TRUSTING

The Independent Financial Advisor

CIFA www.cifafound.ch

N°4 - November 2005

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TRUSTING – The Independent Financial Advisor

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CONTRADICTORY OPINIONS

A pivotal role in protecting the interests of customers

A single financial services market requires that financial services intermediaries may conduct their activities and provide services freely throughout the EU in accordance with the principles of the Treaties.

The sheer length of time it takes to get new legislation on to statute is a major problem. If European operators are to remain competitive and European consumers are to derive the fullest possible benefit from the single market, it is vital that we can enact and up date legislation fast.

The intermediaries are a vital link in the process of selling products and services in the EU. They also play a pivotal role in protecting the interests of customers, primarily by offering them advice and assistance and by analysing their specific needs.

Therefore, it is again necessary to stress the urgency of developing a truly integrated retail market in which the interests of consumers and service providers are properly protected.

The Directive on Insurance Mediation has been adopted to set up a legal framework which ensures a high level of professionalism and competence among intermediaries whilst guaranteeing a high level of protection of customers' interests: only ten member states have so far concluded the transposition of this Directive in their national legislation!

Clearly, there is no real political will to meet the deadlines of 2005 set in the Financial Services Action Plan. The failure again of timely delivery of the required individual measures unfortunately endanger the overall optimal timeframe.

There obviously remains a concern about the pace to deliver the Action Plan in line with the political statements of successive ECOFIN and European Councils, in view of the paltry enthusiasm of national bureaucrats, based on their narrow vision of society, for anything that might represent the slightest change in their little practices or privileges...

The excess of overregulation are imposed by the civil servants of the member states - not by the Union.

Simplification of regulations is essential and possible. A great deal could be done to facilitate life for European intermediaries and to limit the paperwork which can hamper the growth of the industry.

The formulation of European legislation for financial services, whilst being effected for the protection of consumer's interests and applicable without pointless restraints for practitioners, requests the political need to attack the ensuing problems, even if the politicians are showing a certain reluctance for European harmonisation of legislation, that would take a more liberal direction, and be more genuinely concerned with consumer interests, than certain national administrations might wish.

The intermediaries are subjected to extremely constraining regulations, exacerbated by new technologies and demands of a generally distressed and misinformed clientele. The regulatory costs also are far too high and place unnecessary and costly burdens on intermediaries.

Only a co-regulation of the industry by both regulators and professionals can assist the anxious consumer in the right choice of options and alternatives for the sound management of his or her wealth.

Vincent J. Derudder
Secretary General of FECIF
Member of the Executive Committee of CIFA

News briefs

News briefsNews briefsNews briefsNews

Making money out of indexes. For investors who love index investing such as institutional investors, assets linked to a large hedge fund index, are a dream. In this regard, funds linked to the largest hedge fund indexes have experienced a solid growth in their assets under management during the recent months. From March 2004 to July 2005, assets linked to the MSCI Hedge Invest Indexes have tripled. However, the choice of the index must be made carefully. As indexes are sometimes built according to vague criteria, investors should care off the way the funds are selected (or not) and wonder why the index was created. As a measurement tool or as a product? The question of the length of time the index has been around is also of importance.

Japan's government pension investment fund (GPIF) to invest under strict criteria in Hedge Funds as of March 2006. The GPIF is the largest pension fund in the world with total assets of $ 379 billion. Investment criteria will probably prevent GPIF from investing in FoFs.

Credit derivatives current trading practices under scrutiny of NY Fed. 14 firms active in the credit derivatives market convened to a closed-door meeting with the NY Fed on 15th September. A particular attention will be set on assignment and confirmation of trades but no specific directive expected to come out of the meeting.

Size: a matter of survival.

Assuming that almost 50% of hedge funds manage less than $ 25 million the question of survival of such small funds is a crucial point. For a fund managing $ 20 million, that charges a 1% management fee and an incentive fee of 20% of the profits, and makes 8%, the revenues would amount to $ 520'000. That is not a lot compared to the costs of running a fund. Once the fund paid research, legal costs, rent of the office, salaries for the staff and partners there is not much remaining. And that is with a fund making 8%, not 3%... That is the reason why a large number of funds, unless they attract new money (and also new costs, i.e. regulatory) are condemned to go out of the business prematurely.

Are there too many hedge funds?

According to hedge fund analyst and respected columnist John Mauldin, the current number of hedge funds does not constitute a bubble. With an estimated number of 7'700 hedge funds, funds of hedge funds and CTA's managing almost $ 2 trillion, the hedge fund world is a dwarf compared to the 54,500 mutual funds worldwide managing $ 14,5 trillion. Furthermore, with regards to the $ 36 trillion of equity on world stock exchanges and the $ 49 trillion of the bond market, hedge funds are rather small players. For instance, an estimated $ 1.4 trillion are invested by hedge funds in equity market, which represents about 4% of total world equity. Mauldin even suggests that investors need the number of hedge funds to double or triple in the coming years in order to replace the funds going out of business, or those that reach their capacity and close to new investments. Moreover, the largest the hedge funds supply is, the bigger are the investor's chances to find a manager with significant value-added skills. Assuming that only the best funds will survive…

MONEY MARKETING

IFA costs double over three years

Cost of compensation and regulatory fees has more than doubled in the past three years, as IFAs are being pinned down by increasing levies and a removal of the Pass subsidy, wrote Money Marketing.

The Aifa has made a final appeal to product providers to subsidise IFAs' compensation levy, as director general David Severn accused the regulator of seemingly one-mindedness to "strangle the life out of the IFA sector" while also showing concern that, combined with PI insurance problems, firms could run aground.

Aifa figures revealed a general sole trader could see FSCS, FOS and FSA fees jumping 43% from £1.538 for March 2003, to £2.700 this year. The effect of the loss of the Pass subsidy of 80% of the FSCS component of those fees resulted in many IFAs fees doubling in real terms. Despite this, the ABI said - on behalf of its members - it would not consider a U-turn on subsidies.

Severn said: "I want an urgent and fundamental review of the compensation and funding arrangement," adding much of the blame could be attributed to providers withdrawing subsidies to the FSCS in March."

FSA spokesman Rob McIvor, said: "If an IFA goes into default and IFAs do not pay for it, who should?"

Pensions Technical Solutions managing director Carl Melvin, said: "What does the FSA know about being a small IFA? Many IFAs are hanging on by their fingernails."

A LIBERAL NAMED JESUS

"The only form of economic thinking which is in accordance with the Gospels is liberalism!" It is on this strong and politically incorrect conviction that Charles Gave bases his new pamphlet, in which he analyzes the texts of the Gospels as an economist whose credo is liberalism. *"If the Gospels are the very foundation of our civilization, if they are truly timeless and placeless, then they must have something to tell us today on what is moral in the economy. They have possibly been read too much by clerics, moralists and philosophers, and not enough by economists and financiers,"* says Charles Gave. Written with fire and bite, **Un libéral nommé Jésus** (available only in French for the time being) is neither a theological nor even a religious book. It is the essay of an economist who believes that the honour of liberalism has always been to protect the civil and economic liberties against the constant infringement of political power.

Charles Gave, an internationally acknowledged specialist of the financial markets, published in 2003 at Editions Robert Laffont **Des lions menés par des ânes** (Lions lead by donkeys), an essay on the (upcoming although quite avoidable) crash of the Euroland in general and of France in particular.

Un libéral nommé Jésus, Bourin Editeur, Paris, 2005.

Long only funds might represent a good opportunity for investors if focussed on commodity markets. In spite of short-term volatility, long-only funds are likely to profit from expected long term rise in commodity prices.

According to a recent survey conduct by Northern Trust and Scorpio Partnership, Swiss family offices consider the back office as their greatest burden and the easiest part of their business they can outsource. Outsourced back office would improve quality and reduce costs and might result in maximizing banking relationships.

Cayman Islands registered a record number of new hedge funds during the first half of 2005 in spite of slowdown of capital inflow. With an increase of 13%, the number of registered hedge funds jumped from 5'932 to 6'527. The growth is expected to go on.

TAX & JURISDICTION
Fraudsters use UK as a base

Companies using false UK addresses are scamming people throughout Europe and the US, according to a fraud research company. Tony Hetherington, UK director of the Regulatory Intelligence Agency (RIA), claimed there are around 41 offshore operations that they are aware of that use fake UK addresses and phone numbers and typically are based in Spain, Switzerland, Hungary, Czech and Nigeria. These 'boiler rooms' have the facade of a debt collector or a credit reference agency.

Karin Loudon, spokesperson at the UK's Financial Services Authority (FSA), said: "It is an issue that we are concerned about and we started issuing individual lists last December as well as warnings on our consumer website but these companies change names and premises from week to week. We also work with other jurisdictions to try to disrupt their practices."

"The best way for investors to avoid these types of scams is to check with the FSA to see if the company is registered for business. We receive between 500-600 enquiries a year and if an investor falls for one of these scams there is no fallback for compensation for them."

German Social Democratic Party (SDP) dislikes Hedge Funds. After comments by Franz Muentefering comparing Hedge Funds (and Private Equity companies) to hoards of locusts, SDP's dislike of HF is becoming more and more apparent. Chancellor Gerhard Schroeder called for investigation regarding hedge funds, claiming the Germany needs foreign capital invested in a productive way instead of speculative investments.

"26th STATE" COULD BE A HAVEN FOR IFAs

The European Commission could exempt IFAs from EU single-marketregulation by the creation of a "26th EU state" for firms wanting totrade across borders. The proposal, which is outlined in an EC GreenPaper on Financial Services Policy, is designed to offer a lifeline tofirms which are keen to escape costly EU single-market regulation in thefuture. Dubbed by Eurocrats the "26th regime", companies that want totrade only within their own country could potentially opt out of futuredirectives introduced to regulate interstate trade, such as Mifid. Theregime would help to stop the practice of gold-plating of EU directives,which has recently been criticised by European Commissioner for internalmarkets and services Charlie McCreevy. The EC is planning to launch astudy on the feasibility of introducing the regime. The proposals havegained tentative support from some trade bodies. The Association ofBritish Insurers says the 26th regime is superficially attractive but itraises concerns about the complexities and the possible costs of introd-ucing it. However, Cardiff Pinnacle deputy head of risk Keith Martinurges the UK financial services industry to back the concept. He says: "The European Union has grossly overdone its single-market measures.Rules to make interstate business easier have been needed but theserules should not be applied an IFA selling a product to someone a coupleof miles away from his office." **(MoneyMarketing)**

The **IFA Promotion** group is predicting a buoyant year for customer savings. The group's annual Get Saving! report showed savings outweighing borrowings by the largest ratio since 2001. The ratio for savings against borrowings identified from the report showed Britons are borrowing 57p every £1 they are saving. At the beginning of 2004 the report showed that for every £1 saved £1.50 was borrowed.

Recent Edhec Risk and Asset Management Research Centre (Nice, France) survey finds recent lowering of profits in hedge fund industry results mainly from cyclical factors more marginally from over capacity.

Hedge Funds indexes have grown up but questions still remain. Driven by investor demand and commercial opportunism from index providers, hedge fund indexing has experienced solid growth in recent years. A number of 17 to 20 indexes currently intend to track the performance of the hedge fund world. For the moment, there are no standards regarding the best way to build a hedge fund index. Thus, measured performance might vary widely from an index to another. For instance, in June 2005, composite returns for five of the leading indexes were within 70 basis points of each other (they ranged from 0.9% for the S&P to 1.6% for MSCI's). Worse, the difference was of 130 basis points in May. However, according to a recent Edhec Business School study, the situation is improving. The study showed that discrepancies are reducing and that they tend to happen in times of greater stress in financial markets. The question of the representativeness of the indexes is also of importance as some indexes are based on a number of hedge funds ranging from 41 (S&P) to 3'100 (HedgeFund.net). Indexes should thus be considered for what they are, benchmarks that collectively can help measuring the relative performance of absolute return strategies.

Future of structured products linked to hedge funds performance uncertain in the U.S. In spite of strong demand from investors and enormous potential for the industry, the wide distribution of these (still very rare) products is subject to a number of uncertainties. Regulatory oversight, rising interest rates and lack of mass distribution are as many obstacles to cross.

Campaigning body the **IFA Defence Union** is considering launching a test case against the FSA and Financial Ombudsman Union over their handling of mortgage endowment complaints. The group is complaining that the FOS is ignoring time bar rules contravening the Human Rights Act.

INDUSTRY NEWS

Pictet opens Paris office in Euro marketing expansion

The Pictet Group has opened a branch office in Paris to be headed up by both Joel Rochat and Herve Thiard.

Rochat, formerly the head of private banking marketing for the Pictet Group, will be responsible for private wealth management services.

Thiard, currently the head of marketing and sales of Pictet Funds for the French market will be in charge of investment fund sales to corporate clients.

The opening of the French office is part of Pictet's strategy to strengthen its position in the French market as well as continuing to grow a presence in Europe. Pictet has marketed its funds in France since the summer of 2000 through various distribution agreements with financial institutions.

Claude Demole, managing partner of Pictet & Cie, said: "We firmly believe that there is a wealth of potential for demanding clients seeking custom-tailored services, long-term relationships, independent investment advice and the utmost discretion. An office in Paris will allow us to offer French clients unique access to the investment expertise of the Pictet Group, backed by two hundred years of experience."

Telegrams

*** Colin Powell allies with Kleiner Perkins**

The former US secretary of state will join Silicon Valley venture veteran Kleiner Perkins Caufield & Byers as a strategic limited partner.

*** Largest Middle East PE fund holds first close**

The first closing of Abraaj Capital's second buyout fund on $300m indicates strong investor appetite in the Middle East for local private equity.

*** China investment activity "on hold"**

A board member of the China Venture Capital Association has reportedly said that private equity deals in the country are 'on hold' pending clarification from the government on the use of offshore vehicles.

*** Investors warned on China**

Concerns that investors in China are paying high prices for firms they will struggle to exit from were expressed at a gathering of fund managers in New York.

Hedge fund rolls off with Blum carts

* Bankrupt airport baggage cart company Smarte Carte has a new owner in Black Diamond Capital, a hedge fund and distressed specialist that has taken the company off the hands of private equity firm Blum Capital Partners.

Active Advisors

Asset.tv has launched a hedge fund channel which is to feature industry names talking about their approach to investment as well as their views on current issues. To coincide with the launch, the channel has issued a CD called *Explaining Hedge Funds*.

Is the EuroLand Social Democratic Model going to survive 2010?

The exchange rate is the sewage system through which unearned rights are collected. Jacques Rueff

At the end of the 1970s and the beginning of the 1980s the Soviet Union was the theater of a strong movement of civil disobedience led by the "Refusniks", the most famous of them being of course Sakharov and Soljenitsyne. Then, one of those heroes, a young man named Boukhovsky, published a book called "Will the Soviet Union survive in 2000" in which he analyzed the Soviet Union's deep rooted problems to conclude that the communist system was due to implode sometime before 2000. Implode it did, the Berlin wall falling in 1989…

In this very short paper, we want to review the future of what is commonly called the EuroLand, to conclude that barring a totally new frame of mind appearing in the old Europe, we can be relatively certain that the local social and political model will *not* survive 2010 anymore than the Soviet Union survived 1990… To do so, we will assess the main trends already visible in the world and will quickly review how each one of them is dealt with in the EuroLand, mostly at the political and economic levels.

The review of the Trends

Three ***heavy trends*** have started to hit the EuroLand, and will continue to impact its future as far as the eyes can see.

They are, by order of importance:

- Demographic forces
- Technological innovations
- A new form of business organization.

1. Demographic forces: the coming pincer

In 1950, three quarters of the babies born around the Mediterranean Sea were born on its northern shores. Today the reverse is true; three quarters are born on its southern shores.

As a result Europe is facing a double problem: the *aging* of its population together with a massive and unavoidable *immigration*. In Spain, in Italy, in Germany, in Eastern Europe the fertility rate of women has fallen to levels never seen before in history, 1.2 to 1.4 child per woman (2.2 children per woman is considered a requirement for the stabilization in numbers of the population). In less than twenty years, those populations will start falling in numbers, and the dependency ratio (ratio between the parts of the population working to the parts not working) will skyrocket. Social costs will go up, and we would be surprised if the new and young immigrants were queuing to pay for an aging population which was unwilling to pay for them a few years before…

Europe is thus facing an awesome pincer: the first branch is the aging and the disappearance of its endogenous population, while the second branch is a huge and uncontrolled immigration, originating in the totally different cultural and religious background of the Arab world. Simply think about the demographic imbalances between the Christian and the Moslem populations in Lebanon in the 60's and how it impacted Lebanon in the 80's, and you will have a good idea of EuroLand circa 2030…

2. Technology: the slow decay

It is now a cliché to say that we have started the "third wave" in economic history. (The first one was based on agriculture, the second one on industry; the third one has its foundations in knowledge.) Europe led the way in the intellectual prowess which brought us where we are. Not anymore. More than 60 % of the patents originate now from the US, while Asia, China and Japan are climbing pretty quickly. This weakness is becoming wide spread and extremely well recognized: for example according to a classification made by the Chinese authorities of the best universities in the world (this is done to help Chinese students select their universities for graduate studies), one has to go below the number thirty to find the first

French or German institution…a century ago, fifty years ago… one would have been hard pressed to find anything but European universities.

3. A new form of business organization, squeezing tax revenues

Each company in the world must do three things

- Design a product
- Build it
- Sell it

More and more companies are realizing all over the world that the real added value is NOT in the building part (negative cash-flow, capital intensive, labor union plagued, cyclical etc…) but in the first and the third, the design and the selling.

It means in simple terms that the Dell, Ikea, Wallmart of this world are replacing the multinational model (producing everywhere, selling everywhere) by the platform model (designing in selected places, having production facilities nowhere but sub contracting always in the cheapest place to local producers, selling everywhere).

This new model is made possible by the advent of the perfect information world in which we live, and is thus a direct result of the technological revolution mentioned above. But this model has huge implications for the governments of the world.

The platform companies, for all intent and purposes *can pay taxes wherever they want.* They are not "chained" in any territory or nation by a huge and unnecessary work force, and colossal fixed assets (factories, offices, etc…). They will go where *the marginal tax rate is the lowest for the creative people*, the ones responsible for the first and most important part, the design of the product.

