FURTHER LIBERALISATION OF ADMINISTRATIVE ARRANGEMENTS AND POLICIES ON EXCHANGE CONTROLS ON CURRENT & CAPITAL ACCOUNT TRANSACTIONS

23 January, 2018

I. OVERVIEW

After consultation with the government, the Central Bank of The Bahamas will introduce a further relaxation of Exchange Control (EC) arrangements, to take effect on February 1st, 2018. These cover both current account transactions (mostly trade-related) and certain capital controls on private sector investment and financial flows. As formulated the reforms further reduce the administrative drag on private sector transactions and reinforce earlier relaxation, which increased the access of strategic economic sectors to foreign currency financing.

Starting in the mid-1990s, EC arrangements have undergone at least six rounds of adjustments. In 1995 and 2002 changes provided increased delegation of approval authority to commercial banks over a broad range of current account transactions, while in 2006 relaxation focused almost exclusively on capital account restrictions. In 2010, a further delegation of authority was granted to commercial banks significantly, reducing the Central Bank's over-the-counter approvals process. The 2016 reforms expanded current account delegation limits again, and streamlined certain documentary requirements for transactions with commercial banks. Similarly then, new and increased capital account delegation limits targeted further development of the domestic capital markets and offered additional scope for outward direct investments by residents. In 2017, the easing posture granted Bahamian businesses and resident designated entities expanded access to foreign currency financing inflows[1] and removed certain ad hoc processes around approvals to borrow in foreign currency.

The 2018 liberalisation continue to prioritise preservation of the economy's capacity to maintain adequate supplies of foreign exchange for trade-related payments, and to safeguard the stability of the Bahamian dollar fixed exchange rate. The capital account reforms target a prudent balance, promoting economic dynamism through sustainable financial flows,[2] which do not

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[1] In particular, accessible external funding is permitted for up to $5 million per entity every 5 years, for commercial bank and most other financing sources. No limits apply on eligible financing from multilateral organizations such as the private sector windows of the inter-American Development Bank (IDB) and World Bank. Prior approval would still have to be granted by the Central Bank, on a case by case basis, for larger financing amounts not obtained from multilateral agencies, and approval of the National Economic Council would be required if any proposed financing exposure exceed the majority equity threshold for firms that operate in sectors that are exclusively reserved for Bahamians.

[2] For the economy, the foreign currency flows would be sustainable if, over the medium and long-term, they are put to uses that generate positive net returns, either augmenting the economy's capacity to earn foreign exchange or enabling the economy to conserve on use of foreign exchange.

undermine exchange rate and financial stability.[3] On the current account, the delegated authority to commercial banks and money transmission businesses (MTBs) to approve most transactions, without prior reference to the Central Bank, is being increased. This places more reliance on the operating controls within these institutions to assess the bona fide nature of transactions and detailed guidance and training provided from the Central Bank. Ongoing surveillance of the commercial banks and MTBs through their reporting submissions will continue to provide high-level feedback on compliance with the delegated framework.

The measures affecting the current and capital account are summarised in the separate matrices attached.

II. CURRRENT ACCOUNT TRANSACTIONS

(i) *Increased Limits on Delegated Authority for Current Account Transactions*

The approval limits for most current account transactions that have been delegated to commercial banks (authorised dealers) has been increased. Where applicable, money transfer businesses are also able to operate within these parameters, subject to the blanket sales approval limits granted to each entity.

(i) For expenditure categories applicable to travel, the delegated approval limits is increased to $15,000 from $10,000 per individual or purpose of trip, on evidence of planned travel.

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[3] There remains a strong policy commitment in The Bahamas to maintaining the fixed exchange rate, for the benefits it provides for price stability and the ease of trade with the United States. The high import content of consumption and absence of domestic substitutes, moreover, negate any sustainable benefit that would come from having either a flexible or revalued exchange rate against the US dollar. From the perspective of tourism, the capacity to gain competitive advantages from movements in the B$/US$ exchange rate are very limited. Variations in the exchange rate would be expected to generate direct cost pass-through to the industry because of the high import content in non-labour inputs used in the sector and in labour costs which are also grounded in the cost of consumed imports. Various economic studies have estimated that to increase The Bahamas' trade sector competitiveness (including tourism) gains would have to be achieved, among others, from increased labour productivity, reduced energy costs, and structural reforms that improve the ease of doing business. Several recent studies by the IDB and IMF provide estimates of these competitive gaps for The Bahamas and Latin American and Caribbean Region.

