bahamas by Bahamians



What Makes the Regime Effective

- Rapid movement of funds through the financial system is prevented
- Regime is aligned with national investment policy
 - Contracts involving capital flows into The Bahamas less likely to be executed if they fall outside this legal framework, even if controls can be evaded in other respects



Current Central Bank (CBOB) Work Effort

- Most transactions currently delegated to commercial banks for approval, but Central Bank still processes around 24,000 applications annually
 - Will be reduced because of latest reforms, leaving space for more in depth and constructive attention for productive investments
- Some common types of transactions processed
 - Local investments by non-residents: personal real estate commercial activities
 - Capital transactions by residents
 - Operation of foreign currency deposit accounts by “residents” (establishment, renewals & signatories)
 - High-value payments for current transactions (goods, services, etc.) and others like dividends, loan payments, capital repatriation



Interplay with National Investment Policies

Equity Exposures

- Minister of Finance must approve equity exposures by non-residents in local businesses
 - Applications to CBOB involving exposures either through borrowing or issuance of share equity are referred to the Minister with recommendations
- Minister consults with his colleagues when necessary through National Economic Council (NEC)
- The NEC deliberates as a subcommittee of the “whole” of Cabinet
- Any delegated authority to CBOB only spared this process for the limits specified in the 2017 reforms (up to \$5 million movement half-decade)



Interplay with National Investment Policies

Real Estate

- Governed by the International Persons Land Holding Act
- Non-residents need to apply for a permit from the Foreign Investment Board to own property in The Bahamas
 - For contiguous holdings of 2 acres or less of property for owner occupied use the application may be lodged after acquisition is made
 - For other transactions, including supplemental purchases, a permit is required prior concluding the acquisition



Current Investment Facilities Available to Bahamians

- Increased annual access to outward portfolio investments through BISX-listed securities (now up to \$35 million in aggregate)
- National insurance accommodated (up to \$25 million per year)
- Selected access for direct investments abroad without incurring investments currency premium (up to \$10 million every 3 years)
- Since 2017 strategic sectors can raise financing in foreign currency (up to a limit of \$5million every five years)

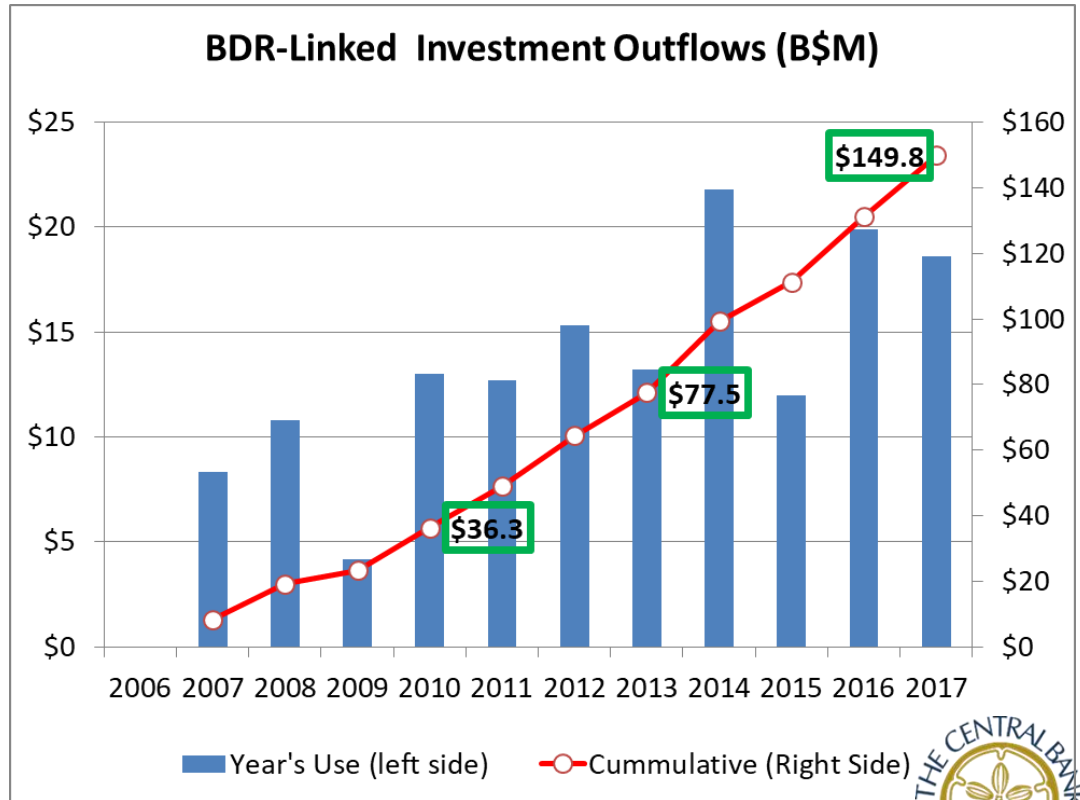


Utilisation of ICM and BISX Facilities

Note:

Cumulative capital outflows:-

ICM: >\$50 million; BISX vehicles: \$150 million; NIB: \$109 million.



Latest Capital Flow Policy Reforms

- Business access to foreign currency deposit accounts for trade payments
- Bahamians now able to repatriate and retain foreign currency assets now held outside The Bahamas



Continuing with Liberalisation (Policy imperatives)

- Flows ought to be sustainable & financial stability safeguarded
- Build capacity to manage liquid capital flows and reform institution and economy preserve credibility
- Place public finances on a sound path



Continuing with Liberalisation

- Fiscal policies have to inspire confidence against exchange rate speculation
- Government reliance on central bank financing should be kept in check

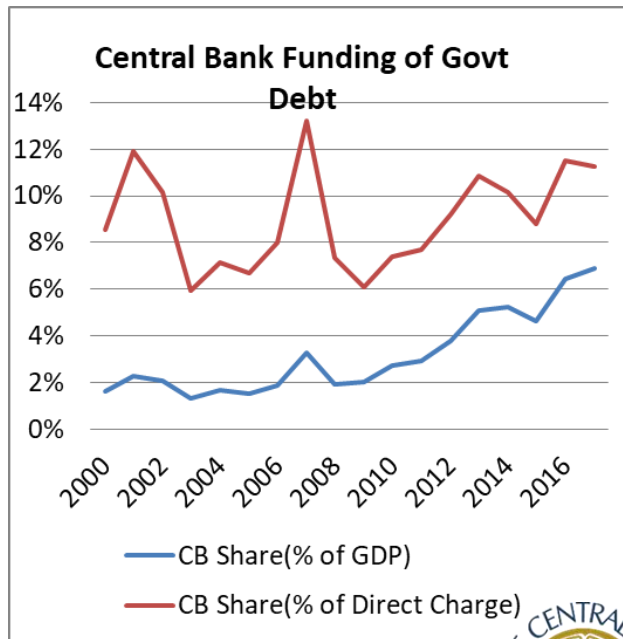
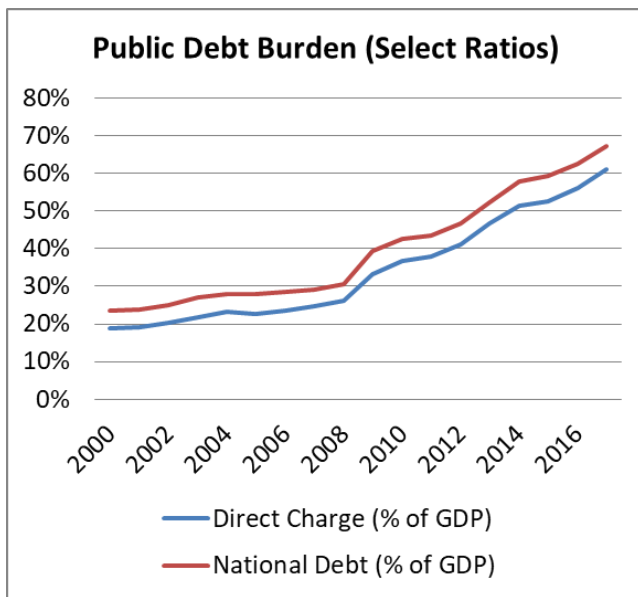


- **Charting the potential or motivation for capital flight**

Unchecked, the potential for capital flight is inferred from the rising gap in the uncovered liabilities of the Central Bank over the last decade, as public debt rose and the relative dependence by the government on Central Bank financing increased. The private sector (mainly individuals) is in ultimate control of the banking sector liquidity that accumulated partly in response to this process.



Over the last decade government debt burden has increased significantly, with reliance on central bank financing also increased.