Taxes are becoming voluntary, which we can all agree does not arrive one minute too early…and should bring sanity in the charmed world of civil servants.

These three forces are there for everybody to see.

Everybody it seems but the EuroLand governments…

The EuroLand answers

For the benefit of the discussion, we are going to assume that in EuroLand we have two players:

- Those who receive their payments, directly or indirectly from the public sectors (civil servants farmers etc…) and who have some kind of power, usually of a political nature (unions, marginal votes etc…). They are in fact operating in what quite a few US economists have called the "political market". In simple terms, it meant that their political weight allowed them all the time to earn far more than their competence would have allowed in a market economy. This they did, needless to say by exacting taxes from our second player.
- Those who receive their payments from the private sector, in the market economy, and not from the political market.

If the reader accepts our classification of the EuroLand work force being split in two, between what we have called in a previous article, the communist sector and the free market sectors, then something is immediately blindingly obvious.

The three heavy trends which we have mentioned in the first part of this paper all play against the communist sectors.

Let us review them.

Demography.

A well trained, well educated young EuroLander will have no reason whatsoever to work in EuroLand to be taxed to death.

He will emigrate, and spend his holidays in his country (at best).

Already more than 50 % of the students graduating from the best schools in France are moving abroad.

Similarly, the not so well educated arriving from the southern shore of the Mediterranean Sea will be unemployable given the high cost of the social legislation making sure that he can not be employed profitably by anyone. Being unemployed, he will be restless, which will require a huge expansion in the police force.

Finally, the pension systems, based on those working paying for those who have retired will undergo a huge crisis of confidence. The pensioners, well aware that nobody will pay their retirements benefits will save like squirrels, making sure that the growth rate of the European economies already weak is staying that way. The net result is of course a real explosion of the deficits of all the EuroLand social systems, more or less all based on the pay as you go system.

Technology

We are living in a world where there is perfect information. In such a world, there is a huge premium not on acquiring the information, which is available freely, but on acting on it, quickly. Of the ten highest standards of living in the world nine are registered by countries which have a common characteristic: numbering less than 10 millions citizens. (One exception the US, which enjoy a decentralized system, which could almost be described as an addition of optimum ten millions nations, sharing loosely a few costs).

So in this rapidly moving world, the future belongs to the ancestors of the mammals, and not anymore to the huge diplodocus. However, the whole effort of the European political class has been to try to create a new Tyrannosaurus Rex, which on second inspection looks more and more like a very slow moving iguanodon (when one hit the poor animal on the tail, it took two days to reach the brain. Looks like the European commission…).

The attempt to create a European State is purely and simply an attempt to go back to the "Nation State", the by-product of the second wave. The EuroLand politicians do not understand the new world anymore than Mr Gortbatchov did.

New form or organization

Schumpeter characterized capitalism as the system in which "creative destruction is allowed".

For geopolitical reasons (fall of the Soviet Union, opening of China and India), and for technological reasons (the third wave), we are entering one of the greatest and most exciting phase of creative destruction the world has ever seen.

One of the end results of this creative destruction unleashed on the world is that the "imperial state" built on the second wave is doomed. It is *doomed* for two simple reasons

- On any simple or sophisticated analysis, its *costs* are going to explode in the not too distant future.
- At the same time, its *revenues* are going to dwindle and disappear. One way or the other, tax revenues in a nation are a function of the wealth created there. The new business model companies, our platform companies, will make sure that they will avoid the countries where the costs are high and will domicile their revenues where the marginal tax rates are low.

Conclusion

If we are right, the biggest victim of the new creative destruction is going to be our cherished European social democrat model. The next wave of creative destruction is going to hit *our* communist system, twenty years or so after *their* communist system…how sad!

However, one can be sure of one thing: they will fight back. The rights to work 35 hours, to retire at 50, to take 8 weeks of holidays have never been "earned" but are going to be honored, for the very simple reason that more than 50 % of the population in Euroland works directly or indirectly for the government.

How do you reform a country in which more than one voter out of two gets subsidies? Answer: you do not reform.

So a bankruptcy is unavoidable? Yes.

The next question is: what kind of bankruptcy? The slow type (ever falling economic growth, lower standard of living, Venice 18th century type), or the fast one (Argentina, Soviet Union), with the currency disappearing altogether? We do not know, but most seasoned observers believe the first one to be more likely.
One question then immediately comes to mind: how do I get protected from such a financial Armageddon?
Simple!
Whatever the scenario retained, the currency will have to go down, either slowly or quickly. The currency in which these bounties will be paid will adjust to these follies. (See Jacques Rueff quote at the beginning of this piece). The solution for the Euroland saver, *for the part of his assets which have to remain in Euros* is thus to invest only in European *equities*, preferably of the platform company type and to avoid as much as he can any asset guaranteed by or issued by European governments (government bonds). We see no reason why the European saver would want to go down with the communist Titanic, if he is not forced to by regulations. Why should he buy a promise to repay by a European government knowing full well that they will be totally unable to repay?

Because governments do not go bankrupt? Be serious! The bonds issued by certain EuroLand governments are of the same quality than the Argentinian debt of a few years ago!

To summarize: of all the things which could happen in the EuroLand in the next ten years, two are sure:

- The Euro will go down, especially against Asian currencies (Borrow in euros to buy assets outside of Euroland seems to be a good idea too)
- Good quality shares (platform companies) will outperform bonds.

Building a long term portfolio on these two quasi certainties does make a lot of sense, in our opinion at least.

Charles Gave
GaveKal Research Limited

For a complete discussion of the platform company concept and its implications on current accounts, financial markets, exchange rates, etc., see **www.gavekal.com**

Switzerland is the most regulated financial centre, but...

Judging from its almost pathetic readiness to fall in line with each and every of the 40 FATF "recommandations", as they have been revised in 2003, Switzerland is undoubtedly the most regulated financial centre in the world. What is more, abidance by the Alaw is, in money laundering as well as in other Swiss matters, extremely high.

Based on the follow up of criminal investigations triggered by suspicion reports emanating from financial intermediaries, there is however scant evidence that such a strict compliance with FATF standards, as exemplified by the Swiss experience, is effective. But there is no saying that the exercise is not worth the fuss: indeed, the very existence of a strong anti-money laundering legislation acts as a deterrent, keeping the proceeeds of crime away from Switzerland as a financial centre.

Is Switzerland the most regulated financial centre in the world? Switzerland certainly is way ahead as far as falling in line with the 40 Recommendations of the Financial Action Task Force (FATF) is concerned. Thus, several European countries have not yet enacted legislation implementing the European Union Second Directive on Money Laundering while a Third Directive is already being published. But what sets the country apart from other jurisdisctions is not so much the existence of stringent regulations, as the fact that these are actually being put into practice. Indeed, in the fight against money laundering as in other matters, abiding by the law is very much a Swiss attitude, epitomized in a lofty conception of the "rule of the law", which means that legal standards exist to be kept. Such a legalistic bias however does not need being stubborn, at least not in money laundering matters where quite the contrary is true. Thus, the Swiss "Money Laundering Act" of October 10, 1997 (MLA), based as it is on the informed cooperation of financial intermediaries, requires nothing less from these than a thorough understanding of the law, contrasting with the somewhat perfunctory compliance which would be regarded as sufficient under a less elaborate regulatory framework. In their "Comparative Guide to Anti-Money Laundering", Mark Pieth and Gemma Aiolfi contrast the "suspicion-based system", as it is exemplified in MLA, with a system based on "suspicious transactions reports" (STR), arguing that the former is more effective. "An usual transaction notification system would generate probably less than 5 per cent of criminal investigations, whereas the corresponding figure for a suspicion-based system could be well over 50 per cent", writes Mark Pieth drawing from the Money Laundering Reporting Office Switzerland (MROS) annual report.

If it true that a STR-based system tends to generate more data than law enforcement bodies may actually proceed, the almost systematic involvement of the judiciary associated with a suspicion based system should not be taken as actual proof of its effectiveness either. In fact, the number of convictions, rather than that of criminal investigations, would seem to be the relevant criterion. Now, from such a standpoint, while bearing witness of Switzerland's considerable goodwill in going along with FATF requirements, statistics remain rather unconclusive as far as the results of such judiciary activism is concerned. In effect, the 3493 suspicion reports transmitted to the MROS ever since the MLA is in force, have given rise to 47 convictions only. Unimpressive though it may be, this figure should however be put into perspective, allowing for the fact that investigations are still in progress in about half the cases under consideration. Another factor to be taken into consideration is the cooperation with other anti-money laundering (AML) authorities abroad which contributes to render the follow up of cases quite difficult. Further confusion may also arise from the variety of sources, the MROS drawing in its report both from its own

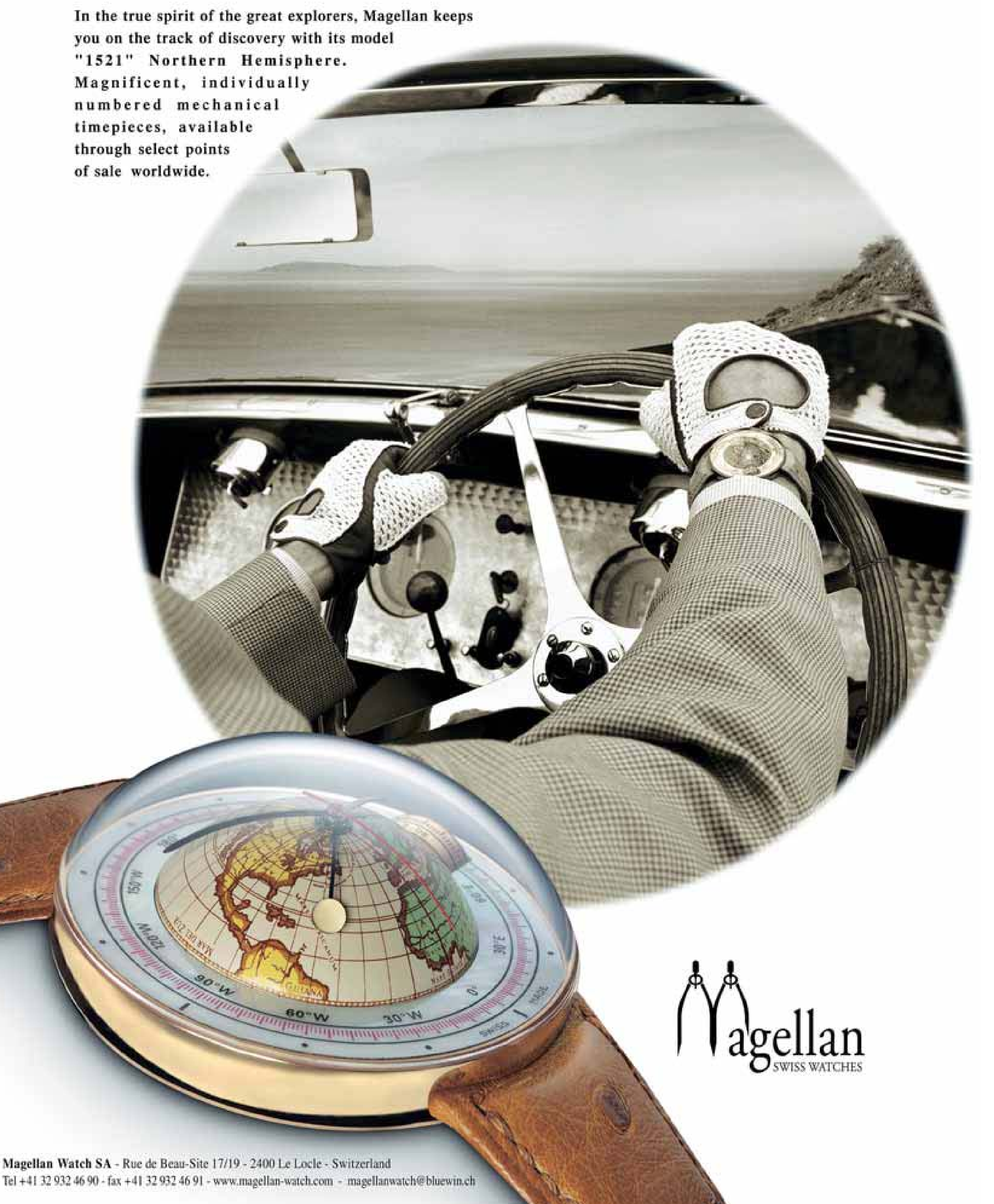
> **"The Swiss system is based on cooperation among professionals who know each other and know their clients"**

data base and from those made available by the judiciary, leaving up to ten per cent of relevant cases unreported, and the Federal police. Thus, the MROS report also include an aggregate statistics of all money laundering related convictions made by Swiss courts, which is not to be confused with the number of convictions resulting from criminal investigations initially prompted by notifications emanating from financial intermediaries. Indeed, money laundering related convictions, as they mostly reflect a rather unsettlingly high level of activity in fairly petty criminal dealings throughout Switzerland, are much more numerous than those truly involving the financial system, with serious money at stake. Now, Federal Counsillor Rudolf Merz was clearly making reference to the overall, more encompassing, figure on his adress of last June 7, delivered on the occasion of the first "Swiss Forum of Self-Regulating Bodies" (SRB), when he spoke of "about one thousand" convictions made, ever since the law was enacted, in connection with the fight against money laundering. Actually, this figure is a rounding up of several entries, namely taking together 481 actual convictions with other investigations having been terminated for lack of evidence. The demonstration was also obviously being made to be heard abroad, namely at FATF headquarters, where doubts have been raised in a not too distant past over the effectiveness of the suspicion based system.

If the willingness of the Swiss Ministry of Finance to combat money laundering is beyond any doubt, the demonstration made before the SRB Forum leaves crucial questions unanswered. The gross figure given in the official adress is begging the difficulty involved in giving an actual picture of the effectiveness of Swiss AML policy insofar as the financial system is involved. It is therefore best to avoid aggregate figures to concentrate rather on given segments of the financial sector. The striking feature of available statistics at this level is that banks account for hardly more than 40% of communication being made to the MROS pursuant to MLA and that this contribution is dwindling. This does not imply that banks are reluctant to cooperate, quite the reverse being true. Rather, it means that most suspicious cases originate from without an established relation, emanating mostly from money transmitters or bureaux de change.

This impression of money laundering as a phenomenon largely alien to traditional money channels is further confirmed by the comparatively low contribution of independent wealth managers to the gross number of suspicion reports made since 1998, only 89 out of 3493. Besides, such a figure does not reflect the extremely high level of compliance evidenced by this category of financial intermediaries over the past few years. This attitude should come as no surprise in a sector where walk in customers are unknown and proper client connections and references of the essence. "In accordance with the law, every financial intermediary is responsible for assessing the situation of his clients and this sets Switzerland apart from other jurisdictions", points out Franz de Planta as Chairman of one of the eleven SRBs instituted pursuant to the MLA. "The Swiss system is based on cooperation among professionals who know each other and know their clients", emphasizes Franz de Planta who likes to recall that the very concept of "Know Your Customer" (KYC) is rooted in the Swiss experience. The validity of such an approach has once more been acknowledged by FATF delegates on their latest evaluation of Switzerland, held on April 8, 2005. Without waiting the release of the official FATF report, favorable hints are being heard from those who were actually involved in the process. Among them Maurice Baudet who was present in Zurich in his capacity of CEO of the Swiss Association of Asset Managers, to confirm that the examination did in effect take place in a positive atmosphere conducive to a thorough understanding of the Swiss approach in AML matters. Believing that the system established under MLA is valuable, he says: "it is ridden with constraints and costs dearly, but it is effective". Indeed, compliance stands presently at more than a quarter of total functioning costs for the average financial intermediary and the percentage is edging up. Within banks, AML related costs have risen by about 60% over the last three years and there is no indication that the trend is reversing.

Now these costs may be about to litterally explode should the draft MLA revision project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released last January effectively come into force by early 2007 according to schedule. As it is the rule in Switzerland, the tentative draft has been submitted for comments to various categories of financial intermediaries on a "consultation procedure" ending April 15, that is to say a few days before FATF delegates were exspected in Zurich. This has been seen as more than a mere coincidence, some commentators pointing out the MLA revision itself was meant to please the FATF, which accounted for the fact that several of its provisions were unanimously criticized for being overdone. So much

As a consequence, it will be ever more difficult to assess the effectiveness of the system…

so that Rudolf Merz felt the need to defuse criticism by announcing in his June 7 adress that the revision process itself would resume so to speak from the beginning.

This should not be understood as meaning that the Swiss Ministry of Finance will renounce its legislative ambitions altogether. Rather, the project will limit itself to those provisions which are seen as necessary in order to comply with the revised FATF Recommendations.

This narrowing in scope is likely to leave out one of the most controversial aspects of the initial tentative draft, that is the setting up of a data base including the names of relevant financial intermediaries in relation with every given communication being made to the MROS. Under the initial draft, law enforcement agencies would have had an on line and almost unrestricted access to such a data base, raising fears of possible reprisals against those involved. Other, hardly less controversial, aspects of the MLA revision are unlikely to be left out of the final draft. Pursuant to the Recommendations, "designated non-financial businesses and professions" will be subject to "regulatory and supervisory measures". This will mean a change in outlook for the MLA wich has been exclusively intended at financial intermediaries. Whether and how this widening focus will impact on the operation of the law remains to be seen. Furthermore, the reporting of any possible suspicion at the very early stages of a relation, even prior to its actually being established, will almost definitely be included in any future version of the law, as it is supposed to come into force somewhere in the course of 2007. In this respect, the Ministry of Finance is unlikely to overlook remarks having already officially been made following the previous FATF round of evaluation, reproaching the Swiss financial sector for protecting istelf against money launderers by "being scrupulous in entering into business relations", thus turning away suspect customers. This is most likely to give rise to many more unfounded reports, increasing the burden of the judiciary in dealing with communications only made for the sake of safety. As a consequence, it will be ever more difficult to assess the effectiveness of the system…

Mohammad Farrokh

IFAs and regulators: beginning of a dialogue

Over 200 independant financial advisors, bankers and regulators from 15 countries gathered in Geneva on 16-17 March 2005 to discuss one of the biggest challenges facing the independant financial community: regulation. After two successful gatherings in 2003 and 2004, this third congress of the Convention of Independant Financial Advisors established the event as one of the major international forums for the financial intermediation community.

