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Change We Need

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Change Is Long Overdue

Leaders of the G-20 countries, meeting at the so-called "Bretton Woods II" summit in Washington recently, endorsed a plan for worldwide action to boost the global economy through tax cuts, higher public spending and lower interest rates.

They have announced a series of immediate and longer-term actions to stabilize the financial system, stimulate domestic demand, help emerging and developing economies battered by the crisis, and strengthen the regulatory framework. They also agreed there should be no rise in protectionism in the face of the economic slump.

They also signalled a determination to press on with the completion of the Doha world trade round by the end of the year. But they put off work on a new global financial architecture, including co-ordinated cross-border regulation of financial institutions and an enhanced role for the International Monetary Fund, until next year.

The world's financial system has been found wanting in the past sixteen months and serious discussions will begin only when Obama is in the White House. Barack Obama cast a long shadow over the talks, even though the President-elect carefully allowed Bush to hog the limelight on his last big set-piece occasion. Obama is thought to favour a bigger package of tax cuts and is open to ideas such as clamping down on tax havens, but these decisions will not be taken until after his January inauguration.

The President-elect and the world's authorities must recognise the eastward shift in financial power. There is a shift in global power. The IMF has forecast all the economic growth that will take place in 2009 will come from the emerging economies, not from the present developed world. This structural shift to the emerging world is accelerated by the fact that their economies are far larger than the last time the developed world experience a recession. China has overtaken Germany to become the world's third largest-economy. Global economic management needs to be rethought to give the fast-growth economies a greater say in what should be done.

As power shifts to Asia there will have to be reforms of the system itself. The recent Washington summit effectively sounded the death knell for the exclusive club of rich nations represented by the G-8. The G-20 includes all the major developing nations - China, India, Brazil and Indonesia - as well as energy-rich nations such as Russia and Saudi Arabia. As far as global governance is concerned, the G-20 is the future, the G-8 the past.

The world confronts huge dangers. It must now minimise the scale of the slowdown and create a more robust economic and financial regime. It can only achieve these objectives if all significant countries co-operate. It is a point the incoming Obama administration, attracted by the lures of protectionism, must note. If the world works together, it can yet emerge healthy from this crisis. If it does not, no government, however powerful, will be able to deliver on its promises. It is as simple – and brutal – as that.

Obama has one great advantage. He is genuinely a charismatic leader whom people will follow. The economic crisis calls out for a renewal of confidence. The whole world needs to believe that "Yes, we can". ■

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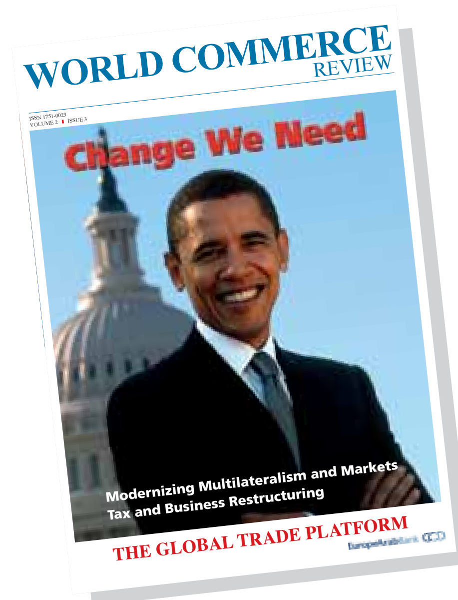

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Modernizing Multilateralism and Markets

Robert B Zoellick is the President of The World Bank Group

Looking back – to see ahead

How will people in 2018 look back on this year?

It depends on what we do.

September was a hard month in a precarious year. A meltdown in financial, credit, and housing markets. The continuing stress of high food and fuel prices. Anxieties about the global economy.

Over the past year, most developing economies grew robustly despite the turmoil. In fact, major developing countries powered an alternative engine of growth. In 2007, they averaged a record 7.9 percent in GDP growth and in 2008 perhaps a still impressive 6.6 percent.

But this is not shared by all. Soaring food and fuel prices are plunging the most vulnerable into a danger zone.

People are hurting. Families are worried about what coming days will bring.

Recent events could be a tipping point for many developing countries. A drop in exports, as well as capital inflow, will trigger a falloff in investments. Deceleration of growth and deteriorating financing conditions, combined with monetary tightening, will trigger business failures and possibly banking emergencies. Some countries will slip toward balance of payments crises. As is always the case, the most poor are the most defenceless.