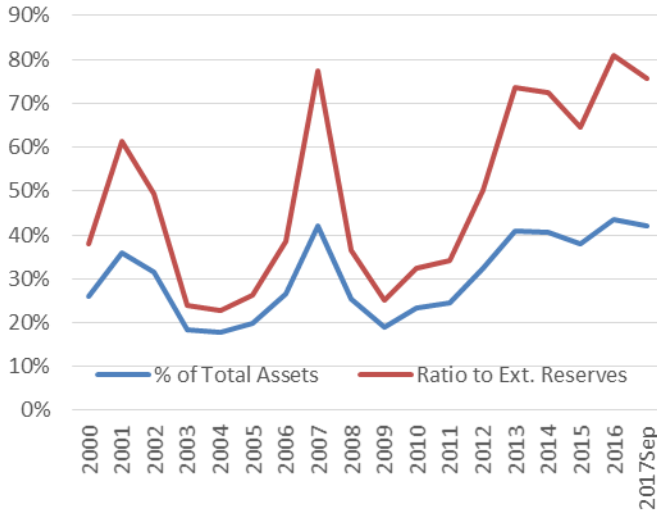


Source: Central Bank of The Bahamas.



Coverage provided by external reserves for B\$ currency liabilities has declined in the last decade.

Central Bank: Gross Claims on Govt (Balance Sheet Ratios)



Note: The 2007 spike was due to a temporary shift in T-Bills from commercial banks to the Central Bank that lasted less than 9 months. The total stock of T-Bills was constant.

External Reserves: Ratio to Central Bank Demand Liabilities (%)



Note: In 2009 external reserve spiked after The Bahamas received \$178.8 million in special drawing rights (SDRs) from the IMF, as part of the Fund's allocation to member countries during the global financial crisis.



**Very liquid, potentially mobile resources
already exist in the financial sector.**

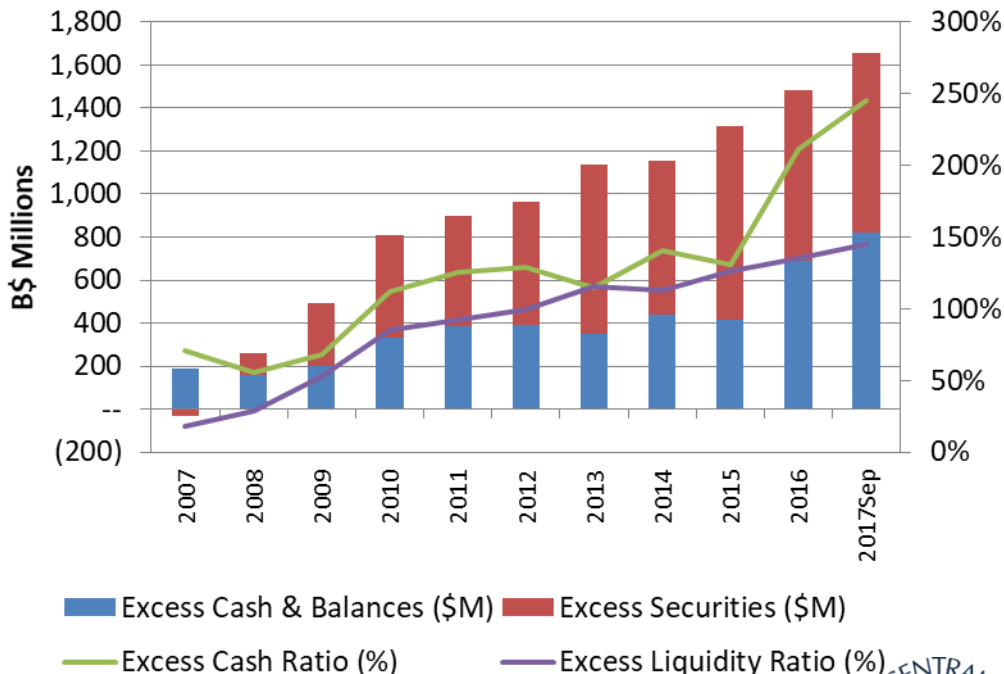


Charting the Potential for Capital Flight

Financial System is Highly Liquid:

Commercial banks have accumulated significant liquidity in both claims on the Central Bank and government.

