# Relaxation of Exchange Controls to Expand Access to Foreign Currency Financing for Domestic Businesses

29 March 2017

(Amendments to footnotes 1&2 on March 30 2017)

## 1.0 Overview

The Central Bank of The Bahamas (CBOB) is announcing a further liberalisation of Exchange Controls, targeting direct investment financing in foreign currency. Selected categories of Bahamian owned businesses which support broad foreign exchange earnings potential or national development goals are targeted to have access to non-Bahamian dollar financing either from local commercial banks or from external sources. A more structured accommodation is also being introduced for "resident" designated entities[1] owned by non-residents to contract financing from international banks licensed to operate from within The Bahamas.[2]

The Minister of Finance has approved these reforms to take immediate effect. They will become operational on April 24, 2017.

The CBOB expects the macro-economic impact of the reforms to be positive, with a gradual stimulus to business activity over the medium term.[3] No adverse balance of payments impact is expected, given the deliberately limited sectors for which such funding would be accessible.

## 2.0 The Current Exchange Control Environment

There is anecdotal evidence that access to Bahamian dollar bank financing is constrained for small and medium-sized domestic enterprises.[4] At present, most local businesses are largely constrained to accessing Bahaman dollar credit. In exceptional cases, the Central Bank has authorized firms to seek foreign currency funding when the evidence was provided that funding in local currency was refused on at least three occasions. Even in these cases, the Bank always considers the potential of the venture to earn foreign currency or to create domestic linkages within activities that reduce the demand for imports. More generally, transactions which either pledge domestic assets as collateral to non-residents, or which invite equity participation by non-residents in locally owned firms, require approval or non-objection from the Minister of Finance. A further consideration is whether the pledged assets or equity is in respect of activities that are wholly reserved for Bahamians. The Central Bank is not aware of any general or exceptional accommodations of such attempts to access financing.

Non-resident investors face less restriction on accessing financing in foreign currency. The exception is that Ministerial oversight is still required when the designated "resident" assets are pledged as collateral, or equity transactions involving other non-residents arise.

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[1] For the purposes of the liberalisation measures, a resident entity is an entity that is wholly owned by a natural or naturalized citizen of The Bahamas and permanent resident without restriction on the right to work in The Bahamas. These entities would be incorporated under the Companies Act. In accordance with guidelines to be issued by Central Bank, these entities would have to apply to the Bank to be formally designated as resident for Exchange Control purposes. A resident entity is an entity that is owned by non-residents (to any degree) or a permanent resident with restriction on employment, save in their own business, which either holds title to real property (e.g., dwelling houses, rental properties and hotels) and/or operates in The Bahamas. It may be an IBC or a regular company.]

[2] A non-resident bank (licensed under the Banks and Trust Companies Regulation Act, 2000) is a bank that has been designated as non-resident for Exchange Control (EC) purposes and operates from within The Bahamas (i.e., in the "offshore sector") and only conducts business with persons (legal and natural) who are non-residents of The Bahamas for Exchange Control purposes. The prior permission of the Central Bank is required to conduct business with entities and individuals regarded as residents for EC purposes.

[3] Creditworthiness, business risk and prospects for favourable medium-term spillovers from the international economic environment will also influence the success of access to financing in a more liberalized environment. The Central Banks expects such conditions to evolve gradually, in a way that positions more firms to take advantage of new investment opportunities over the medium-term.

[4] The Central Bank sought to obtain survey feedback from the local business sector on access to credit in October/November 2016.

Until now, the Central Bank has not actively supported access to funding from international banks operating inside The Bahamas. Such banks are considered non-resident for exchange control purposes and as a condition of their license may not transact with residents or "resident" designated entities. However, there has been interest in accessing such funding for tourism development and for real estate developments under the International Persons Landholding Act, Chapter 240. These have been processed on an ad hoc basis.

## 3.0 Strategic Direction for Exchange Controls

In line with the objective of enhancing exchange control management, the Central Bank of The Bahamas will continue to strive for greater liberalisation, but is still not recommending complete removal of controls on capital transactions. The current initiative is being supported by administrative strengthening, including greater delegated authority to commercial banks, backed by enhanced compliance and monitoring mechanisms.

## 4.0 Anecdotal Insights on Access to Funding

The Central Bank is aware, anecdotally, of concerns expressed by local businesses about access to financing in the domestic market. The Bank sought to obtain more information on the experiences of local firms though an open survey (See Survey in Annex) conducted in November 2016. Prior to the launch of the survey, the Bank met with key stakeholder associations to discuss (1) the state of the business environment, (2) the views and perceptions of the credit environment and (3) the proposed policy. These discussions provided a significant qualitative base from which to draw upon for refining the policy and the survey design. In particular, meetings were held with The Bahamas Development Bank (BDB), The Bahamas Investment Authority (BIA), The Bahamas Chamber of Commerce and Employer's Confederation (BCCEC), The Bahamas Bar Association, and The Bahamas Institute of Chartered Accountants (BICA).