See the collection of articles in "Unleashing Growth and Strengthening Resilience in the Caribbean," IMF (2017) edited by Trevor Alleyne and others. https://bookstore.imf.org/books/title/unleashing-growth-and-strengthening-resilience-in-the-caribbean. See also IDB published: "Understanding Economic Growth in the Caribbean Region: A Conceptual and Methodological Study" IDB (2015), by J. Rodrigo Fuentes, Karl Alexander Melgarejo and Valerie Mercer-Blackman. https://publications.iadb.org/handle/11319/6962

(ii) Approval limits for sundry payments for services (such port expenses, serial rights, registration of patents, commissions, subscription or membership, professional service charges and royalties) is increased in most cases from $25,000 per transaction to the actual amount on the bill.

(iii) For merchandise trade, the approvals against invoices and documented obligations increased across the board to $1 million. Previously, payments were subject to a delegated limit of $0.5 million for non-oil merchandise and $25,000 for oil imports. Also, the distinction of a lower approval limit for payments to individual versus firms in the exporting country is removed, with both now at the higher limits just cited. Enterprises still have the flexibility to receive direct Central Bank approvals for their anticipated annual import expenditures, where individual transactions amount are expected to exceed these thresholds.

(iv) The cap has been removed from the credit limits and therefore external payments on Bahamian dollar corporate credit cards issued to companies designated as residents for exchange control purposes (that is entities owned by non-Bahamians).

III. CAPITAL ACCOUNT TRANSACTIONS

(ii) *Investment Currency Market Reforms*

The premiums on investment currency purchases and sales by residents is reduced to 5% and 2.5%, respectively, from the current levels of 12.5% and 10% respectively. In particular, with limited exceptions (see matrix), capital investments abroad by residents must be made with investment dollars purchased through the Investment Currency Market (ICM), operated by the Central Bank at a rate of B$1.050 =US$1.000, and repatriated proceeds converted (sold) back into local currency at the rate of B$1.025 =US$1.000.[4]

The Central Bank will also delegate the operation of the ICM to commercial banks, at a date to be fixed in 2018, in consultation with the banks.

Under increased delegated authority to Authorized Agents (trust companies, resident for Exchange Control purposes) the Central Bank will allow residents greater flexibility to operate trading accounts with securities held outside The Bahamas. EC approval will only be required to establish and fund the facilities, with continued required use of the ICM. However, prior EC approval will no longer be required for individual trades within these accounts.

[4] The Central Bank's previous offer/bid rates were B$1.125=US$1.00 and B$1.100 =US$1.000, respectively.

(iii) ***Holdings of Foreign Currency Deposits and Investment Assets by Residents***

Upon application to the Central Bank, the Bank will regularize, without penalty, existing foreign currency denominated investments in deposits, securities and other assets held outside The Bahamas by residents, on which prior EC approval was required, but not obtained. Residents are permitted to retain these accounts abroad or to repatriate and maintain the accounts in foreign currency inside The Bahamas at licensed banks and trust companies (Authorized Dealers and Agents). Restrictions remain in place against funding of these accounts with conversion out of Bahamian dollars. The accounts however, will be permitted to fund local Bahamian dollar denominated transactions.

Permission is also being granted for licensed businesses operating inside The Bahamas to establish and maintain foreign currency operating accounts, without prior reference to the Central Bank, of up to the equivalent of US$100,000, only to facilitate payments for trade, and to be financed only from revenues generated in foreign currency. Explicit Central Bank approval would still be required to maintain accounts with balances of more than US$100,000 equivalent.

Foreign currency operating accounts will be subject to the following conditions:

- Credits or deposits to the accounts would be restricted to foreign currency revenue earned in the normal course of business, except where such proceeds are converted into Bahaman dollars to meet expenses inside The Bahamas.
- Utilization of the accounts would be confined to trade-related payments for goods and services obtained from outside The Bahamas, repayment of foreign currency loans and advances, and conversions into Bahamian dollars.
- No payments would be permitted in foreign currency to companies or persons deemed resident in The Bahamas for Exchange Control purposes;
- No cash would be permitted to be withdrawn from the accounts.

Another relaxation is the permission for residents to fund real estate investments abroad at the cheaper official rate, as opposed to through the ICM. A limit of $0.5 million is being provisioned for such transactions, subject to the acquired property being held for direct or immediate family usage by the purchaser.[5] Residents would also be allowed to operate within the $0.5 million limit for purchases of time-share property units, which were currently provisioned at $25,000 per family every 10 years.

[5] One eligible category is the purchase of residences for direct occupancy by dependents who are enrolled in colleges or universities outside The Bahamas. Second homes purchases would also qualify.