"*Is the independant financial sector being regulated to death?*" This provocative question, asked by Charles Poncet, the moderator of the 3rd International CIFA Forum's first panel, summarizes somewhat abruptly the deep concerns of IFAs towards the growing regulatory pressure on their trade.

Under the title "Let's provoke a dialogue with the regulators", the 2005 CIFA Forum offered perspectives and explored solutions to harmonizing the governments' growing initiatives for more regulation with the interests of the independant financial advisors' community." Let us stop complaining and act,"said Jean-Pierre Diserens, founding member of the CIFA." Let us engage in a proactive dialogue with the regulators and offer proposals to improve – rather than just increase – the way our profession is regulated."

A BALANCE OF THE COSTS AND BENEFITS OF REGULATION

During the first day of the forum, several panel discussions between high-level representatives of regulating bodies from France, Germany, the United Kingdom, Switzerland and the EU, together with prominent speakers from the independant financial intermediation community across Europe developed answers to burning questions such as "Regulation: for which objectives?", "Corporate governance: an efficient set of rules to win back investors' trust?" or "Adjusting regulation to the financial intermediaries' activities" and "Building a real co-regulation".

Speakers included personalities such as Angela Knight, Chief Executive of the Association of Private Client Investment Managers and Stockbrokers (APCIMS) in London, Paul Rich from the Financial Services Authority (FSA) in London, Jean-Baptiste Zufferey, Vice-Chairman of the Swiss Federal Banking Commission (CFB) in Bern and Mats Isaksson, Head of the Corporate Governance Division of the OECD in Paris.

VOICES FROM ASIA

At the networking dinner that closed the first day of the conference, M. Jian Tu, Director General of Asset Management of the China Coun-

cil for the Promotion of International Trade (CCPIT) and General Counsel of the Shanghai Stock Exchange, delivered a keynote speech on the structure and evolution of China's financial markets.

The second day's morning session was dedicated to workshops on four leading financial centers: Singapore, Luxembourg, the United Kingdom and Switzerland – each of them presented by two prominent spokespersons.

Closing the event, Marc Faber, Editor and Publisher of the Hong Kong based "Gloom, Boom & Doom Report" and author of the bestselling "Tomorrow's Gold" provided a compelling view of global investment opportunities, especially in rising China and Asia. Gathered to "provoke a dialogue with the regulators", the delegates were themselves "provoked" by Dr Faber's challenging call to relinquish their trusted benchmarks and invest in the booming economies of Asia rather than in the United States, or in commodity markets rather than overvalued real estates and financial assets.

René W. Rohner

SELECTED STATEMENTS HEARD DURING THE FORUM:

(For statements made at the roundtable "Building a real co-regulation", see p. 28)

"This Forum's agenda gives ample proof that you are not afraid to tackle the most burning issues: the purpose of regulation, the role of the State, the control of activities, the respect of privacy".
State Councillor Laurent Moutinot, Government of Canton Geneva

"Regulation is now an international business, even where markets are domestic. We must put our efforts into achieving a proportionate result within Europe. This CIFA Forum is an excellent example of how you can bring common strength to the goal of regulation in a proportional fashion."
Paul Rich, Sector Manager, Retail Intermediaries, Financial Services Authority (FSA), London

"The current situation of financial regulation looks more and more like a regulatory 'jungle', where different bodies – national, European and international – are playing in what seems to be a 'market' for regulatory activities, with competition between regulators and attempts by some of them to monopolize the 'market'. This situation makes it difficult for the industry to know where to lobby for its interests to achieve effective results. It becomes even difficult for academics to follow, as new regulation is issued every other day."
Prof. Michel Tison, Financial Law Institute, University of Ghent

"It is quite extraordinary to have the regulator willingly sitting at a table with the industry to discuss the necessary objectives to achieve in the country. This willingness to dialogue is a fair political sign towards the market."
Prof. Jean-Baptiste Zufferey, University of Fribourg, Deputy Chairman of the Swiss Federal Banking Commission (FBC), Member of the Advisory Board of the CIFA

"We need to bring regulation back up to principles. A professional industry like ours must be able to use its judgement, it must be allowed to shape itself according to the requirements of its customers. The ones who behave wrongly must be punished, but without constraining the whole industry from top to toe."
Angela Knight, Chief Executive, Association of Private Client Investment Managers and Stockbrokers (APCIMS), London

"I think business should be proactive if it wants to be successful in its plea against overregulation. (…) Collective action is needed for the industry to take proactive actions, and this is where an organization like CIFA can play an important role."
Mats Isaksson, Head of the Corporate Governance Division, OECD, Paris

"The trend towards centralized regulation in Europe is growing. National regulators feel more and more restricted in their ability to issue national regulations and have to ensure that they will be compliant with the EU standards in the future. Harmonization is already built into new national regulations."
Hubert Reynier, Managing Director, Regulation Policy and International Affairs Division, French Security Regulators (AMF), Paris

"Despite the professionalism of the majority, some irresponsible individual behaviours have lead to scandals that affected the whole industry, creating responses in the form of regulation. The way to avoid this regulation is to implement a sound corporate governance."
Raphaël Jaquet, Partner, KPMG Switzerland, Geneva

"There is much talk about the rising tide of regulation with which the market operators have to deal. In the case of our country, the problem seems to be even worse due to the Swiss tendency to implement rules and regulations overzealously. This concern is by no means imaginary, but I want to reassure you that the government is fully aware of it."
Ambassador Eric Martin, Swiss Federal Department of Foreign Affairs

"It is important to harmonize enforcement, rather than only rules, as is the tendency in Europe. When every country insists on its own rules, the general compromise is often to add more rules, which is not a good solution."
Günter Birnbaum, Executive Director, Securities Supervision, Federal Financial Supervisory Authority (BAFIN), Bonn

4th International CIFA Forum 15-16 March 2006 in Geneva

The 4th International Forum of the CIFA will take place on 15-16 March 2006 at the Hilton Palace Geneva on the theme of

Four promising roundtables are scheduled for the first day:

- **Organised crime, terrorism, money laundering, fiscal crimes: what are we really fighting? What is the role of financial intermediaries?** Moderator: Prof. Xavier Raufer, Director of Studies, Department of research on contemporary criminal threats, Université Panthéon-Assas Paris II

- **Legislation and regulation: what results? What real efficiency?** Moderator: to be confirmed

- **Which rules for which role?** Moderator: Angela Knight, Chief Executive, Association of Private Client Investment Managers and Stockbrokers, (APCIMS), London

- **Investors' freedom: is it legitimate to impose any limits?** Moderator: Thierry Michel, Member of Executive Committee of the CIFA

The morning of the second day will see the presentation of four growing markets:

- India
- The Czech Republic
- China
- South Africa

For the final debate on the theme of

Fighting greed: what means for what results?

CIFA has approached three outstanding personalities of worldwide reputation.

More to follow on **www.cifafound.ch**

Banks count the cost of the war against money laundering

- Spending up by 61 percent over the last three years
- Transaction monitoring and training main drivers of increased cost
- 67 percent of banks report increase in the volume of suspicions reported to law enforcement
- More needs to be done to ensure global fight against money launderers and terrorists is as joined up and effective as possible

Banks across the world are pumping more money into anti-money laundering (AML) systems and compliance than ever before, according to a global survey performed by KPMG in 2004. The study, compiled through interviews with senior compliance officers from 209 banks in 41 countries addressed issues regarding the impact of the recent rapid strengthening of laws and regulation to combat money laundering, and how they were coping with their increasing responsibilities as the gatekeepers of the financial system.

Of the 209 financial services institutions interviewed about their spending over the last three years, 83 percent said they have invested more in combating AML, on average by 61 percent. The trend is set to continue with most banks expecting spending to increase by over 40 percent over the next three years, demonstrating that much remains to be done to enhance anti-money laundering systems and controls. The main driver behind the past and projected increase in spend is transaction monitoring. Banks are steadily increasing the sophistication of their monitoring methodology with over 40 percent of respondents having already implemented externally developed automated monitoring software. While many banks continue to rely solely on staff vigilance and exception reports, many of these are planning to implement more sophisticated systems.

Training was the second biggest contributory factor to past and expected increased spend, with banks showing a strong preference for face-to-face training over computer-based training.

Anne van Heerden, Partner and Head of Forensic KPMG Switzerland, commente : "Increased regulation and fears over financing of terrorist groups has undoubtedly boosted investment in AML measures and the banks have rightly identified transaction monitoring and training as key areas for investment. Get both of these right and you build yourself a corporate radar system highly attuned to money laundering risk. This not only helps protect the bank from serious damage to its reputation, but also helps protect civil society against its many enemies."

Nearly two thirds of senior compliance officers interviewed across 41 countries said their bank had a global AML policy in place and that they are seeing greater scrutiny applied to their customer base, particularly when accepting new customers and monitoring accounts for suspicious activity more closely. Over 80 percent of banks said that they vary the amount of information they obtain from customers at account acceptance depending on the risk profile of the customer, but surprisingly only about half of these considered whether a customer was "politically exposed".

Two thirds of respondents indicated that they have generated a greater number of suspicious activity reports (SARs) over the last three years, due in large part to better systems for detection and reporting. In turn, this has created a challenge for national law enforcement agencies in deploying the resource necessary to process and act on the increased volume of reports.

The vast majority (84 percent) of banks found the increased burden of anti-money laundering regulation was acceptable. However, most of these believed the requirements could be more effective in combating money laundering in a number of different ways including improved communication with, and feedback from, law enforcement, and better harmonisation of requirements across the world.

Monitoring account transactions across territories was found by the report to be poorly joined up, with 46 percent of those operating in six to ten countries unable to monitor a single customer's transaction or account status across several different countries. A quarter of those operating in more than 10 countries could not do so.

The survey also showed that implementation of AML procedures is undertaken by many global banks at a local level, leaving organisations open to the risks of disparate standards of application, either through lack of expertise or appropriate oversight. 'Criminal Customers' can end up being taken on in a jurisdiction where standards are less robust than elsewhere, thereby gaining access to a global bank 'by the back door'.

Commenting on the findings, Brendan Nelson, Global Chairman of KPMG's Financial Services practice, said:
"The survey shows that Anti-Money Laundering is still very much "work in progress" within the banking industry, with plenty of work left to be done. It is nonetheless clear that banks are committed to playing their role in the war against money laundering and international terror, and also that they want their role to be effective. The challenge for policy makers and law enforcement is to engage more effectively with the industry, and give banks positive evidence that their efforts are leading to improved rates of detection and prevention of criminal and terrorist activity. We must not lose sight of the fact that this is about fighting criminality, not about box-ticking".

Other key findings from the report :

¸ Over 60 percent of banks saw anti-money laundering as a high profile issue at senior management level, 34 percent saw it as moderate profile, and only 5 percent considered it low profile. Banks in Latin America and Russia were particularly likely to consider it high profile (87 percent and 88 percent respectively), while only about half the banks in ASPAC and Africa thought it high profile.

¸ A large proportion of respondents have a formal program of independent testing of their AML systems, although western European banks scored poorest on this, with only 59 percent carrying out formal testing of the effectiveness of their AML systems and controls. This compares to 100 percent in the Middle East and 91 percent in North America.

¸ Increased spending was especially pronounced in North America where 29 percent reported increased spending of over 100 percent in the past three years. KPMG attributes this to the impact of the USA PATRIOT Act 2001, passed in the wake of September 11th.

Anne van Heerden, Partner,
Head of KPMG Forensic Switzerland

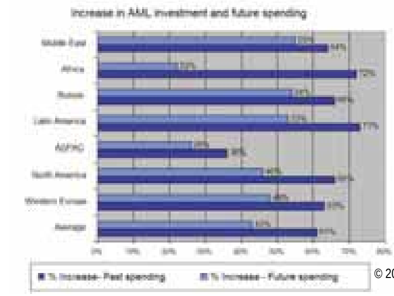
Clarissa Koeppen, Manager,
KPMG Forensic Switzerland

Anne van Heerden, Partner,
Head of KPMG Forensic
Switzerland

Clarissa Koeppen, Manager,
KPMG Forensic
Switzerland

AML costs: strong increase

- Spending up by 61 percent over the last three years
- Further increase of 43 percent over the coming three years expecte



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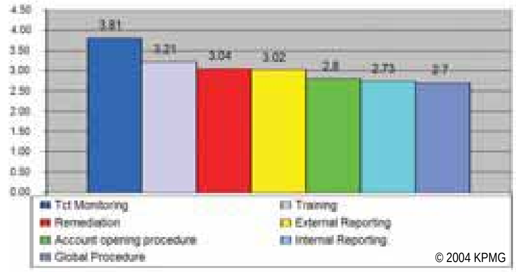
- AML costs not disclosed separately
- Banks find it difficult to estimate AML costs
- Origin of the increased costs to date
  ¸ Transaction monitoring
  ¸ Training
- Further increase in the costs for AML compliance is expected, but with lower growth rates than in the past

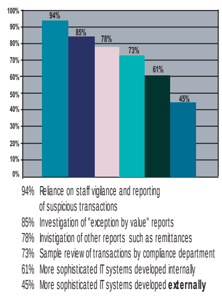
AML costs: Focus of future spending

- Focus on transaction monitoring: automation and improvement
- Training: more personalization ("face-to-face")



- Current transaction monitoring systems extended
- Monitoring of the entire customer relationship, rather than individual accounts only, across organiziational and jurisdictional boundaries
- More individual training instead of Computer-Based-Training

Transaction monitoring: Methods and potential for improvement



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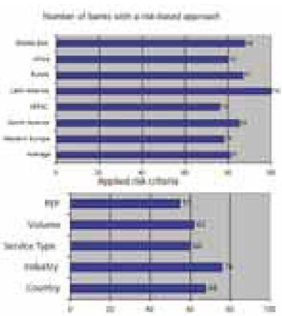
- Staff vigilance, amongst other measures, is applied by 94%; this explains the high importance of training
- About half the respondents apply electronic monitoring tools

Improvement potential:
- Better client and transaction profiling, linking the level of estimated activity to actual frequency and number of transactions
- Pattern recognition of transactions rather than identifying transactions in isolation
- Broadening of electronic systems and enhancing data quality
- Real time monitoring (Embargo filter)

KYC: Risk-based approach and risk criteria



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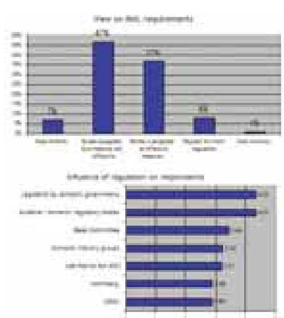
- 81% of respondents follow a risk-based approach when handling new customers.
- PEP risk factor has an amazing low acceptance (55%)
- Western Europe hast the lowest percentage (78%) regarding the risk-based approach, considering responses of Germany, Spain, and Ireland
- Apparent inconsistent rating of the risk-based approach in Western Europe. EU Third Money Laundering Directive wants "risk-sensitive" approach

Regulation: Burden and influence



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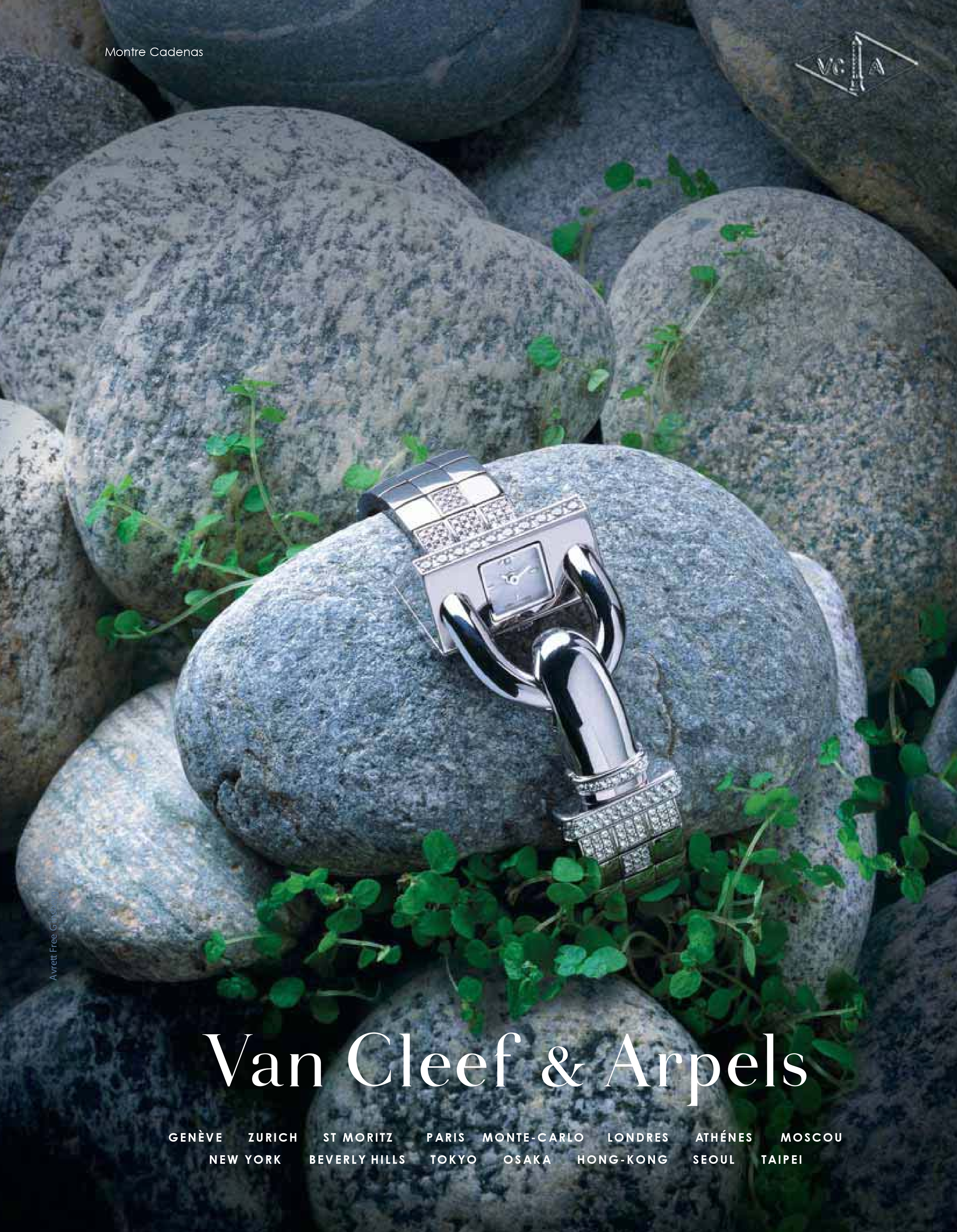
- Regulatory burden is generally accepted
- More effectiveness of regulation is frequently required
- Local laws and regulators have the greatest influence on banks, as expected
- In the USA, 70 % believe the requirements are acceptable but need improvement
- Western Europe mostly thought the burden acceptable, but the requirements needed to be significantly improved



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Managing conflicts of interest in multi-management

The increasing acceptance and rapid growth of multi-management in the UK and continental Europe is highlighting yet again the simmering issue of conflicts of interest. Conflicts in the investment industry have always existed and today are subject to intense scrutiny and control by both regulators and compliance officers.