Liquidity Measures (Ratios on right)



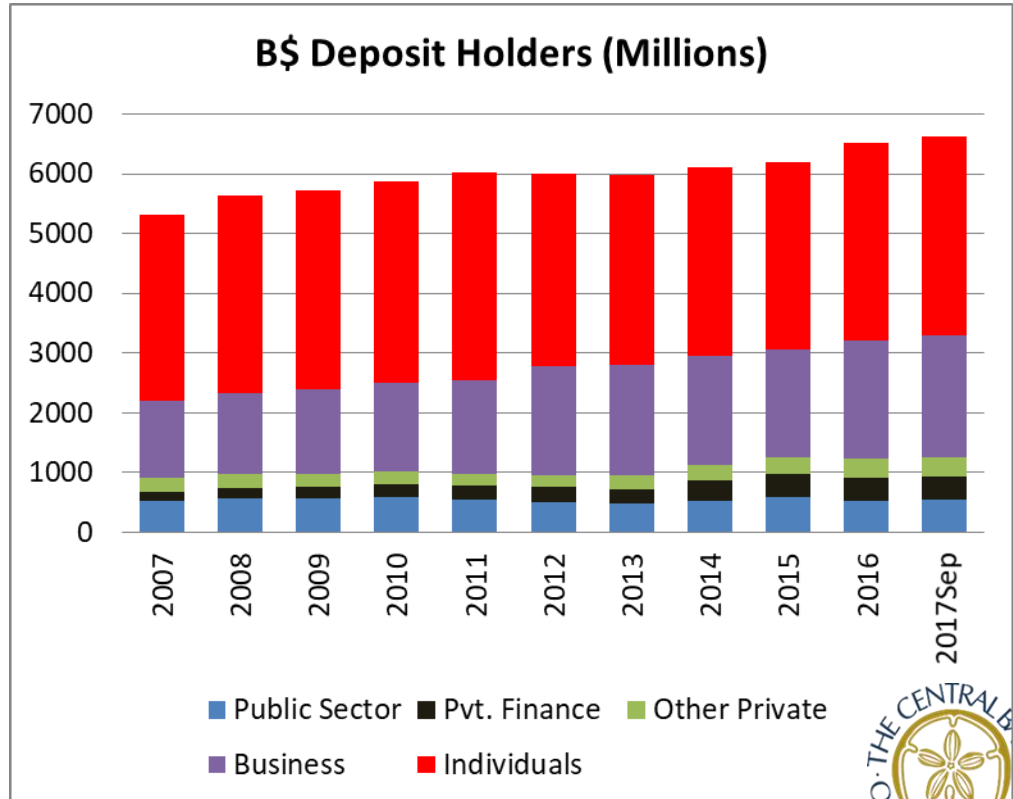
Source: Central Bank of The Bahamas.



Charting the Potential for Capital Flight

Private individuals control most of the deposits in banks. Holdings are highly concentrated:

Less than 10% of accounts store more than half of the total deposit values.



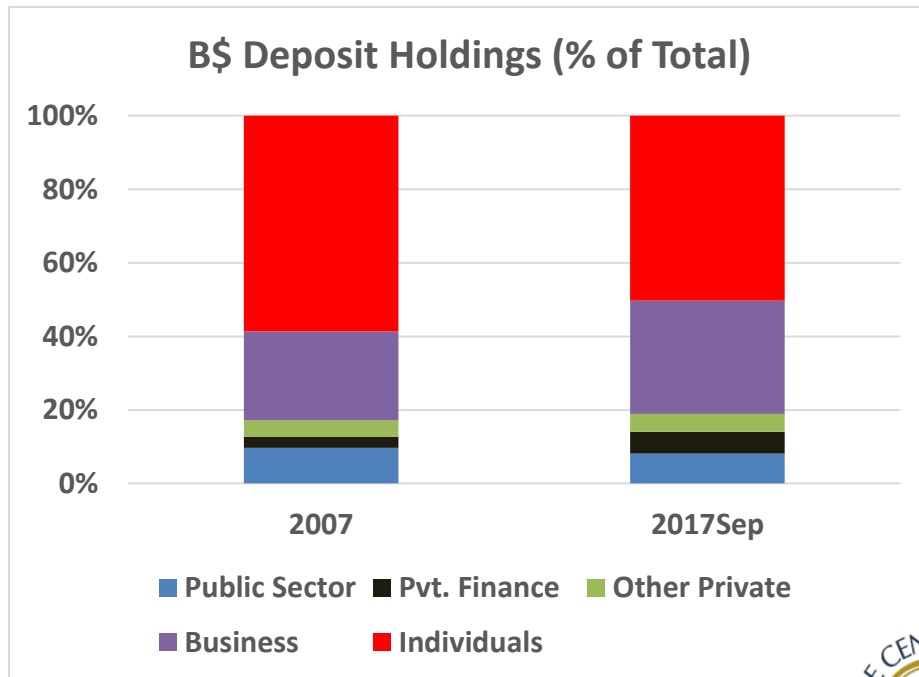
Source: Central Bank of The Bahamas.



