



Risk Reward riskupdate

The quarterly independent risk review for banks and financial institutions worldwide

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10 KEY PREDICTIONS FOR 2011

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DO WE HAVE ANYTHING NEW SINCE 2008 TO OFFER PROTECTION FROM A NEW CRISIS?

With more than 18 years in the global banking sector Marc Eichinger, CEO, API Capital, specialises in offering advice and guidance to institutional investors, high private wealth, lawyers and NGOs seeking to invest in high risk areas within emerging markets. Marc is keen to answer questions that people don't often dare to ask, and is used to looking at problems in a forthright manner. In this article he gives us a satirical update on the financial reforms.

When you have to answer this kind of question you must keep up a good sense of humour. Now that we are in the New Year it is so depressing to hear about rising unemployment and poverty, and don't you just wonder why all these people just don't go back to work? Honestly where is the problem?

Major US banks and securities firms paid a record USD 145 billion for 2009 bonuses. The question is, what can you do with your bonus?

New National Legislation

Let's buy some diamonds from Zimbabwe because in June 2010 the Kimberley process said that the country complies with its minimum requirements and should be allowed to export its diamonds.

Zimbabwe's military seized control of diamond fields in the Marange district in late 2008. More than 200 people were killed and the local population was forced to work but Mugabe bears no responsibilities. Its country could supply 25% of the world's diamonds with such a low production cost that it would be almost insane not to support the mining industry. After all we must participate in humanitarian activities and show solidarity with African countries.

This year one notorious City trader gave us a brilliant example of combining ethics and fair trade. His name is Ward, Tony Ward, not exactly an SAS but he would enjoy the same motto "who dares win". Just call him King Cocoa or Choc Fingers if you meet him.

In July he bought 240,000 tons of cocoa beans, the largest trade in the

last 14 years. It represents GBP658M or five Titanics full of beans in terms of volume. At least if there is a civil war after the Ivory Coast election he will be able to supply the chocolate manufacturers. Nothing is forbidden in doing this; he did it previously in 1996 and 2002. You can gamble with 7% of the world cocoa production and as long as you can get the cash to do it there is no hurdle.



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Facing higher taxes and potential regulation large hedge funds started their migration from London to Geneva which welcomed them. Calvin's city remains very conservative as far as tax and banking secrets are concerned. Looking for a real improvement we found out that in June Switzerland adopted the Council of Europe Convention so it is now forbidden to engage the charms of a 16 years old girl, now she must be at least 18, quite a change!

If Madoff had worked in Switzerland instead of the US he would be free today. The Code of Criminal procedure is not a matter of concern, no risk to stay in jail for the next 150 years.

Bernie was not a terrorist and in Switzerland even if you raise funds with the intent to finance an act of criminal violence to intimidate a population or compel a government or international organization (article 260 quinquies of the Code) your maximum risk is five years of imprisonment.

Missing your regulatory compliance would not be a big deal. "If the author has only accommodated the possibility that those funds are used to finance a terrorist act, it is not punishable under this provision".

Financial Crime Regulation

After the 2008 crisis we could have faced some anti-corruption rules but the Bribery Act 2010 will not be implemented until at least April 2011. There is no objective reason to hurry up, as an example the Financial Action Task Force estimates that "only" 60% of the investments made in Africa are coming from money laundering activities. So we can relax on the remaining 40%.

(Source: *Money laundering and Terrorist Financing Threat Assessment presentation July 2010, GAFI in Paris.*)

Commodities Regulation

Since 2008 we saw some disasters and the most important thing if you invest in an oil company is to make sure that they don't do like BP in the US or Shell in Nigeria. Offshore exploration is highly regulated so you need to check the company expertise.

Market wizards are keen to keep their secrets so I will not give you the name but a small junior company listed on the Toronto Venture Market managed to get six exploration blocks offshore

Namibia for a total of 32 000km². That is definitely the kind of company you can trust for offshore drillings. If something goes wrong they cannot hide it. There is evidently no risk of corruption at all, as Namibia ranks 56 on the Transparency international corruption index 2009, nearly as good as Jacob Zuma's country which ranks 54. Anyway, the Prevention of Organized Crime Act, which criminalizes money laundering, was passed in Parliament in December 2004, but has not been put into effect by the Namibian Ministry of Justice.