To date the same level of scrutiny has not been practiced in the multi-management industry, which is vulnerable to two particular conflicts, a) where the multi-manager is owned in part or in total by a proprietary fund manager; and b) where the multi-manager is part of, or is associated with, an asset consultant.

In the first case the danger is that the multi-manager is implicitely incentivised to use the products of the in-house proprietary manager ahead of those of third party competitors, and is possibly less likely to dispense with those services than those of third parties. The danger can, of course, be eliminated by precluding the use of the in-house managers but this removes potentially attractive products from the universe of opportunities and weakens the multi-manager's offering ccompared with competitors.

In the second case, the roles are reversed. Here the asset consultant might be tempted to recommend the services of the associated multi-manager ahead of others whose product offering is equally suitable for the needs of the client. This particular conflict is common in the industry because many asset consultants have sought to supplement their income and utilise their existing manager research resource by launching multi-manager products. The consultants, operating in an industry characterised in the Myner Report as a 'small low-profitability market' have countered the threat of multi-management by turning it into an opportunity and have in turn become major participants in the multi-management industry. Rather than letting the opportunity slip from their grasp, they have attempted to exploit it to the full. In so doing they have created the potential for impartiality.

The widespread recognition of the problem – or, at the very least, recognition that there is a perception of a conflict – has lead some asset consultants to disengage completely from their multi-management arm. Others, to a greater or lesser extent, continue to work with their multi-manager partners. In order to preserve their integrity and credibility of industry participants and to ensure that best advice is not only given but is seen to be given, complete transparency of decision taking is vital.

> ***"Trustees should ensure a proper process in selecting service providers which must include due consideration of cross-ownership."***

Pension trustees should ensure a proper process in selecting service providers which must include due consideration of cross-owwnership. At the very least the contractual arrangements should encompass full declaration of potential conflicts, together with any fees or commissions that arise, and written justification of recommendations and actions where conflicts might occur to ensure complete protection, a principle of separation of all service providers should be applied. The key questions which trustees should surely ask – and which multi-managers and asset consultants should therefore ask of themselves – are "is my multi-manager more or less likely to use the products of a particular asset manager if that manager is part of the same firm?" and "would my consultant advise that its own multi-management arm should bee fired – or would it delay?"

Glyn Owen
Head of MultiManagers
RMB International

(This article also appeared in Global Pensions, London)

Switzerland will have to change its tax system under the pressure of the EU

Dr. Roger M. Cadosch is attorney at law in Berne. He specializes in tax matters and has just published a ground breaking study entitled "The influence on Swiss tax law of the Swiss-EC agreement on the free movement of persons" (Staempfli, Berne).

Dr. Roger M. Cadosch

He argues that the bilateral Agreement on the free movement of persons has far reaching implications on Swiss tax law, which have largely been overlooked yet. The agreements were signed on 21 June 1999 and entered into force on 1 June 2002, after all Contracting Parties had ratified them. By ratifying the Agreement on the free circulation of persons, Switzerland gradually guarantees the free circulation of persons as it is already existing within the EU. The seven agreements are administered by Joint Committees, which take care of the proper implementation into national law and issue recommendations.

An interview with Dr. Roger M. Cadosch

Mohammad Farrokh: In your book you don't hesitate to contradict the Federal Council which, in its June 1999 Message on the Bilateral Agreements with the EC, argues that the free circulation of persons has no implications as far as Swiss tax law is concerned. How did you come to the conclusion that the latter has to be amended?

I have had the opportunity to undertake a thorough study of European law at the University of Leiden in The Netherlands. Going through the "acquis communautaire" and reviewing the cases of the European Court of Justice (ECJ), I have come to the realization that the principle of non-discrimination is very much the cornerstone of European law. Looking now at the Agreement itself, it is clearly stated at article 16 that Switzerland has to refer to Community law and practice, therefore integrating the non-discrimination principle. As it has been drafted before the Agreement with the EC however, Swiss tax law is based on a sovereignty which the country has partly accepted to renounce. The law has last been amended in 1990, with the enactement of the Federal Taxation Act which has entered into force in 1995.

Actually, article 16 of the bilateral Agreement on the free circulation of persons is somewhat ambiguous. It says that, in implementing the Agreement, due reference should be made to the relevant ECJ case law. What do you make of this provision?

Indeed there are various possible interpretations, as you have seen reading my book. But one has to take into consideration new developments having taking place since the date of signature. In this respect, one has to take note of the fact that EFTA Court has departed from the restrictive approach which was previously deemed applicable to the Agreement. Therefore, Switzerland also has to follow the evolution of the ECJ on free circulation cases.

But ECJ is not competent to act in Swiss matters. If a European citizen feels discriminated against by Switzerland, he has to go to the Swiss Federal Tribunal (SFT). Is there any relevant decision by the SFT which would actually set a trend in tax matters?

There has so far been no such case as far as tax matters are concerned. But there have been some cases based on the non-discrimination principle as applicable to the free circulation of persons. Actually, the Federal tribunal has decided on three such instances in 2003 and new cases have arisen ever since. What is relevant in this context, is that the interpretation I give of article 16 has been upheld by the Court, which has also been giving due consideration to ECJ case law rendered after 1999. This underlines a dynamic attitude when it comes to interpreting the Agreement.

In your book you present an extensive overview of ECJ decisions, concentrating on case law prior to 1999. In this context, the 1995 Schumacker case undoubtedly represents a landmark. What should be made of it from a Swiss point of view, especially since it is relevant to the situation of frontier workers who now number not far from 200'000 people commuting to Switzerland, most of them on a daily basis?

Schumacker was a Belgian working in Germany as a non-resident where he was being taxed at the source without being given the benefit of the tax allowances he was entitled to. He successfully sought relief with the ECJ whose ruling has prompted the German tax authorities to grant frontier workers the same deductions as those considered acceptable for residents. The Schumacker principle is accepted by the Swiss tax authorities. On the top level of Federal tax administration, the principle is recognized, but the implementation is left at the discretion of cantonal tax authorities. While assessing taxpayers, these do not check automatically if social deductions are applicable. But Switzerland should in fact go one step further and amend its law in order to fully comply with the ECJ in the ruling rendered in the Biehl cases.

Is there a difference in the way source taxation is applicable to frontier workers on the one hand, resident aliens on an annual "B" permit on the other?

Source taxation follows the sames procedures for all the taxpayers concerned, whether living in Switzerland on a limited residence permit or non-resident, that is frontier workers. There is one significant difference however: if a resident earns more than 120'000 Swiss francs the ordinary procedure becomes applicable on a retrospective basis. In practice, it means that he is still being taxed at the source on his salary but subsequently receives a tax return to enable the authority to make a full assessment with all the allowances involved.

Many Swiss taxpayers would regard it as a favor not having to fill a tax return. Furthermore, an assessment may end in allowances being granted but also in new taxable income or wealth being uncovered. By the way, the 120'000 Swiss franc limit is being put at 500'000 francs in Geneva whithout raising protest from the people concerned who seem on the contrary to appreciate being taxed at the source…

Some expenses can be considered only on the basis of tax return, e.g. alimony payments, interests on private debts, expenses for further education. These deductions are denied to foreigners residing in Switzerland on an annual permit. A the moment, they are being taxed more than they should and the same applies to frontier workers. It may be true that some people are contented with not having to be assessed by the tax authorities. But something else is at issue here, i.e. tax evasion.

Tax evasion may sometimes be legal. I am referring to lump sum taxation as it is granted to wealthy foreigners who may live in Switzerland without being assessed on their worldwide income. As far as I know, this status is specific to Switzerland, or am I mistaken?

The UK has a special regime known as taxation on a remittance basis. It is applicable to people having a residence in the UK without it being considered a domicile. They are therefore taxed on the amount being transferred to a British bank account. But elsewhere in the EU, lump sum taxation is unknown. The Swiss exception however does not detract from what I said on Swiss source taxation being contrary to the EU non-discrimination principle. This is because you have to keep in mind that people on a lump sum taxation or "Pauschalbesteuerung" (in French "forfait fiscal") are not allowed to work in Switzerland. Thus, even if the system is to be subsequently made to change, lump sum taxation would remain unaffected.

Is this to say that lump sum taxation may not be regarded as a practice discriminating against Swiss taxpayers?

What Switzerland is actually doing in this respect may be termed reverse discrimination. Now, the ECJ has not released an opinion on such a case. What the EU prohibits is discrimination against nationals of one member State working in another. In other words, it takes a cross-border situation for the ECJ rulings against non-discrimination to be relevant. In the longer run, however, I do not exclude a development which would rule out reverse discrimination as it is exemplified in Swiss lump sum taxation. Indeed, the ECJ has already demonstrated a capability to go very far, issuing unexpected decisions in contentious cases.

Isn't Swiss practice in this respect being looked at askance by neighboring EU countries?

For the EU or OECD, putting lump sum taxation on a black list would also be an option, probably an easier way than an ECJ ruling. At this stage, this is not on the agenda, as the issue of domiciliary companies has on the contrary been settled in a sense favorable to Swiss interests. Coming to the attitude of neighboring countries, e.g. France and Germany, it must be said that they do not recognize Swiss lump sum taxation when applied to their nationals. As a result, these tend to avoid residing in their home countries if they want to benefit from a tax haven in Switzerland.

In the end, then, those with lump sum taxation have it their way…

Yes, but it does not mean that everybody is happy. I have a client for instance who considers moving from Geneva to another canton, possibly Vaud or Berne, because he is not contented with his lump sum taxation. He believes that the amount exacted from him is too high.

Are you not, as the saying goes, rocking the boat? No author has been going as far as you did in your book, questioning so to speak the entire Swiss fiscal policy?

When the bilateral Agreement on the free circulation of persons was signed, some scholars raised to suggest that Switzerland should change its fiscal policy, but they did not elaborate. Subsequently, a few articles have been published to question some specific aspect of Swiss tax policy, but nobody is proposing to undertake a comprehensive tax reform.

In your book, you do review the options available as far as amending Swiss tax law is concerned. Which one do you favor?

I have considered a few possibilities and I am convinced that a generalized withholding tax procedure, as it exists for instance in Germany, is the best possible option. Since taxation at the source cannot take every situation into consideration, it would have to be supplemented by an assessment made on the basis of a return which the taxpayer receives, as a rule, at the beginning of the following year.

Building a real co-regulation

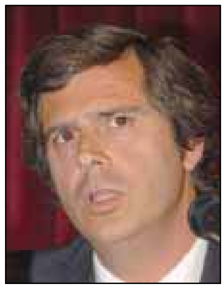

Francisco Alvarez


Pierre Christodoulidis


Vincent J. Derudder


Mea Hiskes-Willemse


Claude-Alain Margelisch


Alberto Romagosa


Richard Stevens

One of the highlights of the 3rd International Forum of the CIFA was certainly the roundtable on co-regulation. Extracts:

"This panel is dedicated to practical issues about co-regulation, with representatives of various industry associations at the table," announced **Pierre Christodoulidis**, Executive President of CIFA, co-moderator of this discussion. "Two main themes will be addressed: what is the best approach to regulation: co-regulation or State regulation? And which are the success criteria of co-regulation models and their comparative advantages?"

Turning first to **Mea Hiskes-Willemse,** Secretary General of the Dutch Association of Asset Managers, Pierre Christodoulidis asked her if she thought that her association's consultations with the regulator were really useful, or only an alibi?

"I think the first question to answer is: what is consultation?" she answered. "To talk about co-regulation, one first has to clear what is understood by this concept. Co-regulation is not just information, and this is the first issue that has to be discussed with the regulator," Mrs Hiskes-Willemse said. "As a regulator, if you only inform the market, you miss the point of getting information from the market, which allows for better regulation. Good regulation is effective and efficient regulation. Effective in the sense that it doesn't go into too many details and that it concerns only whom it should concern, with an eye on the practical side of entrepreneurship. Efficient, because very often the regulator is financed by the industry. Rather than hiring ex-employees from the industry to get 'market information', like he does in Holland, the regulator ought to hear what the market and its players are actually saying – something the regulator doesn't really do. I am trying to educate the regulator in this regard, that's my job," she said.

Sectorial approach

Regarding the relationship with the regulator, the moderator asked **Claude-Alain Margelisch,** Deputy CEO of the Swiss Bankers Association, about his views on the best approach, and whether a differentiation between the various classes of financial intermediaries was necessary. "The Swiss Bankers Association has a long tradition of self-regulation of over 20 years," said Mr Margelisch, "and enjoys good collaboration with the regulatory authorities." He also noted that, at the level of international organizations like the OECD or the Basle Committee on Banking Supervision, a genuine consultation with the industry was gaining ground. For Mr Margelisch, it is absolutely clear that a differentiated approach by categories of financial intermediaries has great advantages, with different associations representing the particular interests of their members. The only issue can be one of transparency. "If you have so many organizations responsible for the implementation of self-regulation, you must have an absolute transparency between the different organizations," he said. Adding that, for the customers, it was fundamental to have a clear distinction between supervisory authorities on the one hand, and the self-regulation organizations on the other hand.

"Switzerland is particular in the sense that it is a very international platform," said Mr Christodoulidis, whereas in the other European countries, the issues related to regulation are more of domestic nature. The experience of Spain's professional associations with their national regulator is revealing in this respect.

The Spanish experience

"The large banks in Spain are regulated by the law on financial markets," explained **Alberto Romagosa,** President of AIF, one of the two major associations of financial intermediaries in Spain. "This law was very disappointing for our profession, as it didn't regulate investment advice at all: it regulated the brokers, the portfolio managers, the fund managers, but didn't say anything about us." The financial advisors in Spain are organized in different professional associations. To this day, the profession is living in a self-regulated environment, unrecognized by the government since it is not in the Spanish law. The new European directives brought a big change to this situation, said Mr

"The large banks in Spain are regulated by the law on financial markets"

Romagosa. Investment advice, which was, and still is, seen as an accessory activity of the financial market in the Spanish law, isn't an exclusive activity of the financial firms anymore. The Spanish government now has to adapt the current Spanish law to include the investment advisors as a special activity. "This puts us in a complicated situation, as we all of a sudden have to be part of the game," he added. In Spain, the two main associations joined forces to discuss with the Spanish authorities how to implement these new European directives in order to protect their profession. "Otherwise the authorities might regulate without hearing us." Mr Romagosa concluded.

Starting from scratch in Cyprus

In Cyprus, a more international financial platform than many national markets in Europe, the national associations of financial services had also to actively participate in the new structuring of the market, through a dialogue with the regulators, explained **Richard Stevens,** Member of the Board of CIFSA. "For many years, Cyprus was under an exchange control regime. So the domestic financial service market was very little, with a very small capital stock exchange." CIFSA, the international financial services association in Cyprus, was set up by firms based in the island, under the Central Bank's approval, to operate financial services outside of Cyprus, or to offer financial services to residents who were exempt from exchange control regulation. "When Cyprus was going through the procedure to join the EU, the authorities needed some sort of financial services act. Which they brought in, by and large, under the terms and conditions of the EU directives of 004," explained Mr Stevens. Unfortunately, a lot of the firms that were members of CIFSA fell outside of that act, he said. "We were advisors, not investment firms. So we are still in negotiation with the SEC (Securities Exchange Commission) over the drafting and implementation of a bill that specifically covers IFAs." Since Cyprus doesn't have a domestic market for IFAs, the CIFSA is hoping that its input will actually guide the authorities for the definition of the responsibilities of independent financial advisors. "We have been very much involved in discussions with the SEC," said Mr. Stevens, "because we were in the awkward situation of being outside the law. We are still under the regulation of the Central Bank, but we will probably come under the regulation of the SEC by the end of this year. We have been able to put a lot of input into the process because it is a new law, and Cyprus is nearly starting with a clear sheet. So we are hopefully writing the right words on this sheet."

The role of the Trade Assocation

With the variety of regulatory bodies, organizations and programs in place (OECD, CESR, MIFID), one can wonder to which point the professional associations can actually participate in the regulatory processes, and what could be their role in coordinating the multiple layers of new codes, regulations and norms.

For **Mr Margelisch**, the role of an association like the Swiss Bankers Association is crucial in this area. "We are the relay between our members and the authorities," he said. In this context, the association is at the centre of the regulation process. "We saw with time that it is no use trying to implement a regulation that the market players cannot apply."

Is co-regulation the best way to overcome the difficulties of regulating a profession as diverse as the independent financial intermediaries? Yes, thinks **Alberto Romagosa**. It is the best way for the regulator to understand the needs of the financial advisors and their clients. "This co-regulation should include the consumer associations and all parts of the industry. Since we all speak different languages, or see things from different levels, co-regulation is the only way to get a harmonized solution. At least today. With the evolution of time, we may see other solutions emerge."

Success criteria of co-regulation

"It's about time to stop complaining, and start making proposals," said **Vincent J. Derudder,** Secretary General of FECIF and co-moderator of the roundtable, quoting the CIFA Forum's introductory speech delivered by Jean-Pierre Diserens. "Complaining about regulation will not make things better," he said. "Co-regulation is an answer, or at least a valuable suggestion. At FECIF, we would very much like to propose it to the EU Commission. The Commission is actually very much aware of the difficulties involved with the implementation of the various directives, and the transposition of these directives into national laws. In a report on investment services issued in July 2004, it concluded on the need to have the industry more involved in the regulation process."