While American eyes are on the intersection of Wall and Main Streets, there is much more to the story. The response to these crises will have to be larger and global.

Voices around the world are blaming free markets. Others are asking about the failures of government institutions. Many will point fingers at the failings of the United States, as the architect of today's global economy.

We cannot turn back the clock on globalization. Nor can we let the crisis of today blind us to the opportunity of tomorrow.

We must learn the lessons from the past, as we build for the future. We must modernize multilateralism and markets for a changing world economy.

Ours must be globalization where both the opportunities and the responsibilities are more widely shared. Without that, we may design a new architecture but it will be a house of cards.

Multilateralism, at its best, is a means for solving problems among countries, with the group at the table willing and able to take constructive action together.

I am a mechanic in multilateralism. For over 20 years, I have been involved in trying to make the international system work. With a crisis in progress I will sketch a larger drawing.

Transformation in the global political economy

To understand today's crisis, we need to consider what has happened over at least the last 20 years.

Today's globalization and markets reflect huge changes in information and communications technology, financial and trade flows, mobility of labour, worldwide interconnectivity – "the death of distance," and vast new competitive forces.

But even those transformations do not capture the biggest change: over the past 25 years, the world market economy has grown from about 1 billion to 4 or 5 billion people. The world's labour force engaged in export markets has grown to over 800 million. These are amazing increases in a relatively short period.

The competition of globalization, the huge expansion of the global labour force, and relatively low commodity prices combined to create something else: a Golden Era for the central bankers. The price dampening effects of these shifts made central bankers look like technocratic wizards – and we liked their magic.

Loose monetary policies and abundant liquidity led investors to "chase yield" – and one another. Investors lent and leveraged against seemingly ever-rising asset values, without attention to credit risk, earning power, and cash flows. Investors did not plan to hold the assets long enough to wait for earnings. Even when they did, the investor share was "guaranteed" by assurances "backed by" those same high asset prices.

With the burst of the internet bubble and Japan's long real estate and banking crisis, the liquidity deluge spilled over to developing countries, especially those whose currencies were pegged to the dollar. Commodity prices fell with the collapse of the Soviet Union, leading to under investment, especially in oil and metals, and then rose dramatically as developing economies hungered for inputs. Fuel and food became increasingly linked, both because the share of energy used in food production and transport increased, and consumers of food and energy have become competitors: a food for oil crisis in the making. And this year we saw it erupt.

The higher prices could push some 100 million people in developing countries back into poverty. We risk a second round of inflation, balance of payments crises, and tight budgets.

The sources of international capital pools have been shifting, too. The commodities boom, especially for energy, led to huge returns, ending up in sovereign wealth funds. Burnt by the trauma of 1997-98, some developing countries resolved never to risk that anguish again and managed exchange rates to create immense reserves. These savings seeded other sovereign funds.

Changes in labour forces, financial liquidity, commodity markets, and sovereign funds reflect an even more significant transformation: new economic powers are on the rise.

The engagement of rising powers with the global economy has made them "stakeholders" in the global system. China is now the world's third largest trading entity. As the middle class grows in Asia, these savers will become important investors in corporate equities in developed countries, further strengthening global links.

These rising powers want to be heard. They want to know what will be their role in making the new rules for the global economy. Having demonstrated their competitive success, these rising powers are suspicious that the more established stakeholders will hold them back, whether through old rules of trade and finance, or new rules for climate change and the environment.

The developed economy "stakeholders," in turn, both benefit from – and are threatened by – the changes. Rising developing economies offer multiple poles of growth that assist their recoveries and offer new possibilities, but they also serve as fodder for scaremongers. Indeed, with growth rates averaging about 6.6 percent between 1997 and 2007, some 25 countries in sub-Saharan Africa, with almost two-thirds of the region's population, offer a vision of yet another pole of growth that might be developed over the coming decades. This could be a great achievement, not only for overcoming poverty and for development, but also freeing untapped talents and energies.

But it will be an achievement left unrealized unless we have the vision and the courage to stand up to the challenges of economic isolationism at home, and to offer the leadership to help make it ▸▸

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happen. The financial and economic pains and fears will reinforce a tendency to pull back. Some feel that the rules of the game – dealing with bailouts, exchange rates, trade, immigration, and foreign aid – leave them out, even if people with higher incomes seem to be able to take advantage of the changes. Many worry that the old "safety nets" to help people adjust to change are woefully out of date. This agenda – not just the aftermath of financial rescues – must be seized by new leaders.