The survey was administered electronically. The survey was sent via an email link to the business community with the assistance of the aforementioned associations. A link to the survey was also placed on the Central Banks' website for access by other businesses not members with these associations. The questionnaire solicited input on four main issues. These were (1) the characteristics of the enterprise; (2) general information on the type and situation of the enterprise, (3) the financing of the enterprise; and (4) the availability of finance and market conditions. It was expected that questions relating to these key areas would provide a better understanding of the issues and circumstances faced by small, medium and large businesses in accessing financing from resident banks and other non-bank financing vehicles.

The response rate to the survey was exceptionally low. Only 20 completed submissions were received despite successive extensions of the deadline. Due to this low response rate, the reform proposals below draw heavily on the stakeholder meetings, along with existing data typically collected within the Exchange Control, Bank Supervision and Research Departments. Limited responses were predominantly from businesses, sole proprietor businesses, particularly importers, with more than 10 years in the wholesale and retail sector, with gross turnover of between $1 million and $5 million dollars annually. Specifically, businesses were from the wholesale and retail trade (30.4%) and financial services (26.1%). Some of these entities, in most cases, already have approvals to obtain foreign currency financing given the nature of their activities. The small and medium sized businesses, were not well represented in the responses, even though, anecdotally, these are the firms that most often speak of consistent lack of access to financing given collateral requirements, the level of interest rates and other factors.

Among the respondents nearly half (47.8%) indicate that funding was inaccessible compared to more than half (52.2%) that indicated that it was either "accessible" or very "accessible. Nevertheless, the perceived willingness of lenders to provide credit had deteriorated in the opinion of some 47.4% of respondents. In the six months leading up to the survey period, many of the respondents did not apply for eitherlines of credit (31.8%), bank loans (43.5%) or trade credit (36.4%). The main challenges cited when applying for credit were the collateral requirements (58.8%), followed evenly by the level of interest rates (17.7%) and other factors (17.7%), such as required guarantees, information requirements, procedures, and time required for approval.

The majority of respondents indicated that over the six months leading up to the survey, general economic conditions deteriorated (63.2%), as did their outlook for sales and profitability (36.8%). Some firms also indicated that there was no change over the preceding six months in the state of the business' own capital (47.4%), credit history (57.9%) or the willingness of partners to provide trade credit (79.0%).

Businesses placed primary importance on finding new customers, followed by coping with new regulations.

## 5.0 Policy Design and Structure

The capital account relaxation measures apply to both resident owned businesses and non-resident controlled ventures and encompasses access to both debt and equity financing. Enhanced reporting mechanisms will allow CBOB to monitor and evaluate the impact of these reforms over time.

Subject to the limits below, the use of local commercial banks would be on the basis of delegated authority against Central Bank issued guidelines, requiring no prior case by case approvals from the Central Bank. All other financing sources would require prior approval from the Central Bank before final execution. This represents new delegated authority from the Minister of Finance to the Central Bank.

### 5.1 Eligible sectors

In line with promoting favourable impact on net foreign exchange earnings (including conservation of foreign exchange outflows), or medium to long-term national development goals, the eligible sectors and activities would be the following:

(1) Agriculture & Fisheries
(2) Manufacturing
(3) Transport (Land, Sea and Air)
(4) Tourism (Hotels & Restaurant)
(5) Construction and Real Estate for Residential Tourism
(6) Energy & Energy Conservation
(7) Education
(8) Health
(9) Telecommunications, ICT, Infrastructure

The Bank will continue to review other applications for access to foreign currency financing on a case by case basis, subject also to the authority which the Minister of Finance exercises in transactions involving participation of non-residents or equity exposures to non-residents.

### 5.2 Proposed Thresholds and Financing Options

**A) Commercial banks & non-resident financiers and investors**

The category of non-resident financiers identified here includes all funding sources other than banks licensed by the Central Bank. Residents would therefore not be precluded from dealing with banks that are licensed and regulated in other jurisdictions, without prejudice to the domestic legal requirements for the registering and stamping of secured claims or mortgages.

Access to external funding will be permitted for up to $5 million per entity every 5 years. (Any application for loans over $5 million would have to be made to the Central Bank). Access is subject to the qualifications below:

- In the case of financing from a domestic commercial bank, no further condition.
- In the case of a sector or activity reserved exclusively for Bahamians, financing from non-residents through secured debt or through equity participation must also not exceed 40 percent[5] of the exposed equity. Should equity exposure exceed this threshold, then the National Economic Council's (NEC's) approval would be necessary first.
- In the case of any unsecured financing from non-resident sources, no other condition.

**B) Banks licensed by the Central Bank and designated as "non-resident"[6]**

These entities are only proposed to provide financing to non-residents, in support of approved investments designated as resident for Exchange Control purposes; and only for resort or residential developments. The following conditions would apply:

- For residential investment property: no limit on the size of secured facilities. Repayment of principal and interest would be restricted to foreign currency income generated by the investment, external proceeds or conversion of Bahamian dollars at a premium through the Investment Currency Market (ICM).
- For resort developments: no limit on the size of financing facility, other than up to the share of beneficial ownership held by the non-resident. The debt must be serviced from the foreign currency or other proceeds generated by the venture or from external proceeds.