So far, the consultations remained unsatisfactory, he said. "If in the end the decisions remain in the hands of bureaucrats, co-regulation misses the point," said Mr Derudder. "But, for the first time, I've heard today from representatives of regulatory bodies that they were not opposed to a closer cooperation – they didn't use the world co-regulation – with representatives of the industry. This is a very positive move, and it shows that they realize there is a serious problem in implementing the various directives and rules that are in the pipeline."

Co-regulation VS self-regulation

But co-regulation is also a new concept for the industry and the experts. "So far the talk was about self-regulation, not co-regulation. We at FECIF believe there is a problem with self-regulation. A lot of politicians don't like the concept, which they too often see as self-protection. Co-regulation overcomes this issue by advocating a form of co-management of the regulatory obligations."

Commenting on the value of co-regulation versus self-regulation, Mr Margelisch said: "I would say that in Switzerland self-regulation is co-regulation. In the high-level discussions we have three times a year with the regulator, we commonly decide what has to be done by the supervisory authority in terms of regulation and by our association in terms of implementation. Coordination is essential regarding these two aspects, and has worked well for us in the banking industry. We have made great progress that way in the last five years, and we could very efficiently combat the problem of over-regulation."

Praising the long democratic tradition of Switzerland, Mr Derudder said that other countries had historically more centralized approaches to regulation. He asked **Francisco Alvarez**, Vice-president of ANAF in Madrid, if he thought co-regulation could work in Spain. Mr Alvarez replied that the authorities had reacted positively to the initiatives of the Spanish associations in this respect. "Spain has absolutely no tradition of consultation. But for the first time, we didn't wait for the mountain to come to us, we went to the mountain," said Mr Alvarez. In a proactive manner, the Spanish associations, once divided, joined forces to draft a document that clarified and defined the activity and requirements of independent financial advisors, and presented it to the regulatory authorities. "We didn't wait for consultation, we went asking for it and obtained it, said Mr Alvarez. It appears that the regulator was somehow waiting for us. To the general surprise, the national securities commission was very happy about our initiative, because they realized that we are actually going to solve a problem for them. Handling the independent financial advisory sector is a huge task. By providing them with a clear definition of our industry, and precisely formulating what we want, we are making it easier for them to put some order in our profession." In Spain today, anybody can be a financial advisor, and no one controls anything, said Mr Alvarez. "So we saw it as our responsibility to start putting some order in our profession, to regulate ourselves first before going to see the regulator. We should stop complaining about regulation and start acting."

"When Cyprus was going through the procedure to join the EU, the authorities needed some sort of financial services act".

PInterested in how this discussion continued, and in questions from the audience? Get the full text on www.cifafound.ch under "Magazine"

Should we blame the hedge funds?

The financial slump following the internet crash has increased the interest for alternative investments as traditional investments were mostly unprofitable. Hedge Funds took the lion share of this trend and democratized themselves. As a result they generated much more interest in the general public and, therefore, are under the scrutiny of the financial and economic press. As they are still lacking transparency and liquidity in comparison to other investment vehicles, they are easily the target of complaints. The increase in criticism stems from different sources: investors, regulatory authorities, politicians, and managers of other fund classes...

Are they justified and, if this is the case, what is the solution?

The most important source of discontentment comes from investors themselves, although it might seem paradoxical as they are investing more money in this type of asset than ever. There is a wide range of reasons for their recent discontentment.

First, the homogenization of hedge funds as a mass product in the past years has inflated the size of funds under management, leaving them with less flexibility, since more money is chasing the same opportunities. In addition, a wider number of fund managers diminishes the capacity to generate good results, since more managers are competing against each other with similar investments. During the first half of 2005 the total return of the majority of hedge funds tended to be lower than 4% and there was a large volatility between the performance of those funds. By definition, this means that performance is not homogeneous. Many a manager have only been able to generate a negative alpha (a measurement of the value-added, or subtracted if negative, by a fund's manager). An aggravating factor in hedge fund performance reporting is the fact that hedge funds communicate performance statistics on a voluntary basis, hence creating a possible upward bias in the overall statistics for the sector as some of them might not be so inclined to divulge return results during any particular period of bad performance.

A short sighted solution that is already seen to be occurring is to improve performance by having the hedge funds managers change the way they invest. Some investors, at least in the smallest funds, are pressuring their fund managers to take even more risk to compensate for the reduced profitability. When the fund managers bend to this pressure the result is a loss of hedging as a protective tool and a multiplication of profit or losses. But risk taking is not to be confused with trying to find original opportunities. Most of the risk taken is similar among managers as many follow the same investment opportunities presented in the market.

In order to find a more appropriate solution, it would be better to try to identify the factors that can explain this diminution in hedge funds returns. There is a wide variety of them:

One of the great advantage of hedge funds in the past has been the ability to operate free of regulatory supervision. This implied that there were no limitations to their activity other than their capacity to exploit market inefficiencies. Recently, this freedom has been reduced and regulations currently taking effect are certainly raising, directly or indirectly, fund's operating costs. In the United States, estimates of the minimum registration costs range from $20,000 to $35,000. The cost of a compliance officer has to be added to this figure. As a result, these additional costs will negatively impact fund per-

One of the great advantage of hedge funds in the past has been the ability to operate free of regulatory supervision.

formance. But, as these regulations remain relatively light compared to traditional investments, the increase in costs is far from justifying the fall in total returns over the past years. The reason is then to be found elsewhere.

Many are asking themselves about the possibility that the main threat to hedge funds has been their own success, resulting in a lack of sufficient market inefficiencies to generate extra returns for so much new money.

The increase in money flow into hedge funds has not led to a similar increase in the number of competent managers. There are too few talented managers available to manage the increase in the number of funds that have sprung to the market over the past years. According to the Centre for Economics and Business Research, this should lead to a drastic reduction of approximately 1600 hedge funds in the years to come. They conclude that this issue will be managed by the market itself. In support of this market evolution theory is that many investors in hedge funds are advancing on the learning curve, and will invest their money in only the best performing managers.

According to a survey by the French business school EDHEC, the so-called “capacity effect” is not seen as a major threat to future profitability by the 183 industry players interviewed between May 31st and July 8th, 2005. The wide majority think that the market will maintain a double digit growth rate and that the recent downturn in return was due entirely to cyclical factors. But they admit that capacity is hindering arbitrage opportunities. The results are therefore quite contradictory and show that there is a lot of wishful thinking still in the market.

For many institutional investors, hedge funds were just the panacea when the market was going down after the internet crash. The role of hedge funds was for many of them quite unclear and they expected both high return and a protection against contrary market conditions. This is far from the reality as the diversity of hedge funds strategies offer the possibility either to be conservative or to aggressively take risks. They are in many cases supporting the fact that the quality of the hedge fund manager is crucial for its performance. Here again, size is an issue as most high quality hedge fund managers are refusing new investor money as they already have too much of it.

A question that some investors raise is if hedge funds are not more interesting for brokers and markets than for the investors themselves. Hedge funds are now representing close to half the daily equity volume traded on the NYSE and the London Stock Exchange, and already 80% of high yield bonds! This has clearly been the growth area for the global brokers. Taking into consideration that these products are such an important source of income for most the traditional capital market intermediaries, and that hedge fund manager is one of the few professions that has so high a remuneration that in a few years one can become multimillionaire, it is easy to wonder if the whole profession has not been biased into overselling the advantages of hedge funds as a whole.

Supervisory authorities have never been at ease with hedge funds. They were, until recently, a fully unregulated niche in the investment spectrum and regulators had little say about it as it only concerned qualified (i.e., very wealthy) investors or off-shore money. The willingness of all the participants (managers, investors and distributors of financial products) to broaden the scope of potential investors has given back a say to the supervisory authorities as hedge funds start to become onshore and distributed to more mainstream investors. The authorities now face two challenges: investor protection and systemic market risk reduction.

Most countries are taking steps to protect their investors from the excesses of such an unregulated segment of the market. For the past years most European countries have set up a regulatory framework defining what is possible to offer as alternative investments to resident investors. As of February 2006, all US-based hedge funds with more than $25 million under management will be required to be registered with the SEC and, since June, the NASD has been revising the sales practices of US brokers to non-qualified investors. The NASD is checking if the brokers clearly informed investors of the risks related to hedge fund investing and how the sales process transpired. But the regulatory momentum is probably about to decline.

There is probably a lack of political willingness or understanding to deal with this issue.

The former SEC Chairman William Donaldson resigned in June and the proposed Bush nominee of Christopher Cox might change the trend: As a Californian Congressman, he demonstrated himself to be a traditional "pro-business" lawmaker who tends to oppose regulation.

After the 1999 crisis and bailout of the Long-Term Capital Management Hedge Fund, it became clear that hedge funds generate a new factor in the systemic risk embedded in financial market activity. Most of these funds are heavily leveraged to realize the expected returns and this leverage is offered by banks that often overlook the real risk behind lending to these financial vehicles. The complexity of the issue is such that on the two sides of the Atlantic there is a deep on-going reflection. In New York, Gerry Corrigan, Managing Director at Goldman Sachs and former Federal Reserve Bank of New York President, leads the Counterparty Risk Management Committee who not only organized meetings for international supervisory authorities to discuss the matter but also issued a second report to drastically improve back office controls to manage the growth in credit derivatives and similar instruments and to avoid backlogs of unsettled trades. The European Commission is also studying this issue and has included it in its on-going study of the asset management sector. Even if there is some concern and some analysis is on-going, the only answers have been the ones given in parallel by both the FSA and the Bank for International Settlements. The first one published a discussion paper on this issue claiming that there was no need for intervention as the risks are not sufficiently material and the second one included in its 75th yearly report that the improvement in counterpart risk management has resulted in a lower leverage of hedge funds than in 1998. Yet no conclusive response to this issue was forthcoming, which is certainly worrying. There is probably a lack of political willingness or understanding to deal with this issue

On the other hand, some politicians are also becoming more negative about hedge funds as they tend to think that the "pure financial logic" of these funds contrasts too much with the political and/or social systems that they want to promote. The most famous case has been the recent upsurge of a big part of the German political class against their practices. This lead Chancellor Schroeder to propose tighter controls over hedge funds activities, particularly over what he calls "stripping of assets". The proposal has already been refused by the USA and the United Kingdom at the recent G8 meeting held in Scotland. Even though it seems improbable that these controls will become law in the future, this proposition of regulation at this level of government raises the question of the positive macro-economic effects of raids (asset-stripping) that lead to the dismantling of big corporations.

One of the less important criticisms is the one raised by managers of other asset classes that feel a competitive pressure from hedge funds. This is specifically the case for private equity. The lack of interesting opportunities generated by pure market inefficiencies has lead some hedge fund managers to believe that they could do as well or even better than the LBO fund managers in the private equity sector. As hedge funds tend to manage more money, they often have the capacity to outbid the LBO funds for available deals. This would normally not be a problem if it weren't for the fact that blindly overbidding ultimately alters the valuations and squeezes the margins at which LBO deals can be profitably carried out, This clearly presents a threat for LBO deals as the increase in entry prices puts under question the possibility to exit with a sufficient profit.

Hedge funds lost their status as a diversification tool for institutional investors and very high net worth individuals in order to become accessible to most financial investors. As a consequence, their increase in size, which gained 150% in the past 6 years breaking the USD 1 trillion ceiling according to Hedge Fund Research (The Economist), their acts have become more visible to regulators and the press. This lead to new criticisms from investors as the hedge funds profitability fell. Clearly the market has currently a certain overhang due to the money poured in the segment resulting in the creation of so many hedge funds and too few talented managers. The democratization of hedge funds is certainly more than a fad, but as the market has to digest most of the money, the buy side has to finish defining the way it invests in this type of tool. This will, in the medium run, drive out of the market the underperforming funds and should stabilize the overall money committed to hedge funds.

François-Eric Perquel
3CF – Consultants in Finance
Managing Partner

Is the real estate landscape in for a landslide?

It seems that virtually everywhere, real estate prices are on the rise. Just how long is this trend going to last? Whether the industry crashes or explodes, one thing is certain – the landing is going to be a bumpy one for economies.

The speculative bubble threatens to explode. Today, real estate prices are soaring through the roof just about everywhere and the trend is threatening the global economy. The increase by two or, in some cases, three figures in real estate prices has been hitting a number of countries over the last 10 years – from Spain to Great Britain, the United States to Australia, and the Netherlands to France. The price per square metre is just taking off and is likely to reach and even surpass the record highs of 1991. In Paris, it has already reached between 6,000 and 7,000 euros per square metre. In New York, a measly 2 room flat rents for between 2,300 and 2,500 dollars per month. In Madrid, the price of houses is skyrocketing at a whopping 20% per year. In Shanghai, it has doubled since 2000. Most onlookers are wondering just how long this is going to last. There are, however, two exceptions to this strangely homogenous phenomenon, notes the daily French paper *Libération.* It notes that Germany and Japan, which, excepting certain expensive districts in Tokyo, have not yet recovered from the crisis that followed the 1991 crash. According to the magazine the Economist which, the first last June, raised the alarm about this troubling trend – "the global growth in real estate prices is the largest in history."

Bonds yielding meagre profits

Responsable for real estate investments at Lombard Odier Darier Hentsch, LODH, in Geneva, Patrick Fournier easily sheds some light on this issue. "Returns from bonds are weak and thus, it is more interesting to invest in real estate," he explains. "In Switzerland, Real estate indirect investments yields 3,7% per year as opposed to less than 2% for the 10 year governement bond. In France, returns expected for 2006 is 4.4% for real estate and 3.5% for bonds." But there are also record low interest rates which encouraged buyers to borrow more money. After

The global growth in real estate prices is the largest in history.

the high-tech industry when belly up on the stock market, consumers who lost confidence in shares sought sanctuary in property. "The most convincing proof that real estate values are overvalued in most countries is the divergent relationship between rental and selling rates," writes the Economist. Just as the price of a share has to be representative of the dividends that its holder will receive, the price of a house must reflect the future profits its owner should gain, be it a matter of revenue from renting or money saved by renting. Beyond these considerations, there is the markets' famous "irrational exuberance" which is when one ceases to buy a good because of its profitability but rather, because one is convinced that its price will go up," finds Pierre Lazuly, a journalist at *Le Monde diplomatique* who runs a website that is exclusively

devoted to the speculative trend currently making ripples in the real estate sector.

An inevitable slump in prices

The Economist's calculations show that prices have reached record highs compared to rental incomes in the United States, Great Britain, France, Spain, the Netherlands, Ireland, and Belgium. This suggests that real estate is still more overvalued than in previous periods. The ratio between real estate prices and revenue is also at record levels in all nine of these countries. The British magazine concluded that a dip in prices is virtually inevitable for the ratios of these prices compared to salaries and rental to regain the average levels of the 1975 to 2003 period. In the next five years, it is highly probable that real estate prices will decline by 20% or more in many countries. According to the economic magazine, real estate prices should fall by 50% in Spain, by 25% in the United States and the Netherlands, and by 20% in Ireland for the ratios to return to their 75 to 2003 levels, "Alarmed by the stock market running dry, investors are placing a large portion of their liquidities in real estate assets, buying and selling property that at times has yet to even be built, thus maintaining high prices. Should the value of houses and apartments plummet with an equivalent increase in interest rates, property owners, even by reselling, will have a hard time paying off their loans."

The ratio between real estate prices and revenue is also at record levels in all nine of these countries.

Up to 40% less expensive

In the event of a real estate market crash, the past shows that prices usually nosedive by an average of 40%, with, of course, sharp fluctuations from one case to the next, writes Eric le Boucher in *Le Monde*. A crash of this sort would be disastrous for the economy; much worse than on the stock market. It carries the risk of a bank slipping and dragging everyone else down with

it. This systemic risk is high up on the global financial ladder. This is why banks keep a watchful eye on real estate prices like milk on a high fire. The bank of England has already raised its rates twice over in an effort to slow the raging fire in the housing industry. Consumers have spent more than they earn. A three room flat in Kensington is negotiated for a cost of around 700,000 pounds as opposed to 200,000 ten years earlier. The extraordinarily low interest rates have enabled consumers to extend their mortgages.