Storm clouds over multilateralism and markets

The events of this year are a wakeup call.

There are storm clouds over multilateralism and markets.

As food prices soared, agricultural markets started to break down under political pressures. Some 40 countries imposed bans or restrictions on exports of food. Others imposed price controls, broke contracts, and halted trading. The UN strained mightily to get countries to double their contributions to food assistance for those most in need. Poor nations struggled to get seeds and fertilizers to farmers. They tried to patch together "safety nets" for the most vulnerable. Poverty, hunger, and malnutrition increased.

As the global system for agriculture ran aground, the World Trade Organization drifted into dangerous waters. The Doha Round hit the rocks.

The climate change negotiations organized under the UN Framework Convention on Climate Change will be made more difficult by the WTO's discord, which will exacerbate the tensions between developed and developing economies. Under the best of circumstances, this negotiation will be an uphill struggle.

Furthermore, the "cap-and-trade" climate change bill that failed in the US Senate this year points to the next challenge for multilateralism and markets. To avoid putting industries subject to carbon caps at a competitive disadvantage, the bill invoked trade protections against exporters that did not face carbon limits.

While needs are growing, the international aid system is not keeping pace.

Donors bring ideas, energy, and resources, but they also can overwhelm national ownership by developing countries, harming the effectiveness of aid. In 2006, there were more than 70,000 aid transactions with an average project size of only $1.7 million. Last year, the average developing country hosted 260 donor visits. Vietnam had 752.

National governments are drawn increasingly to provide aid with their flag, not through multilateralism that encourages coherence and building local ownership. Even so, the G-7 as a whole is far behind its Gleneagles' commitments to boost development assistance.

Private financial markets and businesses will continue to be the strongest drivers of global growth and development. But the developed world's financial systems, especially in the United States, have revealed glaring weaknesses after suffering titanic losses.

The international architecture designed to deal with such circumstances is creaking.

Perhaps the most striking change since my experience in the US Treasury in the 1980s is the loss of fortunes of the G-7. This group once played a valuable role coordinating policy, with agreements such as the Plaza and the Louvre Accords. But the economic summits long ago placed a priority on ceremony over policy. I still harbour hope that the meetings of finance ministers will offer a multilateral navigator in dealing with global financial and economic problems. But the forum falls far short of the need.

A new multilateral network for a new global economy

Even as the United States and the world dig out of the present hole, we need to look further ahead: we will need a new multilateral network for a new global economy.

The Bretton Woods generation left two legacies: first, international institutions and regimes – in various states of service and repair. Second, and more important, that generation left an intellectual, policy, and political commitment to act multilaterally to turn the problems of an era into opportunities.

Some are calling for a 21st century approach, but many are falling back to mid-20th century models.

The new multilateralism, suiting our times, will need to be a flexible network, not a fixed nor unitary system. It needs to maximize the strengths of interconnecting and overlapping actors and institutions, public and private.

We have seen that the more adaptable national economies handle the inevitable shocks and changes most effectively; applying that experience, the multilateral system needs to build in flexibility. It also needs to use markets and incentives for private sector organizations and individuals, profit-making and civil society NGOs.

The new multilateralism should be respectful of state sovereignty, while at the same time recognizing that many issues do not respect state borders.

This new multilateral network needs to be pragmatic. Its baseline work is to foster cooperation by encouraging exchanges of perspectives on interests, both domestic and international. Often just sharing information is a start.

Then we should encourage a search for mutual interests. Sometimes mutual interests can be fostered with incentives – and international institutions can become catalysts for action. Practical problem-solving builds a culture of cooperation.

Our new multilateralism must build toward a sense of shared responsibility for the health of the global political economy. This means – chiefly and critically – that it must involve those with a major stake in that economy, those willing to share in the responsibilities along with the benefits of maintaining it.

We must redefine economic multilateralism beyond the traditional focus on finance and trade. The changing world economy demands that we think more broadly. Today, energy, climate change, and stabilizing fragile and post-conflict states are economic issues. They are already part of the international security and environmental dialogue. They must be the concern of economic multilateralism as well.

Priorities - a new steering group

The new multilateralism will still depend principally on national leadership and cooperation. Countries matter.

The G-7 is not working. We need a better group for a different time.

The G-20, though valuable, is too unwieldy in moving from discussion to action.

We need a core group of finance ministers who will assume responsibility for anticipating issues, sharing information and insights, exploring mutual interests, mobilizing efforts to solve problems, and at least managing differences.

