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HEADLINE: Having reformed its banking, Bahamas searches for growth

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BODY:

NASSAU, the Bahamas _ The transformation from secretive island banking haven to global financial player, an ongoing process that is now in its third year, is exacting a high price for the Bahamas.

In fact, the financial sector is shrinking _ no small concern, since it's the second most important contributor to the economy after tourism.

Bahamians are eager to get their financial industry growing again. But a continuing slump on Wall Street, fallout from Sept. 11 and a no-growth American economy aren't helping. In essence, the archipelago is finding it must chart a new course even as the seas are shifting.

"I think we've gotten out of the state of shock. We're recuperating from injuries," said Owen Bethel, head of Montaque Securities, the largest Bahamas-based securities firm. "Where we end up is anyone's guess."

With tourism _ the nation's biggest revenue producer _ also slumping, it's clear Bahamians need to figure out how to reinvent themselves quickly to play in the global game.

In recent years the financial industry here was caught off-keel by stinging international criticism, suddenly swamped by new regulations _ and is currently treading water.

On one level, the Bahamian response to the challenges of the last few years brought overdue reforms that leaders here now acknowledge were clearly needed.

The industry is better regulated, more cooperative with international authorities and no longer interested in anonymous depositors with cash in a bag.

To be sure, there are skeptics who question whether the reform is real and enduring. "From what we've seen, the enforcement and supervision are still pretty weak," said

Charles Intriago, who publishes Money Laundering Alert, a Miami newsletter.

On the other hand, the country has won high praise from Washington, London and other major money centers.

"These improvements are a testament to the effectiveness of international cooperation in combating money-laundering," U.S. Treasury Secretary Paul O'Neill said last year, referring to changes not just in the Bahamas but also in the Cayman Islands and Panama.

But here on Bay Street, the commercial center of Nassau, the plaudits aren't universally appreciated, and there are some who question whether the political and economic price of the changes have been too high.

Perhaps dating back to Blackbeard the pirate, some people handled their finances in the Bahamas because they could do so in secret.

Bank secrecy, in the modern era, became perhaps the industry's single greatest asset and the Bahamian financial industry's competitive edge. Money could be hidden from tax collectors, creditors and the long reach of the law in a secret Bahamian account.

Because bankers often didn't know who they were really dealing with, it was impossible to ascertain whether the funds were obtained through legitimate means.

"We can't claim we were lily-white," said Julian Francis, head of the Central Bank of the Bahamas. "We had some weak points."

But in the late 1990s, the Bahamas and other offshore financial havens came under fire from Washington and Western Europe for their low-tax, light-regulation strategies. There is no income tax, no tax on dividends and no capital gains tax in the Bahamas.

The Organization for Economic Cooperation and Development, comprised of the world's wealthier countries, claimed low-tax policies were an unfair form of competition and placed the Bahamas on a list of jurisdictions it deemed unfair tax havens.

An affiliate of the OECD, the Financial Action Task Force, alleged the havens were using secrecy to coddle money launderers and other criminals, and the Bahamas went on its blacklist, too.

The implication was those on the lists could either change their ways or face economic sanctions. The pressure intensified after Sept. 11. New laws such as the USA Patriot Act extended American regulatory reach to offshore centers as well.

The goal, of course, was to track down terrorists and their financial networks.

The Bahamas responded to the blacklisting with a spate of new banking laws and regulations, and it had written its own anti-terrorism law by the end of last September.

Among the changes was a requirement designed to put an end to shell banks by 2004. Shell banks are shadowy institutions that have nameplates on the wall but no other physical presence. What shell banks do, and who they do it for, has always been a mystery.

The Bahamas also has gotten rid of tens of thousands of international business companies, or IBCs, which let anyone park assets here, no questions asked.

And earlier this year it signed an information-sharing agreement with Washington, pledging to help the United States track down tax evaders when the evidence is compelling.

"We complied, passed our laws and got where we are," said James Smith, the finance minister of the Bahamas. "But our respect for the OECD fell through the floor."

He also voices disappointment at Washington's lack of support. "I think the U.S. needs to give us a little more support within the OECD and tell them to back off," Smith said. "We believe we have the right to choose whatever tax system we wish."

That resentment is widespread throughout the islands.

Tommy Turnquest, head of the opposition Free National Movement, the party that led the drive to tighten banking oversight when it was in power, believes the changes contributed to the FNM's being turned out of office in the May election.

"We came into a lot of criticism and one reason, I think, was many were not pleased with our methodology of changing laws," he said. "But we were caught in the position where if we didn't change laws the financial sector would be nonexistent today."

The election swept the Progressive Liberal Party, led by Prime Minister Perry Christie, into office.

There is still a large and important financial sector in the Bahamas: 350 bank and trust companies and dozens of mutual funds. The industry's fees contribute 20 percent of the government's budget.

But if the Bahamas is going to compete as a global player, it needs to change and adapt.

Experts here say the country must address three major issues as its financial sector moves into the future: labor, products and service.

The labor issue has several complicating factors. The country has an extremely small work force of just 165,000 people. There are no finance schools and no MBA programs. Recruiting foreigners can be a tough sell abroad _ heavy import duties on consumer goods make the cost of living high here and it's politically unpopular domestically.

The result is that the Bahamian labor market is ill-equipped for global competition, said Reece Chipman, who trains students for certified financial planning and similar occupations.

"We spread ourselves very thin in terms of expertise," said Chipman. "In the U.S., specialties are almost down to a science. Here, we do a little bit of everything. But we'll have to become specialists, or we can't compete internationally."

Chipman said the Bahamian banking industry must also change its mindset. Historically, it depended on low taxes and secrecy. In the future, he said, it must rely on intellectual capital.

"We're not a country that fosters dreams," he said. "We need to create products that are unique to the Bahamas. We need to be financial engineers."

What type of products? Bahamians see several possibilities, including:

Making the Bahamas the investment banker for the Caribbean _ creating development funds, bond markets and capital markets for countries that are desperate for professional financial services. The question would be whether there is a big enough market to sustain an industry here.

_Developing greater expertise in insurance niches, such as captive insurance. Captive insurance is when a company, such as a medical practice, sets up its own insurance firm to cover its needs. The difficulty might lie in the fact that other havens, such as Bermuda, have strong backgrounds in the insurance field as well.

_Becoming an e-commerce center. The Internet bubble has burst, but electronic commerce isn't going away. The Bahamas' location would allow international transactions to be cleared in a tax-free environment, although the idea's drawbacks include the fact that long-distance phone service is very expensive here.

Others say the Bahamas needs to market itself in a new way and promote the fact that it no longer offers bank secrecy but rather provides a professionally regulated system with a high degree of oversight.

That could help draw an important contrast with other offshore havens, where financial scandals often result in heavy losses for unsuspecting clients.

"We can gain business from other jurisdictions that don't handle this process well," said Joe Euteneuer, director of business development for Emerald Key Advisors, a money management firm. "It's really up to us to see how we handle it internally."

He added: "Now is the time to raise the level of service, raise the number of products and increase the level of sophistication."

Wendy C. Warren, executive director of the Bahamas Financial Services Board, a financial industry trade organization, concurs.

"The mantra is, we are blue-chip, well-regulated and cooperative," she said.

If the recent past proves anything, she said, it's that the greatest strength of the Bahamian financial industry was never secrecy laws nor favorable tax treatment, nor even its fortunate proximity to the economic giant just beyond the horizon.

It was, instead, the ability to adapt. "The last few years have been a very strong testing period for the Bahamas, no question about it," she said. "But at the end of the day, I think the Bahamas has responded well."