Charting the Potential for Capital Flight

Private individuals control most of the deposits in banks.

Some modest share shift has occurred to businesses since 2007.



Source: Central Bank of The Bahamas.



Sequencing of Reforms is Important

- Remain in a position to manage liquid flows...
- Undertake reforms first, then liberalise
- Prior capacity must exist to collect timely data to monitor private sector activities
- Coordinated mechanisms should exist for prudent oversight of all regulated financial sector activities
- Tax policy tools may need to evolve further to give fiscal authorities more flexibility to influence private sector's financing behaviour



Scoping future reforms...

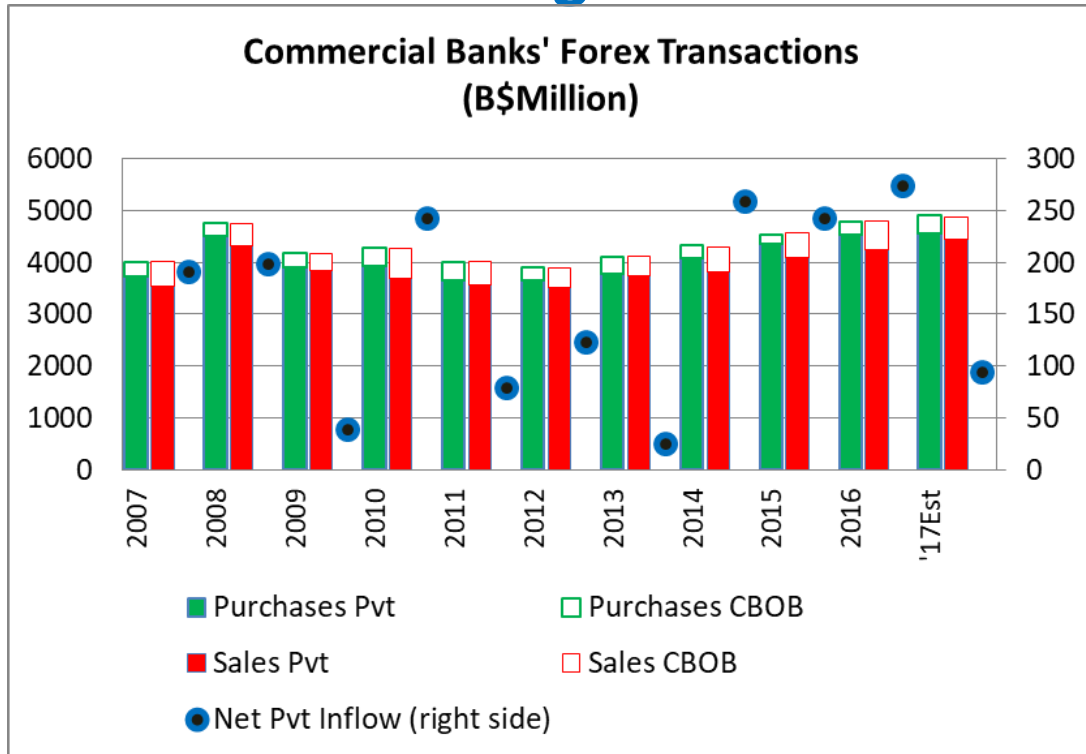


Scope for capital flow liberalisation on portfolio and direct investment outflows can capitalize on potential shifts in composition of existing capital flows...

- Economy would still live within its annual income constraint.
- Medium term policies can focus on reducing high liquidity that could fuel more volatile, unmanageable liquid flows.



Capitalising on shifts in Composition of Existing Flows



Source: Central Bank of The Bahamas.