(iv) ***Signatories on Foreign Currency Deposit Accounts and Renewal of Account Permits***

With the increased flexibly to maintain operating foreign currency accounts, the Central Bank is also delegating greater autonomy to commercial banks to vet account signatories and to monitor ongoing eligibility to maintain such facilities. As such, the Central Bank is discontinuing the annual approval process for individual signatories on foreign currency accounts and the annual renewals of permits to maintain such facilities. Once a foreign currency account has been approved, the authorization to maintain the facility would remain in force as long as the account holder continues to operate as a licensed business.

(v) ***Bahamian Dollar Credit Facilities for Temporary Residents***

The amount that temporary residents may borrow in Bahamian dollars to finance owner-occupied dwellings is increased to B$1 million from B$400,000. Eligible persons must have resided and worked in The Bahamas for at least three years.

(vi) ***Unchanged Capital Provisions***

The Central Bank has not proposed any amendments to ether "special criterion investments" or the BISX-traded B$ Bahamas Depository Receipts program, which both support investment funding outside The Bahamas at the official rate ($B1.00=US$1.00). The domestic market continues to adjust to both limits which were revised in 2016. Then, the annual allocation for BDR linked purchases of foreign capital market securities was increased from $25 million to $35 million, subject to an overall cap of 5 percent of the Central Bank's foreign reserves. This allocation is shared among all of the BISX licensed domestic broker-dealer firms, which are allowed to structure portfolios of foreign currency denominated assets which can be purchased by Bahamians. Under the special criterion framework, Bahamians are also allowed to make direct investments, either in businesses abroad or in ownership of firms within The Bahamas' "offshore" sector. In 2016, the allowance was doubled to $2 million per person or entity, subject to an overall limit of $10 million per investor group/transaction every three years.

IV. Assessing the Impact of the Measures & the Way Forward

The liberalization proposals are not expected to pose unmanageable pressures on foreign exchange markets or on the foreign reserves of the Central Bank. Tourism inflows are expected to strengthen over the medium-term, providing support for any net increased demand for foreign exchange. In the business sector, where the reforms are most significant for access to foreign currency deposit accounts, impact would also be contained by the restriction that funds accumulated must be used to pay largely for imports of goods and services. On net, such benefitting non-hotel, commercial sectors are still expected to incur most of their revenues in Bahamian dollars and, as such, still have to purchase some foreign exchange to meet import obligations. On the supply side for foreign exchange, existing hotel sector activities, with a dominance of revenues in foreign currency, already make significant conversions into domestic currency to cover local expenses. This channel will continue to satisfy general domestic needs.

The reduction in the investment currency premium, though, poses potential for new net foreign exchange demand. However, this is an issue only to the extent that it could draw on existing liquidity within the banking system.[6] Keeping a positive premium in place would help to moderate this influence and is a prudent policy that would allow the Central Bank to monitor impacts over the medium-term. This would also allow the Bank to explore further avenues for gradual relaxation, as domestic economic and policy conditions permit,[7] including in proportion to net inflows of repatriated assets currently held abroad by residents.

As an important benefit, these reforms shift a further significant processing of foreign exchange transactions approvals outside of the recurring purview of the Central Bank. This is an administrative cost saving for the private sector and for the Bank's internal resources. In particular, the annual correspondence stream around the renewal of permits for foreign currency deposit accounts will cease, as will correspondences to the Bank around signatories on such accounts. For current account transactions, a higher volume of trade payments will also bypass direct Central Bank approvals. More efficiencies would materialise once the operation of the investment currency market shifts to commercial banks.

As part of the implementation process the Central Bank will provide requisite training and guidance to commercial banks, trust companies (Authorized Dealers and Agents) and money transfer businesses. Also, consultation with these institutions would inform both the interim and longer-term reporting systems necessary to monitor private sector activities. Such surveillance is vital both for statistical purposes and to guide monetary policy formulation.

[6] The reduction in this this liquidity over hang would be achieved in direct proportion to the central banks' ability to reduce its existing credit to government. Such credit is the counterpart to domestic money that has been created over the years, without the corresponding increase in the external reserves balances. It summarizes the private sector's potential capacity to make claims to convert Bahamian dollars into foreign currency, for which counterpart reserves would not exist.

[7] Credible fiscal policy reforms would help to strengthen medium and longer-term confidence in the exchange rate peg, and minimize speculation-induced capital flows. Also, the policy and structural frameworks to manage the economy's foreign currency liability exposure risks have to evolve at least one step ahead of liberalisation, as financial stability concerns would become more poignant.