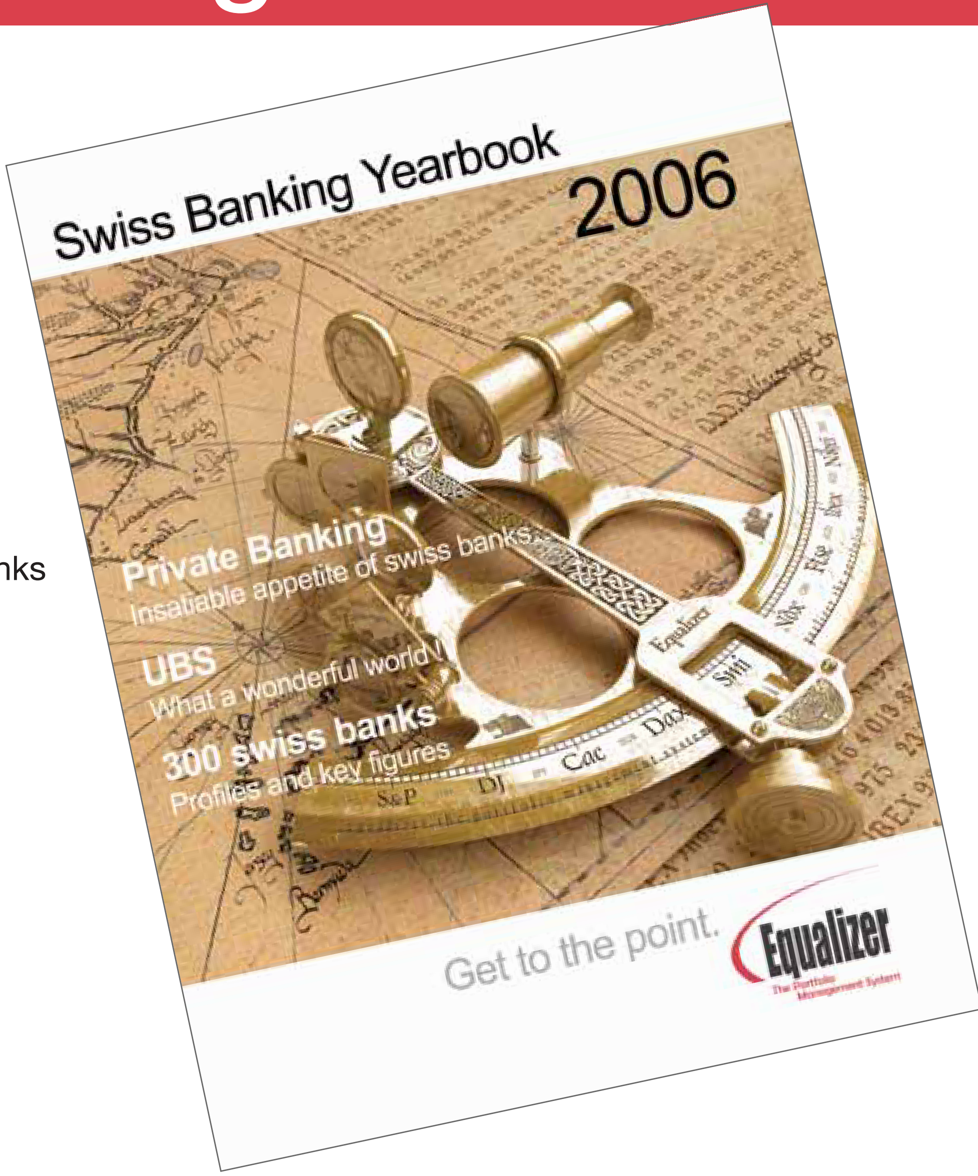
In America, economic growth is strong and consumers have guts of steel, feeding on the soaring real estate market which fattens their wallets through mortgage refinancing and bone dry savings accounts. After denying the existence of a real estate market blown beyond all imagination, American Federal Reserve chairman, Alan Greenspan, suddenly warned against the end of the real estate boom. "The real estate boom will inevitably settle down," he declared. "The level of real estate transactions currently at record highs will decline, prices rising more slowly or even falling. Mortgage refinancing will decrease and with it, expenditure on personal consumption. Estimates of the expanse of the process vary immensely." In reality, it could really do some damage.

Is recession hovering in the distance?

In the United States, homes have become veritable slot machines, as the Economist explains. Not only are first home buyers falling more heavily into debt than in the past. They are also taking advantage of the value of their assets to get even more cash for spending. For this reason, a real estate crash is much more dangerous than a stock market crash and is followed by a period of economic slump that is twice as long, resulting in recession. IMF experts have calculated that a plummet in real estate prices is much more damaging than on the stock market. According to them, as the French daily, *La Tribune,* outlines, a stock market crash, defined as a decrease of at least 30% costs the equivalent of 4% growth in two years. A real estate crash, defined as a decrease of at least 14% in prices, produces twice the amount of damage – 8 growth points lost! The recovery time is also a lot longer – four years instead of 18 months for a stock market crisis. According to the Economist, it is anything but coincidental that the only two countries where real estate prices have gone down in the last 10 years, Germany and Japan, both experienced the lowest growth in private consumption among all industrialised economies.

"The real estate boom was only made possible by the swell of debt which in turn has been encouraged by the extremely low interest rates maintained by the Fed," writes Jean-Louis Richard in the Genevan paper, *Le Temps*. Its official market rate remained at 1% for a year until June 2004. This rate is unusually low and should help to avoid deflation. According to Merril Lynch, this sector, which represents only

Swiss Banking Yearbook 2006



Private Banking
Insatiable appetite of swiss banks

UBS
What a wonderful word!

300 swiss banks
Profiles and key figures

Exclusive study S&P
Are the swiss funds managers more powerful than the others?

Giuseppe Melillo, a Swiss journalist who has received several awards for the quality of his reporting, and **Jaona Ravaloson,** a Parisian financial analyst specialized in the banking sector, have carried out a relevant overview of the Swiss financial center.

Leading article by **Marian Stepczynski.**

To order: www.swiss-banking-yearbook.com

5% of the United States economy, has been the source of half of the jobs created since 2001. It is, indeed, a global vehicle of employment, but not for much longer. Investors, who account for one of every 6 buyers in the States, will no longer be able to pull it off. They didn't hesitate to buy, even when the rent was inadequate to cover the mortgage. Every month, they sustain losses. They might then want to get rid of properties. What lies at the bottom of this situation? - The supply available for rent.

Are things going to slip gently or are we going to have a landslide instead?

Today, as *La Tribune* points out, "two scenarios are possible – a gradual and controlled fall in prices or a real estate landslide." In Great Britain, the interest rate rebound began as early as October of 2003 and the housing prices are beginning to stabilise. The result is that growth in consumption has been divided in three to 0.5 during the first quarter of 2005 notes Le Temps. "The price for housing in the United Kingdom experienced its most significant decrease in twelve and a half years between the months of March and May, the number of sellers continuing to grow before increasingly prudent buyers," observed the Reuters agency the 14th of last June. It went on to add that, "the May index is the lowest since November 1992 after the end of the 80s real estate boom.

"Economists demonstrate that real estate market crashes historically follow those of the stock market. Yet, there hasn't been a stock market crash in three years. So, doesn't that suggest that we're at the peak just before the avalanche?" asks Eric Le Boucher in *Le Monde*. "Central bankers are trapped. What can they do to get out? Lowering rates will only feed the growing market and make for an even more catastrophic crash in the long run. Raising them will bring the growth trend to a sudden halt, thus running the risk of a real estate market in crisis." For his part, Patrick Fournier sees no signs of a crash occurring as long as the demand remains higher than the supply. "European pension funds on average only devote 6.5% of their holdings to real estate.. At a rate of 10% it would be a 150 billion euro investment, more than enough to keep prices up." But in that case, will pension funds will also be the tape that will patch any holes currently threatening the real estate market after being jostled about on the stock market, investing significant sums in overvalued shares shortly before the high-tech securities crash.

Giuseppe Melillo

Interview

How far are we from the real estate market crash?

"We don't see a global house price bubble", **says Zoltan Szelyes, head of econometric modeling and global real estate analysis at Credit Suisse in Zurich**. E-mail interview.

Trusting: The real estate price hike is on a global scale. Why? Do central banks have a shared policy on interest rates? Are there other reasons?

Zoltan Szelyes: - There are several factors which contributed to the growth in global housing prices. Significant growth of real disposable incomes and demographic shifts for the age groups relevant for housing have taken place in the last ten years. These entailed a significantly higher demand for housing units. In addition to these long term tendencies, decreases in interest rates and bond yields brought about lower mortgage rates which made it more affordable to purchase houses. In some regions like the UK, weak building volumes also contributed to the high price increases.

Trusting: - Germany and Japan are exceptions to the current real estate rule? Why is this?

Z. S.: - One has to differentiate between the reasons the weak state of the housing sector in these countries. In Japan, the real estate market imploding the early nineties and the banking crisis brought about a longer period of deflation. Incomes were under pressure and so the demand for housing was weak. In Germany, there was an excess supply in the early nineties caused by government grants for construction especially in the Eastern part of that nation. In addition to this, a weak consumer sector with stagnant wages and gloomy expectations for the future were responsible for a sluggish demand for housing.

Trusting: - Are there measures that would help to avoid the start of a speculative wave in real estate? If so, why haven't they been taken?

Z. S : - With the exception of some local US markets, we don't see a global market bubble in real estate. As housing markets are influenced by local factors, it is very difficult for central banks to take the necessary steps to avoid the creation of local bubble markets because monetary policy has more influence on national tendencies. From a scientific standpoint, it is not easy to distinguish between a fundamental evolution and price rises due to speculative tendencies.

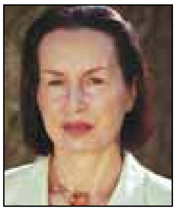
Trusting: - What is the influence of real estate investment funds in the current market surge?

Z. S.: - Real estate funds only invest to a minimal extent in the housing sector. Most of the investments are in the office or the retail sector. Prices for retail and office space have not yet exhibited such an enormous growth as housing prices. These two sectors are also driven by different fundamental factors than the housing sector.

Trusting: Are we heading towards a market crash, or deflation?

Z. S.: - We expect the house price growth to continue but globally we will experience higher national growth differences. In the US, we expect a lull in growth in real estate prices. While some US regions are at a higher risk, we rather expect a stabilisation on a national level than a decrease in prices. Nowadays, we are experiencing quite a different macroeconomic environment than during the last real estate market boom in the early nineties. At that time, monetary authorities had to increase interest rates due to high inflation. In the meantime, central banks made enormous advances in keeping inflation low, so the interest rate volatility also decreased significantly. In addition to this, the banking sector has a lower susceptibility to housing risk as a result of a more efficient banking system due to improved regulation (Basel II).

Amid global monetary convulsion, is the Euro a "reserve" currency?



Cosima F. Barone
Managing Partner of FINARC SA

A brief glance at history reveals that before the U.S. Dollar's reign as a "reserve" currency began in earnest in 1920, there have been five well defined cycles, each lasting roughly a century, when a "superpower of the world" imposed its supremacy over other countries: Portuguese (*1450-1530*), Spanish (*1530-1640*), Dutch (*1640-1720*), French (*1720-1815*) and British (*1815-1920*).

Gold standard systems were dominant in most of the 20th century. After the pre-1914 "classical" gold standard, during the 1920s reigned a new British-induced "gold-exchange standard" (*redemption only allowed in large and expensive bars of gold bullion*), which suddenly broke down in the 1920s and 1930s, leading to the tragic events of the 1930s, the collapse of the financial system and the "Great Depression".

Again in 1944, it became important to rely on a different form of gold standard, the Bretton Woods Agreement (*signed up by 45 nations on July 22, 1944 - the U.S. Dollar, then defined at 1/35 of a gold ounce, was effectively the only currency redeemable in large bars of gold bullion by foreign governments and central banks)*. Other world currencies were defined in terms of the U.S. Dollar, thus giving the USD its monetary "reserve" status still prevailing nowadays. This last gold standard eventually collapsed in August 15, 1971, when Richard Nixon (*then residing at the White House*), feeling how unbearable the pressure at the U.S. gold window by France (*Charles de Gaulle*) had become, abandoned the Bretton Woods gold-exchange standard. That way the last connection between the U.S. Dollar and gold was severed.

Fast forward to current times. No other currency other than the U.S. Dollar has the implicit characteristics of a central bank "reserve" currency. The U.S. do have the strongest world economy, with a relatively simple tax system and low tax rate for corporations and individuals, a light regulation system and a relatively hands-off governing power. Perhaps, thanks to having the best technology, the U.S. has proved throughout history to be flexible and more adaptable to events than Europe and Japan, for instance, while its demographics are in much better shape than for the rest of the world. Undoubtedly, the U.S. is, so far, the only defense superpower in the world.

> "To be rich is glorious"

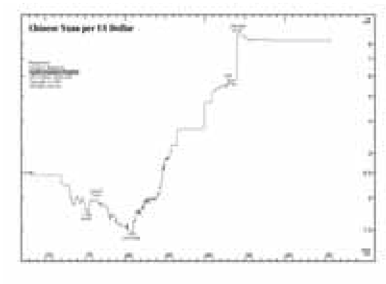
Modern day's central banking handling of foreign reserves show troublesome changes. In their intensive search for improved yields on reserve assets, central banks tend to move way out on the yield curve, as opposed to the customary short-term financing, some of them are moving down to the credit spectrum into corporate fixed-income securities, and few have even moved into equity investments. Thus, central banks are acting in the same manner as private sector investors and increasingly taking risks. Major changes are indeed unfolding in global central banking, deeply affecting the long standing principles and the very selection of foreign currencies to hold as "reserves"!

The robust growth that the Chinese economy is experiencing, in great part related to the extensive savings (*12 trillion Yuan, or U.S. $1.48 trillion, roughly 50% of income and 45% of GDP*) and to the influx of foreign direct investment (FDI) since 1992 inspired by Deng Xiaoping wind of more economic freedom and his famous words "to be rich is glorious" (*reforms began as early as in 1979*).

During the last decade, the Chinese Renminbi (*Yuan*) has been pegged to the U.S. Dollar at 8.276 Yuan. However, in recent times American politicians did cry foul and argued that China had to subject its "fiat" currency to market disciplines and floatation. On July 21, 2005, the People's Bank of China (*PBoC - Chinese central bank*) by implementing a "partial-float" (*more apparent than real*) of its currency (*Chinese Renminbi, i.e. "people's money", also called Yuan*), effectively China engineered a re-peg to the U.S. Dollar at a different level, just 2.1% higher (*at 8.11 instead of 8.28 Renminbi to the USD*), with the Chinese currency allowed to float within the same 0.3% band in force over the last decade and anchored it to the U.S. Dollar, the Euro, the Japanese Yen and the Korean Won.

At the end of March 2005, China was holding $223.5 billion of U.S. Treasuries (*$158 billion in March 2004 USD vs. $610 billion total reserves at the end of 2004*), representing roughly 31% of the nation's $711 billion current total central banking reserves (*$403 billion in 2003 - $212 billion in 2001 - $105 billion in 1996*).

Undoubtedly, the world is trying to "slowly" move away from a system in which one currency is the global standard. Would it be the ultimate effect of globalization?



The Fate Of The Euro

Routinely, around the most prestigious financial circles on planet "Earth", experts pound the table about the idea that the Japanese Yen, the European Euro, and recently the Chinese Renminbi, should be "established" as international reserve currencies and put in a position to challenge the long standing dominance of the U.S. Dollar. There are only two seasoned currencies, nowadays, having enough liquidity to be considered global currencies: the U.S. Dollar and the Japanese Yen. Undoubtedly, an aspiring third has been, since its advent in 1999 (*crisp bank-notes issued in 2002*), the European currency unit: the Euro.

According to a recent study by the U.S. National Bureau of Economic Research, about if and when the Euro could overtake the U.S. role as a reserve currency, a hypothetical Euro supremacy would take another 20 years to emerge under two essential assumptions: a) that Britain and other European Union countries adopted the unit (*highly doubtful!*), and b) the greenback continued to substantially decline in value.

Central banks usually refrain from disclosing the currency structure of their reserve holdings. However, based on available data, evidence exists that there has been a gradual, yet insignificant, deterioration in the net reserves position of the United States in recent years (*according to the U.S. National Bureau of Economic Research, about 64% of the $3.81 trillion world's central bank reserves are denominated in U.S. Dollars, and roughly 20% are in Euros*). Interestingly enough, the amount of reserves that "all countries" (*66% in USD and 16% IN EUR*) and "developing countries" (*62% in USD and 15% in EUR*) held in USD and EUR varied only slightly since 2000. Therefore, hundreds of billions of U.S. Dollars and other foreign currencies have been already invested in the Euro.

A source of concern remains the fact that the Euro is a flawed currency, functioning within an inherently flawed EU system. Major events, that have been unfolding in Euroland over recent years (*EU 1997 Stability and Growth Pact sabotage, Constitutional Treaty failure and budget negotiations' collapse*) especially after the Euro's introduction in January 1999 (*€ currency unit*) and January 2002 (*€ bank-notes*), shed light on the Euro's flaws and on how the European Union is tearing itself apart as it experiences its worst identity, political and economic crisis post World War II.

In times of economic gloom, European economies find themselves in a situation where there are no policy tools readily at hand to deal with the urgent problem of declining aggregate demand. Fiscal policy remains constrained by the EU 1997 Stability and Growth Pact and devaluation is no longer an option member nations might turn to, since the currency zone is so widespread. Moreover, the EU economy's deep-rooted weakness constitutes a major obstacle to the achievement of EU political unity.

Chances are, therefore, that the greenback might hold its "reserve" currency status for another decade or two!

Vanishing is, therefore, the Euro supposed "growing credibility as a genuine store of value alternative to the U.S. Dollar", as the Euro's so perceived international acceptance derived especially from its "not being the greenback". Is breaking the single currency an option? Italian Prime Minister Silvio Berlusconi's Euro bashing recently joined this emerging voice. In a context at the basis political (*general elections due before June 2006*), economics are not absent in the overall picture. Italy, which is currently sporting a 4.3% deficit, is clearly lacking two of its preferred ways at sparking economic growth: 1) currency devaluation, and 2) interest rate cuts.

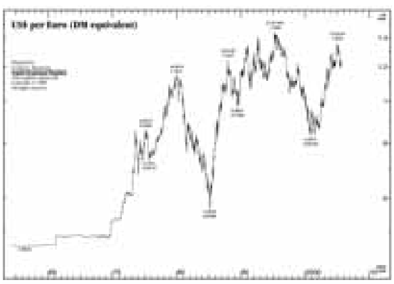
Therefore, Italy will probably pressure the European Central Bank to implement yet easier monetary conditions, despite the fact that ECB borrowing rate stands at a 2% historic low, unchanged for two years, and that M3 money growth averaged 6.7%, instead of the 4.5% ECB target, a sign of ample liquidity provided by the central bank during its six-year existence. Should the ECB fail to ease soon after summer, Berlusconi might be tempted to threaten disengagement rather seriously. Global financial markets would be severely affected by the mere threat that one of EU founding member countries (*Italy, succumbing to desperate economic and fiscal travails*) might consider to withdraw from the Euro.

A troubling fact is that the EU does not allow monetary divorce! Then, the public is to assume that international guidelines would apply. According to experts and legal scholars about international central banking (*Hal Scott of Harvard Law School and Charles Proc-*

tor, author of a new chapter about withdrawal from the Eurozone in the 6th edition of "Mann on the Legal Aspect of Money", considered to be "the Bible" of international monetary law), despite prohibition in EU treaties, the Italian government would have the legal ability to recreate its own currency and rewrite Italian financial contracts (*bond obligation*) into "new" Lire.

Such an occurrence (*a worst case scenario*), would cause a financial crisis of monstrous proportions (*foreign holders of the €1.5 trillion Italian public debt would realize their positions do carry unwanted risk*). It would push a de facto bankrupt government into formal insolvency, wreck the Italian banking system, cause huge trouble in the entire Eurozone and shake the Euro, affecting as well the global financial system.