**C) The private sector lending arms of multilateral agencies (example: IDB, World Bank).**

- No restriction on lending to resident entities. These lenders apply rigorous due diligence and are development-focused in their activities.

### 5.3 Applications processing

The Central Bank will maintain a very transparent process for applications for funding under the categories identified above. This includes documentation that would have to be submitted in the case of funding obtained from non-commercial bank sources. The proposed delegated authority for commercial banks would allow such applications to be processed against due-diligence systems established within such lenders, without prior approval from the central bank.[7]

[5] The 40 percent exposure limit is based on the National Investment Policy, which restricts foreign participation in reserved sectors to no more than 40 percent.

[6] The Central Bank has prepared detailed guidance notes on the process that will be circulated to non-resident bank licensees.

[7] Where particular commercial banks are found to have deficient systems, delegated authority to approve credit would be withheld or suspended. Subsequent lending would only be allowed against prior exchange control approvals.

### 5.4 Access to Foreign Currency Deposit Accounts

No consideration is proposed for any expanded access to foreign currency deposit accounts for local businesses that are permitted to obtain funding in foreign currency. Non-resident investors in real estate and resort developments, however, would continue to be processed for access to such privileges.

Local firms would be required to convert funding proceeds into Bahamian dollars, or to manage such disbursements directly in foreign currency, timed with the importation of investment goods and services. Bahamian owned firms having approved access to foreign currency financing would subsequently be allowed access to foreign exchange at the official rate for all debt servicing.

## 6.0 Management and Monitoring Mechanisms

The Central Bank will closely monitor inflow activities related to the relaxation measures. The monitoring framework will track utilisation, business growth and resources which firms rely on to meet debt serving obligations. In addition, the Bank will monitor the impact of wider access to funding on the business model of commercial banks, including the impact on the interest rate competitiveness of Bahamian dollar facilities, and general stability of banks' operations. Any indication that the activities exert a net drain on foreign exchange would be justification for more restricted eligibility criteria. Important levers will remain at the Central Bank's disposal such as i) the frequency of access to foreign currency financing, i) maximum size of funding access and the iii) range of eligible activities and sectors.

# Annex: Summary of Relaxation of Exchange Control (EC) Measures on Capital Transactions
## (Access to Foreign Currency Financing)

March 2017

| Investors / Sectors | Current Policy | Proposed Change / by Source of Funds | Prior EC Approval | Financing Limit | Monitoring Process |
|---|---|---|---|---|---|
| Bahamian owned firms<br>1) Agriculture & Fisheries<br>2) Manufacturing<br>3) Transport (Land, Sea and Air)<br>4) Tourism (Hotels & Restaurant)<br>5) Construction and Real Estate for Residential Tourism<br>6) Energy & Energy Conservation<br>7) Education<br>8) Health<br>9) Telecommunications, ICT, Infrastructure | Limited to foreign exchange (forex) earning activities, subject to having been rejected at least three (3)times by commercial bank | Limit to forex earning & forex saving activities; activities with developmental impact as follows: | | | |
| | | i) Commercial bank financing, under delegated authority | No. | Up to $5 million per firm every 5 years (*) | EC application;<br>Commercial banks' forex sales reports. |
| | | ii) Non-resident funding or partnerships | | | |
| | | a) Unsecured funding | Yes | Same as (*) above. | Same as above. |
| | | b) Equity participation or secured debt; not exclusively reserved for Bahamians | Yes | ≤ Same as (*) above; & no more than 50% of exposed equity. 1/ | Same as above. |
| | | c) Equity participation or secured debt; & exclusively reserved for Bahamians | Yes | Same as (*) above; & no more than 40% of exposed equity. 2/ | Same as above. |
| | | iii) International financial institutions (includes private sector facilities of IDB and World Bank) | Yes 3/ | None | Same as above. |
| Non-resident controlled investments designated as "resident" for EC purposes (Real estate resort development only) | Existing framework is ad hoc. | iii) Non-resident banks licensed by the Central Bank | | | |
| | | a) Residential or real estate investment | Yes | None; must service debt with forex proceeds of business or in Investment Currency Market (ICM) at a premium. | EC application;<br>ICM data. |
| | | b) Hotel or resort development | Yes | Secured funding not to exceed equity ownership | Same as above;<br>Balance of payment reporting;<br>Banks' forex sales reports. |

**Note:** 1/ "Exposed Equity" refers to the share of ownership in the firm that would be lost in the event of a loan default, or the share of the equity held by a non-resident in a partnership arrangement.

2/ The National Economic Council (NEC) approval process would be invoked for equity exposures above the 40 percent threshold.

3/ Entities seeking funding from the private sector facilities of international financial institutions will be allowed to seek approval in principle from the lender for their financing and to register such with the EC Department afterwards.