Future Administrative Reforms (Targets)

- Further reduced need for current account approvals (delegate to commercial banks with guidance)
- More reliance on systems of regulatory compliance to enforce polices for capital and financial policies
- Migration to all electronic, forms-based applications (would enable more rigid application filing requirements)
 - First, increase the immediate reliance on email
 - Simultaneously, introduce secure correspondence portals; expand & enhance suite of e-forms
 - Next, complete current website redevelopment; enhance public interface and improve tracking of applications
- Secure electronic integration with The Bahmas Investment Authority for FDI processing



Future Investment Policy Relaxation (Potential)

- Further reduction in EC restrictions on dollar limits on commercial banks' foreign currency lending (since prudential standards would govern)
- Revisit the investment currency market framework and the mandatory custodial role of authorised agents (trust companies)
- Explore increased access of residents to foreign currency accounts in domestic banks
 - Supported by regulatory oversight of banks' behaviour
- Reduce the scrutiny on personal land holdings by non-Bahamians
 - Government incentives to prevent tax arbitrage between owner-occupied versus income generating properties would be important



Commercial Banks & Regulated Sectors as the Gatekeepers

- An administrative retreat in central bank oversight would not equate to weaker national oversight mechanisms. Some frameworks would need more redesign to take advantage of the alternative mechanisms.



Towards Less Administrative Oversight of Investment Regime?

- More enhanced system for Anti-Money Laundering & Counter Terrorist Financing are emerging; emphasis on tax compliance in home country of international persons
 - Banks must manage credibility and legality of flows that they process
 - Preserve correspondent banking relationships
 - National risk vulnerabilities to ML/TF abuse assessed higher for domestic non-bank financial activities and transactions involving international persons
 - Some areas under scrutiny for Bahamas: real estate transactions, legal sector operations, international persons
 - Emphasis on transparency around natural persons as ultimate beneficiaries of financial flows and assets



Towards Less Administrative Oversight of Investment Regime?

- Heightened focus on tax compliance and transparency in home jurisdictions of international persons and entities
 - OECD's Base Erosion and Profit Shifting Initiatives (BEPS) sharpens the focus these issues
- Bahamas also at higher than desired level of assessed and perceived risk / lower than desired level of assessed effectiveness
- Stronger regulatory incentive structures for transaction monitoring and disclosure should make it easier to take a more arms-length oversight of Bahamas' Investment Regime
 - Regulatory compliant systems will fill the gap.



Importance of Data & Policy Management Framework

- Decision making on managing capital flows and financial sector soundness will still require data
- Greater reliance will have to rest the on the effectiveness of other systems
 - VAT Filings (these capture, imports & investments for commercial sectors)
 - VAT & Public Treasury: Property transactions
 - Commercial bank reporting (forex and balance sheet composition)
 - Automated systems for compliance with international tax cooperation should be adaptable to share consolidated views of residents' foreign currency deposit movements



When Will Benefits of Reform Materialise?

- Expected to be gradual
- A question of enabler's vs stimulants
 - Relaxation makes the environment easier to navigate (allow businesses to take advantage of opportunities)
 - Keeps focus on domestic cost elements in business operations like productivity and effective costs and quality of inputs
 - Keeps focus on factors outside The Bahamas that drive the international marketability of Bahamas' products and services



An Agile Policy Framework with Broad Reach

- Objective: manage economy effectively, without having an overly burdensome administrative approach
- Keep the financial sector involved and within reach of policy tools that can be used (as market based as possible)
 - Interest rate policies that touch on all sectors; after tax rates of return
 - Promote efficient capital markets into which business graduate to raise funds
- Discussion around alternative systems of taxation become more relevant



An Agile Policy Framework with Broad Reach

- Encouraging more flows through capital markets
 - Local capital markets are still under developed
 - Stimulate and facilitate more use of depository receipts (regulated market)
- As demand grows provide more access for direct investment financing through the 2017 framework



An Agile Policy Framework with Broad Reach

- Provide more definition to special criterion category for direct investments made abroad by Bahamians
- Consider how a more delegated approvals process can be developed for inward FDI (with system of review and appeal) in designated sectors
 - Base delegation on a floor for the size of investments that must obtain NEC approval



Conclusion

- The Central Bank will remain supportive of reforms to for increased capital account liberalisation
- Keeping financial sector actors, broadly defined, at the centre of reforms will enable further retreat from administrative controls especially on current account trade payments
 - This focus will also support policy relaxation for capital and financial flows
 - Important stakeholders in a compliant regulated space include realtors, attorneys, financial institutions
- Caveats must continue (for now) around liquid short-term flows
- The Central Bank will encourage informed policy debate on reform options



Thank you!