Although it may be premature to consider the Euro's days as a single currency numbered, it can be safe enough, however, to consider it carrying only minimal "reserve" currency's characteristics, especially because its current unstable situation comes on the aftermath of the European Union's major failures (*constitutional referendums, budget summits, etc.*) threatening the very stability of all EU institutions. However, central bankers being historically obsessed about avoiding the collapse of a major institution, the ECB is likely, in my opinion, to avoid the outlined worst case Euro scenario and agree to ease its monetary policy.



Hence, entirely open remains the question about the next "phoenix" able to rise from the ashes and overtake the U.S. Dollar position as the world's "reserve" currency. History may not be repeating itself, but it often rhymes. According to history, the natural life of a predominant currency extends some 100 years. Chances are, therefore, that the greenback might hold its "reserve" currency status for another decade or two!

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Notes:
1) all charts have been provided by Mr. John Carder, CMT, of Topline Investment Graphics, www.topline-charts.com
2) the extended version of this article is available as a Special Report (bonus) on www.finarc.ch to current and future subscribers of the "Inferential Focus" by the same author

Latin Europe: a growing demand for financial advice

The industry's lanscape is fast changing in Latin Europe, while an increasingly complex legislative framework stimulates a growing demand for financial advice. Anticipating somewhat on EU legislation, Italy has created a new status, that of consulente finanziario. While asset management and financial advice are being kept strictly separate in France, independent firms are cooperating together to offer a comprehensive service to the client. Portugal has an already elaborate but rather small independent financial sector, whereas numerous Spanish IFAs are preparing for the implementation of a new EU Directive after April 2006.

In Italy, the status of *consulente finanziario indipendente* (CFI) has been patterned on the independent financial adviser concept, as it has been existing in the UK since the 1950s. Established pursuant to a 1991 law, the status has not become effective until after 1998, following additional regulation introduced to enable would be IFAs to operate on a free basis. In this respect, Italy is anticipating on the EU Market in Financial Instruments Directive (2004/39) the enactement of which has been postponed to April 30, 2006. "The purpose of the Directive is fourfold: regulating access to the profession of financial adviser, introducing liability insurance and capital adequacy requirements, laying down guidelines as far as client information is concerned", sums up Vincent J. Derudder. This being said, the Secretary General of the Brussels based FECIF (*Fédération Européenne des Conseils et Intermédiaires Financiers*) believes that implementation of the Directive is likely to vary very much from a country to an other, as is already the case with existing EU laws and principles.

On the background of a rather liberal policy in financial matters, Italy should be well placed to take the lead as far as IFA market practices are concerned. In this country as elsewhere in Europe however, the banking sector still dominates the industry, leaving little room for truly independent financial operators. Thus CFIs number at most in the hundreds, a few years after the last stumbleblocks on the road to independent financial advice have eventually been removed. This should come as no surprise in a country where many advisers active within existing banks already enjoy considerable freedom of action. Indeed, *a promotore finanziario* (PF) –as he is called- is in a position fairly close to that of an independent asset manager, as it exists in Switzerland, at least in some respects, except for the fact that those operating in this capacity still have to maintain a close connection with a bank. For the latter, working through PFs is tantamount to a vast reduction in costs while offering the very flexibility which is likely to appeal to a mature market. Thus, a PF may include in his asset allocation products not being on offer within the bank he works for. The client will appreciate decisions being taken in his own best interest while appreciating the safety of still maintaining an institutional contact with an established bank.

On such a competitive market as is Italy today, responsiveness to the needs of the client is of the essence. Indeed, a *promotore finanziario,* and that is all the more true of a CFI who will as a rule operate entirely on his own, should devote 60 to 70% of his time to prospecting for new clients. These will mostly be drawn from a pool of about 10 million Italians those who, among other criteria, command at least 40'000 euros of assets ready for investment. This profile may

vary very much from one bank to another, from middle class Italians with a few tens of thousands euro to high net worth individuals, as Aldo Varenna points out. He is in charge of international relations at *ANASF Associazione Nazionale Agenti servizi Finanziari.* Based in Monza, he is himself active as *promotore finanziario* for Fideuram, a part of San Paolo Group. "I have my own office within the bank and a private secretary", he says. As far as allocation of assets is going, he has the choice among 8 to 10 financial products, funds, equity, bonds, insurance products, which constitute an attractive range for a clientele fairly upmarket. In this context, Aldo Varenna manages assets worth about 110 mio euro, far above the national average. In other, less exclusive banks, the typical *promotore finanziario* is likely to command amounts as low as 10 mio. This diversity is not surprising in a country where financial advisers working in PF capacity now number around 35'000, a dramatic increase from the 1000 or so already present on the market in 1978, at the time when ANASF was established. This makes Italy the third largest country in Europe in terms of number of financial advisers active on the market, behind Britain (40'000) and Germany which is miles ahead with 100'000 or so professionals already working on a fertile ground. Will the new *consulente finanziario* status meet with the same measure of success? This will depend in part on whether CFIs will, at some point in the future, be allowed to manage, and not simply advise on, assets which under existing regulations they are not supposed to do.

As the example set by the French market would tend to suggest, however, the new status is already interesting enough, as it is in its present form, to attract quite a number of professionals, who will be eager to respond to a growing demand for advice in financial and related matters. In France, the distinction between financial advice and asset management is quite clear cut. Those dealing in counsel will soon as a rule have to be members of the organization representing their industry, the *Chambre des indépendants du patrimoine*. Already, the "Chambre" speaks on behalf of about 1400 affiliates, about 70% of the professionals active on a market which is still largely institutionalised, that is in the hands of extensive banking networks. IFAs in France, advice and asset management taken together, number hardly more than 3000, about the same figure as that applicable to tiny Luxemburg. This means among other things that competition from banks is rather stiff, while independent players are amenable to cooperation, at least to some extent. Thus, practitioners working on their own as advisers will as a rule channel customers to portfolio management firms, the so-called "sociétés de gestion de patrimoine" (SGP).

These belong in principle to an umbrella organization known as *AFG Association Française de la Gestion Financière* which boasts 1500 affiliates. When broken down into its constituent parts however, the membership show that the market is less lively as the global figure may lead to believe. Indeed, leaving aside 1070 Sicav or *Sociétés d'investissement à capital variable*, the SGP or portfolio management firms strictly speaking number 347, a rather unimpressive figure in the context of such a large European country. A few of these, especially among the smaller ones, may still indulge at times into some financial counselling, even though the legal pressure to keep management strictly separate from advice in financial matters has been mounting steadily over the past two years. The idea is that every player on the market should stick to his constituency, if he wants to act in a responsible way. Whether such a rigid distinction is practical is yet another matter. But it is much too early to say, since the regulations laid down in the 2003 Financial Security Act (*loi de sécurité financière*) are still to be fully implemented. In this context, advice itself breaks down into several categories depending on related financial matters. To be in a position to respond to the needs of prospective clients, an adviser has to be licensed to practice at least in three lines of products. "Our affiliates have to comply with five main sets of rules", adds Olivier Collin who is heading the *Chambre des indépendants du patrimoine*. The typical client who will best benefit from the kind of service provided by an independant adviser is rather upper middle-class, with assets above the 100'000 euro line. As Olivier Collin points out, the "Chambre" is very young at least in its present form, since it has been established in 1996 with the merging of associations the most ancient of whom had an history dating back to 1978. As investment products grow more sophisticated with attendant penalties more threatening in case of mismanagement of the paperwork involved, especially when it comes to tax matters, the market for professional advice looks promising. In France as elsewhere, it will take some more time however for the new rules to fall into place. To take but one instance, the new European directive on insurance, in force since January, 2005, still has to be translated into national laws.

In Portugal, the industry of independent asset management and financial advice is still comparatively small, although well diversified. Thus, APFIPP *Associaçao Portuguesa de Fundos de Investimento Pensoes e Patrimonio* acts as an umbrella organization for four kinds of financial intermediaries. Initially a mutual funds association, APFIPP extended by 1994 its membership to real estate funds before including asset management five years later. In 2003, the entry of pensions funds into the Association was made to coincide with a change in name. As a result, the four market segments which, as a rule, Portuguese banks are likely to outsource to external companies are now being integrated within the same organization. For an association covering the whole range of independent financial activities, APFIPP is rather small with a membership not in excess of 40 firms, most of them affiliated with the five main banking groups contending on the market. This leaves about 25 to 30 companies staying out of the association, acconting for less than 10% of assets under management in the "independent" sector. As far as financial advice is concerned, the market is still emerging in Portugal, with only 8 such firms registered to practice in this capacity with the relevant supervisory authority. To say the least, this is far short from the thousands of IFAs active in countries such as Britain, Germany or The Netherlands. Such data have to be put into perspective, that of a market which is less sophisticated than most in Europe. APFIPP statistics are telling: while assets under management with its members total 23 mio euro, private clients on a discretionary mandate represent only 500 mio. This amount reads with reference to rather exclusive criteria, which tend to exclude potential clients with less than 250'000 euro. Actually, upmarket companies do not take portfolios under the 1 mio mark into consideration as far as discretionary management is concerned.

In Spain, although the present political environment would not seem at the outset to be particularly responsive to the needs of the financial sector, the mood among IFAs is rather buoyant and the prevailing belief is that obstacles will be overcome whatever these will be. In this perspective, such associations as ANAF (Asociacion Nacional de Asesores Financierios) and AIF (Asociacion Profesional de Asesores de Inversion y Financiacion) are conducing talks with the administration in order to set the stage for implementing the EU Directive 2004/39 after April 2006. What is at stake is the possibility for financial adviser to keep operating on the market on a truly independent basis folowing this date. This will depend on the willingness on the part of the State to issue licenses pursuant to the EU Directive in such a way as to enable IFAs to position themselves in an attractive way on a market which is still largely unregulated. "Spanish authorities are afraid at the idea of giving licenses to individuals, even if they meet capital requirements", say Alberto Romagosa as Chairman of AIF. Thus, there may be up to 40'000 individuals providing financial advice throughout Spain, mostly tax advisers, lawyers or real estate agents operating on a part-time basis. Speaking as Vice-Chairman of ANAF, Francisco Alvarez puts at 5000 the number of those who can be regarded as IFAs, only a fraction of whom are affiliated with a representative association. Obviously, this will change very much if ANAF and AIF are successful in their dealings with financial market supervision authorities since it is their objective to set up a self-regulatory framework to implement EU legislation after April 2006. What remains to be seen is whether clients will follow since, in such a context, they would have to pay directly for services provided while, in the present situation, many IFA work on a commission basis with established financial institutions. As a rule, such relationships would have to be exclusive, but in practice many individuals operate as agents of three or four banks or financial societies.Everybody being fairly happy with the present state of affairs, there is no undue haste in implementing the new Directive.

Mohammad Farrokh

Groupement Suisse des Conseils en Gestion Indépendants

Swiss Association of Independent Financial Advisors

Pierre Christodoulidis, Founding President of the SAIFA, and Jacques Grivel, one of the association's Board Members.

The SAIFA - Swiss Group of Independent Financial Advisors – is an association founded by highly experienced independent financial advisors which aims to promote dialogue with financial institutions (banks, fund managers, etc), authorities and regulators to help establish the most favourable professional conditions for the smooth and harmonious development of its members' professional activity.

Established in 1993 by a group of ten independent financial advisors, the SAIFA now has over 220 members. Its significant growth in the last two years merely shows the increasing interest of financial sector professionals in this association. Initially focused on private wealth management, the SAIFA has, over the years, extended its membership to include institutional and mutual fund management specialists, financial planning and insurance experts, as well as brokers.

The financial advisor's professional charter enshrines the rules of professional ethics, compliance with which makes it possible to provide guarantees on the quality of wealth management services. Here, the SAIFA promotes the introduction of new quality standards in performance measurement and risk management. It aims to encourage the adoption of these standards by its members and the authorities in order to increase client satisfaction, prevent abuses and disputes and thereby avoid politically-imposed regulation.

Dialogue with financial institutions and authorities

GSCSI gives priority to dialogue with financial institutions, with the aim of developing harmonious relationships between partners, in order to improve administrative procedures, the sharing of information and product development, and to better represent the interest of clients and financial intermediaries in relation to fees and commissions.

Lobbying the authorities and regulators is necessary to represent effectively the interests of the profession, currently preoccupied by excessive regulations and bureaucratic red tape, which lead to inefficiency and disproportionate growth in administrative expenses.

Defence of the profession requires it to abide by strict moral norms aiming to combat unethical practices and conflicts of interest, which are detrimental to the reputation of a profession whose good name has been tainted by too many scandals.

The SAIFA is an association run on a collegiate and voluntary basis by the members of its Board. This approach is only possible thanks to close cooperation between professionals in the sector, based on mutual trust and on respect of strict moral and ethical standards. Solidarity is the key to development of the corporate spirit which the SAIFA intends to promote among its members.

Its monthly meetings serve not only to foster this aim but also try to disseminate information and round off its members' training.

The SAIFA helped create the OAR-G (www.oarg.ch), a self-regulating anti-money laundering body, to comply with the relative Swiss Federal Law of April 1998, which came into force in April 2000. The OAR-G monitors compliance with the legally-required duty of due diligence and with procedural requirements.

More recently SAIFA launched the CIFA Foundation (www.cifafound.ch), a broad international platform open to all financial intermediaries who wish to defend the IFA profession on a national and international level.

For further information: **www.gscgi.ch**

Vereniging van Vermogensbeheerders

Dutch Association of Asset Managers

Mea Hiskes-Willemse, *Secretary General of DAAM*

The Dutch Association of Asset Managers (DAAM) was founded in 1999. From the beginning it represented almost two thirds of the asset management firms in the Netherlands. Members of DAAM must be registered as asset management firms with the Authority of Financial Markets (AFM) and have to offer their services on the Dutch market. The association's members vary from very small companies to the asset management subsidiaries of large investment firms.

The aim of DAAM is to serve the interests of its members in every aspect of their business. This can vary from informing them about the latest developments in legislation concerning working conditions to practical assistance with the Duty of Care. The association's main concerns are monitoring legislation and supervision in respect with the core business of its members: asset management.

DAAM's two main tasks can be summarized as follows:

- Informing members about changes in Dutch legislation. In the Netherlands, the Ministry of Finance has started the lengthy process of developing a new law: the Law on Financial Supervision, which will combine all securities regulation in a single statute.
- DAAM also gives attention to new international developments, such as the IFRS rules.

DAAM is consulted by the legislators and regulators on behalf of the asset management firms in the Netherlands. In this respect we are member of the Raad van de Effectenbranche. The REB is an umbrella organization comprised primarily of the organizations representing non-bank Dutch investment firms. The membership of the combined associations ranges from proprietary trading firms through full-service broker-dealers to specialized investment managers. The REB represents well over 100 firms in the Netherlands. Via the REB, DAAM participates in a network of European associations which allows to combine all forces for lobbying activities to the European Commission, the European Parliament, etc. on Mifid and CRD subjects.

Developing a new law such as this Law on Financial Supervision is a major operation which absorbs much of DAAM's attention. The association is in the process of consultation with both the Ministry and the two supervisors: the AFM for the behavioural supervision and the Dutch Central Bank for the prudential supervision. In this process the Dutch Ministry of Finance has chosen a whole new way of lawmaking. All associations in the financial market are invited to submit their comments about the draft of the new law in a preliminary stage. This presents two advantages: the Ministry can profit of the know-how of the market participants, and the market can try to ensure that the law is coherent with real business. Until now, both participants in this dialogue, the Ministry and the representatives of the market, are quite content with this way of acting.

Another item which is of great importance to Dutch investment firms is the cost of supervision. Both supervisors are almost fully financially dependent on the firms that are active in the financial field. For the roughly 190 REB-represented firms the cost of funding their regulators is some € 10 million. And the organizations of both supervisors keep on growing. In 2000, the AFM employed about 150 persons; the number has now increased to 400! The chairman of AFM has announced that further expansion can be expected in the next two years…

The general tendency in the Netherlands is for individual investment firms to grow in size. Due to the increase of costs – notably the increasing cost of regulatory compliance – many small investment firms are finding it difficult to achieve adequate profits. In DAAM's view, this is a dangerous development. The association's Board and Management think that small and medium-sized enterprises are essential for the healthy economic development of the Netherlands and of Europe, because of their capacity to present innovative investment solutions to their clients.

For further information: **www.vereniging-van-vermogensbeheerders.nl**

The Board of Directors of DAAM.
From left to right:
Jan Willem Rempt, Bart Weijerman, Simon Cohen, Jim Schalm and Marc van Poeteren, Chairman.
Missing on this picture:
Harman Kloos.

Arbeitgeberverband der finanzdienstleistenden Wirtschaft e.V. (AfW)

Employers' Association of the Financial Services Providers

Alexander Pohle, President of the AfW

Through its active and successful lobbying and media activity throughout the European Union in the last few years, the AfW has developed into the most influential and numerically strong lobby association for professional independent financial services providers in Germany. It has acted predominantly in Brussels and Berlin for the professional independent financial advisers and, consequently, has recognised and pre-empted the signs of the time with regard to internationalisation.

Touchstone for the 2005 German parliamentary election

For the first time in Germany, the small and medium-sized financial services providers, who do not use a particular product range, are benefiting from the AfW's lobbying. Now they can assert influence on politicians and their decisions themselves. Due to the fact that the AfW releases the answers to the questionnaires it has addressed to the parliamentary parties before the advanced 2005 parliameentary election, all interested member firms receive important information for their election decision.

The first nationwide study initiated by the AfW on the significance of the independent financial services provider industry now conveys a yearly overview of the situation of independent financial services providers as well as of their economic importance.

Quality label for improved quality

AfW has introduced a quality label for financial services providers. Supported by consumer associations, chambers of industry and commerce and other trade associations, this label vouches for quality, proximity to customers and transparency in analysis, consultancy and procurement of financial products, in the interests of consumer protection and for raising the reputation of our profession.

Rapidly growing number of members

In contrast to the current trend which sees parties and associations losing members, the AfW has been able to increase its number of members fivefold between 2002 and the middle of 2005. Over 1,700 insurance brokers, investment agents and financial services institutions with more than 25,000 in-house and freelance employees belong to the association. Our members are guided by the credo of tailor-made advice to customers, a long-standing customer partnership based on trust and independent choice of financial products. By the end of 2005, the number of members will have more than doubled again.