“London still attracts the best performers especially within the oil and gas or mining sector”

In 2010 London still attracts the best performers especially within the oil and gas or mining sector, and that remains the best protection you can dream off as an investor.

Take the example of Tullow which paid cash USD1.45 billion to Heritage for a licence in Uganda that was just cancelled by the Government of Uganda after the deal. Tullow Oil CEO Aidan Heavey has been named as this year's UCD Business Alumni of the Year.

First Quantum also did well investing huge amounts in the Congo before being completely frustrated in favour of ENRC. Both companies are listed in London, that did not protect First Quantum shareholders but they can expect an arbitrage to take place in the next ten years.

Banking Regulation

As far as banking regulation is

concerned, Basel 3 remains the most important challenge. The international banking system will be safer but nothing will happen until 2019. Until then you just have to pray. In the US where God saved us from the communists, Obama's administration has been defeated and the Financial



Reform could be in trouble but so far the bill has been signed into law.

This Law constitutes an attempt to prevent a future financial crisis. It establishes a Consumer Financial Protection Bureau within the Federal Reserve and there should be no more sub prime crisis. Banks and other financial institution must do due diligence on the income and credit histories of mortgage applicants. The Financial Services Oversight Council should also scan the market and detect potential dangers that could destabilize the system.

In theory federal regulators will have the power to seize and dismantle troubled financial firms before their bankruptcy make a new mess. 2010 saw

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125 bank closures, with six in a single weekend in September.

Proprietary trading is almost forbidden and private equity investment is restricted to 3% of the bank capital.

Capital Markets Regulation

But the most protective rule was released by the US SEC on November 3rd through the whistleblower provisions. Under the proposed rules which should be implemented in 2011, whistleblowers are eligible for awards when they provide original information to the SEC voluntarily. Only individuals are eligible but they can make a fortune. The award will range between 10% and 30% of the monetary sanctions whenever the penalties exceed USD 1 M. No wonder why the FBI is getting busy these days, but the future will tell us whether this “revolutionary” program will remain in place.

“According to the Center for Responsive Politics in Washington, during the second quarter of 2010, the finance, insurance and real estate sector donated \$28 million to congressional candidates, party committees and political action committees, with \$16 million going to Republicans and \$12 million going to Democrats. That’s a

major shift from the first quarter of 2009 when the sector pumped \$15 million to Democrats and \$10 million to Republicans. The finance, insurance and real estate industry also allocated \$252 million into their own lobbying efforts in 2010.” (Source: Market Watch October 28th 2010)

Finally Belgian bonds are rated AA+ at Standard & Poor’s and Fitch Ratings and Aa1 at Moody’s Investors Service, the second highest grade at each company. Irish debt is rated AA- at S&P and Fitch and Aa2 at Moody’s. Portugal’s is A- at S&P, AA- at Fitch and A1 at Moody’s.

The ratings are stable when compared to 2008 but during the crisis Belgium had a government which is not the case since April 22 2010. The country will inevitably split in two and they keep on issuing public debt. Ironically Belgium took over the Presidency of the European Union Council as from July 1st, without legitimacy at home; Belgium’s politicians are managing the new Euro zone crisis. Still within this context France and Germany pushed for the reopening of the already irrelevant Lisbon treaty and Herman Van Rompuy bought a suit of armour.

Euro in Greek “uro” means urine and the Euro zone is now so much at risk that we may remember this detail very soon.

A Glimmer of Hope?

A tiny glimmer of hope comes from the other side of the Atlantic with Jules Kroll innovative Kroll rating agency. Kroll wishes to restore trust in credit ratings by establishing new standards for assessing risk and by offering accurate, clear and transparent ratings. In other words the rating agency is not paid anymore by the issuers but the asset managers. Does it not make sense?

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