Exerting influence on the legislative procedure

The increase in members and the good corporate reputation of the AfW are above all attributable to its nationwide information campaigns, e.g. about the consequences of the EU Investment Services Directive for investment fund agents in Germany, and to its lobby work in all current legislative procedures:

- the AfW supports the rapid implementation of the EU Directive on Insurance Mediation without concessions in German law
- it passes on opinions on the Retirement Income Act and on the Financial Markets Promotion Act
- through its involvement with Members of Parliament and the Federal Ministry of Finance, a moratorium has been declared, which suspends the levy of VAT on sub-brokering of financial services in Germany.

Involvement throughout the EU

It is solely due to the involvement of the president of the AfW, Alexander Pohle, in Brussels and Berlin, that – contrary what the EU initially had in mind – financial services providers in Germany can still distribute investment funds without additional restrictions and conditions which would have considerably limited their financial strength and independence.

The professionalism and influence of the AfW is enhanced by the fact that the president of the AfW is also a member of the Advisory Board of the Federal Financial Supervisory Body (BAFin), the Advisory Board of the German Product Testing Foundation, and the Presidential Board of the Action Committee for Small and Medium-Sized Business (AWM).

The AfW is a member of important umbrella organisations such as the Umbrella Organization of Independent Financial Services Providers (DA-FIN), the Action Committee for Small and Medium-Sized Business (AWM), which acts and is influential throughout Europe, and the European Federation of Financial Advisers and Financial Intermediaries (FECIF).

For more information: **www. afw-verband.de**

Are We Heading Towards a Third Oil Crisis?

For a long time overlooked and thought to be of little importance, the huge explosion in oil prices has suddenly provoked the return of inflation and threatens profits and the stock market and could even lead to a global freeze in growth. What can be done to combat this new danger looming on the horizon?

The belle of the ball in summer of 2005, oil prices reached all time highs, passing the 60 dollar limit to later soar over the 70 dollar-per-barrel bar. This 60% hike in prices doesn't seem to be going away either. The 50 dollar comfort zone seems to be a thing of the past and, according to experts, the cheap oil era will soon be behind us. Are we heading towards a third oil crisis? This is now the question being asked today - which was not the case earlier this summer. In July, Pierre Darier, president of the Swiss Association of Private Bankers in Geneva, was surprised at the lack of inflation despite record breaking gas prices. “What is surprising about this oil crisis,” he explained three months ago, “is that, unlike the oil meltdown in 1973 when high prices provoked inflation, this time, the price per barrel is rising but this is having no direct effect on prices in general. There is no inflation."

The return of inflation

Only three months ago, economists were talking about global competition and especially the impact of Chinese merchandise unbeatably low prices which were preventing companies from dumping the burden of their increased costs on their customers. But all good things come to and end. In July, inflation made a comeback in the United States with 2.3% of the annual cycle, the highest increase in eight and a half years. In euro territory, figures have reached 2.2%, a figure that is 2% higher than the Banque Centrale Européenne's (the European Central Bank's) expectations. The announcement of these figures was only somewhat surprising due to an astonishing economic paradox in the making. Asian economies, which are more oil dependent than OECD countries, are really feeling the crunch of the oil crisis. “The appreciation in value relative to the dollar that has occurred among Asian currencies, including the Chinese yen has undoubtedly helped the countries of that region to bear the blow of the oil crisis,” expressed Union Bancaire Privée (UBP) head economist, Patrice Gautery in Geneva. “In China, oil companies have also reduced their margins as they are state-run. But they're starting to feel the heat.” Indeed, the Chinese government put its oil companies to the grindstone by fixing its domestic price of oil per barrel this summer at $43 to $47 while negotiating a $67 price tag on oil sold on the international market. But, it so happens that??? Scompanies Sinopec and PetroChina refuse to make donations to Chinese refineries at a price that is $20 cheaper than on international markets. As a result of this, the cost of Chinese goods could start climbing. And, as China has become the world's factory, as Gautery suggests, global consumers might end up paying the price with the risk of slipping into a world recession. According to some experts, high oil prices could freeze growth in Asian countries pulling their economies into

a recession. Such an event would reduce the demand on oil and would therefore prevent prices from crossing the $100 per barrel benchmark – a level that would be comparable to that of 1973. .

1973 all over again

The similarity between today's scenario and that of the great oil crisis of 1973 is undeniable to Gautery. "We have been experiencing an oil crisis for the last two years, but unlike in 1973, the price of oil per barrel did not double from one month to the next, but gradually instead," he declared. "For the last two years it has rising steadily and is currently over $65. At between $75 and $80 a barrel, the situation would be comparable to the 80s crisis." Everyone is already beginning to feel the consequences of these developments.

Yet, several factors help to soften the blow of severe oil shortage. The structure of developed economies has been modified since the first oil crisis to become service economies. The member countries of the OECD now rely on two times less the amount of oil than at the end of the 70s as it takes a lot less fuel to produce software as opposed to steel. Furthermore, due to the development of alternative energy sources and more efficient production system, production of the same GDP unit currently requires two times lesser amounts of black gold. Despite that, the price of crude oil has only continued to rise. Could the price per barrel of oil one day reach the disastrous heights of $100. It's always difficult to play guessing games. A year ago, a price as high as that seemed hypothetically improbable. But according to the highly influential commercial bank, Goldman Sachs, crude oil prices could reach 105 dollars per barrel by this 2007. According to the calculations of the International Energy Agency, this could cost global growth two points. Actually, the hypothetical scenario of oil rising to 80 dollars a barrel by December is plausible. At the start of summer, the West Texas Intermediate's 80 dollar per barrel options were a source of much activity on the New York Mercantile Exchange. On the options market the call 80 demand exploded. According to the Bloomberg agency, there were 6,900 call 80 dollars in circulation in July as opposed to an average of 77 in January. On this basis, the Deutsche Bank strategies estimate the probability of crude oil reaching 80 dollars before the end of the year at 16%.

Hurricane Seasons

The volatility of the markets may also be explained by the "hurricane season" that runs from June to November. "A destructive hurricane such as Ivan last September would be enough to raise oil prices to 70 dollars," stated Simon Wardell, an analyst at Global Insight in London, quoted by Bloomberg. Hurricane Katrina seems to have proven him right as it damaged numerous American refineries and paralysed 90% of oil production in the Gulf of Mexico. This had serious repercussions on the price of gas. Last March, Venezuelan president Hugo Chavez threatened the United States to make crude oil prices climb to 100 dollars per barrel should the American government attempt to displace his regime. Just an idle threat? One can't be sure. Due to political instability in some oil producing regions, the uncertaintly surrounding oil availability remains prominent. There is, of course, the Middle East that remains little more than a pile of rubble, with American mayhem in Iraq and Iran's plans to develop nuclear bombs. In Africa, countries such as Nigeria, a major oil producer, is a regular stage for conflict between the government and its population which as been excluded from the miracle of oil. In Ecuador, protestors demanding that oil wells be made public, are paralysing production.

Since, the turn of the century, oil prices have remained very high. According to a study conducted by the International Energy Agency the average price of oil and natural gas between 1985 and 2000 was 20 dollars. Since then, it has risen to 29 dollars. In 2004, on the oil and natural gas market, which has been quite strained, prices have experienced the most significant progression since the early 1980s. This

In July, Pierre Darier, president of the Swiss Association of Private Bankers in Geneva, was surprised at the lack of inflation despite record breaking gas prices.

sharp increase is due primarily to the dynamism of the Chinese economy and the of newly industrialised nations that tend to increase their energy consumption as well as an overall improvement in economic conditions in some regions of the world, particularly the United States which, as a result of this, will have to face some tension in its national reserve stocks. However, this alone cannot explain the evolution of oil prices between 2003 and 2004 which had also been largely influenced by speculative overreactions to potential disturbances in supply because of events in Iraq and the Near East on one hand, and the institutional crisis prevailing in Russia and Venezuela on the other. "A refinery in the United States has problems and it's the price of crude oil that goes up, not gas. It doesn't make any sense," declares Gautery. "Industry players expect high prices." On internet forums, the general public is accusing American pension funds and speculators of adding extra weight to crude oil prices. It is true that, since the start of the 80s, term markets have clearly increased in importance. Today, the volumes of crude oil processed by term contracts have gone beyond the global volume of production on the main crude oil term markets which are the New York Mercantile Exchange (NYMEX) and the International Petroleum Exchange (IPE) in London. In addition, there are also electronic stock exchanges such as Intercontinental Exchange, the owner of IPE, whose transaction volume now surpasses NYMEX and IPE!

Should speculators be excluded?

Should speculation on crude oil be stopped? Should we go back to state to state contracts and to administrative prices without a market of traders seeking to cover themselves with options? "It isn't possible to exclude speculators from term markets or put an end to term markets: producers must be able to protect themselves against price fluctuations and keep their profit margins in these transactions. Furthermore, one cannot regulate the world economy as these are totally liberal markets," explained Bernhard Lippuner, head of Commodities and Structured Trade Finance at Credit Suisse, one of the three largest banks in oil. It has raised its line of credit in this sector from 20 to 30% between 2004 and 2005. It is also true that term markets have been strongly used by speculators who buy and sell without being a producer or consumer of oil products, they trade on paper. With their arrival, term markets have grown significantly, particularly in oil which is the number one raw material. Without speculators, they would have much less support. "Furthermore, it is extremely difficult to estimate the share of speculations on these markets and the physical market also speculates. But term markets are a recent phenomenon for oil. In the 80s, black gold was never that important. At that time, term markets primarily dealt with agricultural products such as coffee, soya, and cereals. Is the term market on crude oil justifiable as its price should continue to rise due to a decline in production? "The term market on oil is entirely justifiable if one excludes speculators as it protects against price fluctuation," explained Lippuner. "But without speculation which can make prices skyrocket, the markets would be less volatile."

"Industry players expect high prices."

Should the oil market be made an affair of the State?

Oil being a highly strategic commodity, is it not conceivable to develop state to state exchanges without any middlemen, much like Venezuela does with many countries in the Caribbean and Latin America? "There will always be cases of state to state agreements for purely political ends as is the case with Venezuela," affirms Lippuner. "But with the current trend being toward the global liberalisation of trade, it is difficult to imagine oil being exploited solely by governments." The oil market therefore has

"At between $75 and $80 a barrel, the situation would be comparable to the 80s crisis."!

a strong chance of remaining volatile and oil prices are unlikely to go down any time soon. But oil being priced at 80 dollars a barrel will pose serious problems for the United States which already has a budget deficit and, for some economies, this will be a bitter pill to swallow. It could also improve the competitivity of alternative energy sources, such as natural gas, and also relaunch the atomic energy debate as is already the case in the United States and Switzerland.

Negative result on the stock market

Soaring oil prices have also begun to hit companies and stock trading hard as it limits consumer purchasing power and raises company overhead costs. An example of this domino effect is the American distribution giant, Wal-Mart. In the first half of 2005, Wal-Mart had a profit of 2.8 billion dollars, a low profit yield compared to previous years – a progression of only 5.8%. "Wal-Mart failed to reach its objectives as our customers are being assailed by high gas prices, » declared the American distributor with the largest fleet of trucks in the United States. Consequently, its shares slipped by 3.4% in a single session. In Lausanne, Vincent Perrouchoud, manager of the Espiritu Santo portfolio foresees a 10 per cent dip on Western stock markets in the six months as stock markets are near their peak. Shares could lose their appeal to the benefit of bonds which will once again offer interesting returns," stated executive director

of Capital Management Advisor, Allesandro Mauceri to Le Temps in Geneva. Another sign of an uncertain market climate is the fact that gold is already gaining in value.

The return of oil dollars

With extremely high oil prices, the members of OPEC, who account for 40% of production worldwide, could bank over 560 billion additional dollars in 2005, a figure that is 35% higher than in 2004 if the price of black gold remains above 60 dollars until year's end. Saudi Arabia will garner 130 billion on its own while the Gulf countries will earn 250 billion. Will we witness the return of massive oil dollars in western banks? Nothing could be more uncertain. Today, the financial situation of oil producing countries is not as good as it was thirty years ago. Some of them have budget deficits and are in debt. "This new mannah from oil heaven could enable them to reduce their debt and improve their financial situation," suggested Gautery, head economist at UBP in Geneva. He also added that "the hike in oil prices has been taking place for the last two years and we still have not seen any big in flow of massive oil dollars." Unlike the 70s and 80s, these countries might have to choose between social spending with the acquisition of new equipment and investment. According to Bloomberg, due to the chaos prevalent in Iraq, defense and security budgets should increase by 5% in 2005 and in 2006. Furthermore, the international community hopes that they will increase their production. This is expected to cost 100 billion dollars and mannah from oil heaven simply won't be enough to finance it.

Giuseppe Mélillo

Exceptional performance for funds investing in Russia, Eastern Europe

Funds investing in Russia and in the countries of Eastern Europe have produced exceptional performance in the last few years. Numerous managers, including Firebird, Hermitage and Prosperity, regularly see their funds ranked among the top performers, irrespective of category.

The reasons for these results are primarily macroeconomic. Firstly, in terms of political risk, the situation has improved significantly since the 1990s. Russia has progressed from a phase of dismantling the soviet economy into a period of democratic consolidation, in which the Yukos affair can be viewed as the final stage of segregation of powers between the State and private sector.

The fundamentals of the Russian economy are now highly robust: average GDP growth of 6.5% since 1999, high levels of consumption and investment, low interest rates, foreign exchange reserves in excess of USD 140 billion, and a budget surplus. However, even today, and in spite of this flattering profile, the Russian market remains one of the cheapest in the world. In terms of its P/E ratio, the Russian market is trading at 6.1, while the S&P is at 20 and Japan at 36. Fund managers can therefore take advantage of the discount on Russian assets.

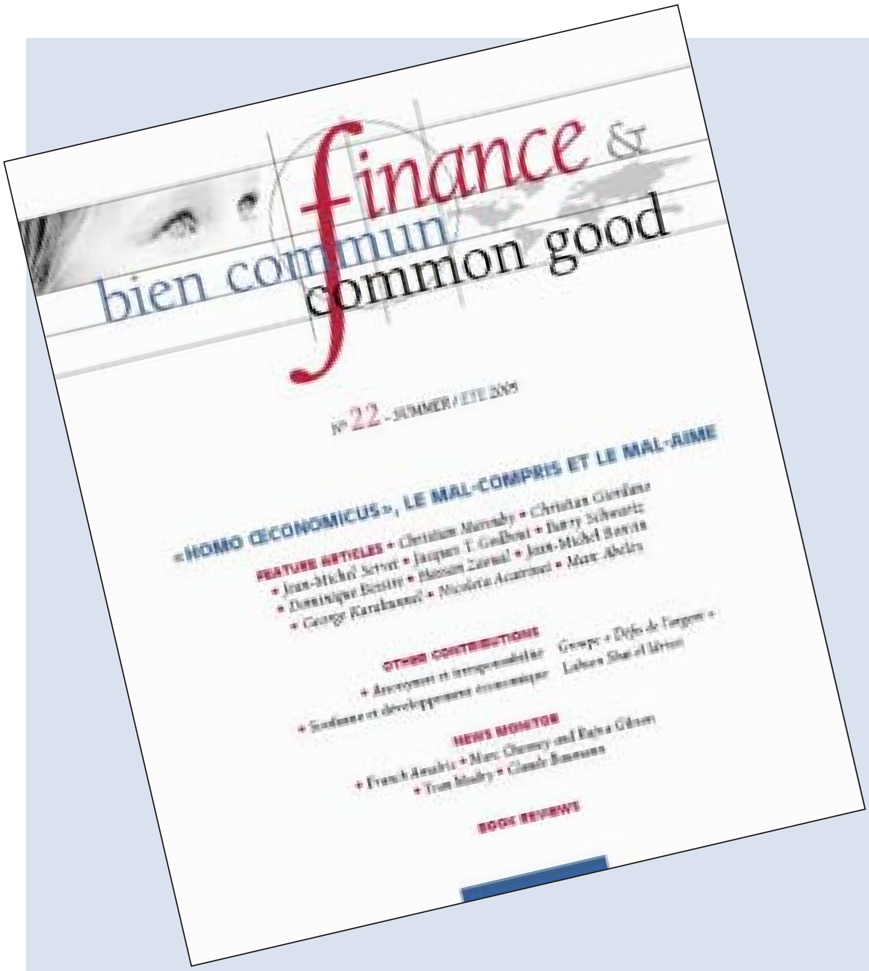
Additionally, fund managers are exploiting major structural improvements, particularly in the energy, telecoms and electricity sectors. On top of this, some former soviet republics and other countries in the former eastern bloc are being bolstered by a trend of convergence towards a European standard. Finally, the recent boom in raw material prices is particularly good news for Russia, which has exceptional oil and gas resources, not to mention nickel, palladium, coal and steel. This surge in prices is bolstered by demand from China, to which Russia is one of the leading suppliers.

These macroeconomic factors are complemented by intrinsic improvements in asset management itself. The asset management industry in that part of the world, which was still rudimentary until a few years ago, is now developing rapidly. Liquidity and volumes in the local capital markets are on the increase. The same applies to foreign investors, who are present in ever-greater numbers and whose access to markets is being made increasingly straightforward.

This upbeat environment explains the proliferation of funds linked to that region, some of which use sophisticated strategies involving the application of hedge fund techniques. Regulations are becoming more flexible, making it easier to create attractive investment products. Fund managers investing in Russia and Eastern European countries are now able to use hedging instruments and specially-tailored derivative products. They are also able to take short positions in an increasing range of equities. Funds are an extremely effective investment vehicle for that region. Unlike equities, they enable the risk to be diluted across a diversified pool of assets. Investors have to select the best fund, or the one most suited to their specific risk and reward requirements.

This is the aim of the "Russia & Eastern European Hedge Funds 05" Conference. This event, organised by Jetfin, a hedge fund specialist, and Academy & Finance, professional financial conference organisers, will be held at the Palace Hilton Hotel in Geneva on 1 December 2005. The conference will provide a platform for fund managers specialising in the region. It aims to provide answers to investors' questions and enable them to have a better understanding of the implications of investing in that part of the globe.

For a detailed programme of the conference, go to:
http://www.jetfin.com/downloads_free/AF175RussianEasternEuropean05.pdf



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