For financial and economic cooperation, we should consider a new steering group including Brazil, China, India, Mexico, Russia, Saudi Arabia, South Africa, and the current G-7.

Such a steering group would bring together over 70 percent of the world's GDP, 56 percent of world population, 62 percent of its energy production, the major carbon emitters, the principal development donors, large regional actors, and the primary players in global capital, commodity, and exchange rate markets.

But this steering group would not be a G-14. We will not create a new world simply by remaking the old. It should be numberless, flexible, and over time, it could evolve. Others may be added, especially if their rising influence is matched by a willingness to help shoulder responsibilities.

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This new steering group should meet and videoconference regularly to foster group responsibility. The deputies should have frequent and informal discussions. An active network of bilateral consultations within and beyond the group will support it. We need a Facebook for multilateral economic diplomacy.

The IMF and World Bank Group, perhaps with the WTO, can help support this steering group. We can identify emerging problems, supply analysis, suggest solutions, and draw on our own broader membership to propose coalitions to address issues.

The steering group members will still need to work through established international institutions and regimes, which include other states. Sovereignties will be respected. But the core group would increase the likelihood that countries draw together to address problems that are larger than any one state.

We need this mechanism so that countries are not left to fail – with all the human, economic, and political consequences this entails for both them and their neighbours. We need it so that global problems are not just mopped up after the fact, but anticipated. We need it to develop the habit of dialogue and the necessary relationships of trust before the crisis hits. We need it to shape multilateral solutions.

International finance and development

We have seen the dark side of global connectedness. We need to navigate toward the light.

The first task will be close to home. Next year, there will be a major effort in the United States to overhaul the failed system of financial regulation and supervision. There will need to be improvements in clearing and settlement. Rules on transparency, capital, leverage, accounting, and increasingly important, liquidity, must be modernized.

We must ask why so many thoroughly regulated and supervised institutions got into trouble. Any risk-based model, no matter how sophisticated and well supervised, depends critically on the assumptions. What happens when the assumptions fail?

The changing conditions that trigger failure will increasingly be dependent on shifts in the world economy. Just as the crisis has been international because of interconnectedness, the reforms will need to be multilateral.

The Financial Stability Forum (FSF), ably chaired by Mario Draghi of the Bank of Italy, has started to tackle these issues. But the FSF concentrates on the OECD countries. Whether through an expanded FSF, a stronger FSF-IMF linkage, or the Steering Group, these financial supervisory issues will need to be addressed in a broader multilateral context.

We must bolster an IMF early warning system for the global economy, focused on crisis prevention and not just crisis resolution.

Recent financial shock waves in the United States are reverberating in the global economy. The stark reality is that developing countries must prepare for a drop in trade, capital flows, remittances, and domestic investment, as well as slowdown in growth.

Countries with sound fiscal and balance of payments positions should be encouraged to spur domestic demand through consumption and investment. But others have little fiscal space, risky current account deficits, balance of payments problems, financial danger, or all four. The Fund and the Development Banks will need to assist. For some larger countries under threat, the steering group and friendly countries should act in concert with the Fund and the Banks to offer support linked to policy reforms that will return the country to sustainable growth.

The IMF must also have an ongoing role in the world's exchange rates system, beyond surveillance. As Jean Pisani-Ferry wrote recently, a large part of the developing world is not yet ready for independent floating of their currencies, because of incomplete financial liberalization and anxieties about uncontrolled adjustment. The IMF, backed by the steering group, can offer more options, including pegs linked to currency baskets or commodities. Over time, we need to prepare for an international finance system with multiple reserve currencies, with others connected by various pegs.

The new multilateralism must put global development on a par with international finance. Until we build a more inclusive globalization, the world will remain unstable, no matter how big the financial rescue packages.

Economic multi-polarity offers stability and opportunity, just like a diversified portfolio of investments. But to boost more inclusive and sustainable growth, we need to think about aid differently.

In September, at the United Nations, international partners raised $16 billion for development projects. This money is vital, and we need more if we are to meet the Millennium Development Goals.

But we also must broaden our approach. We must listen to the growing number of Africans who are telling us they want markets and opportunities, not aid dependency. Private capital and markets will remain the drivers of growth. We must look beyond projects and programs to new ways of doing the business of development. We need innovative instruments and intermediation to: help connect Sovereign Wealth Funds to equity investments in Africa; build local currency bond markets in emerging markets; manage development risks through insurance facilities for weather and catastrophic events, and to help small farmers; demonstrate the viability of public-private financing partnerships to develop infrastructure; and broaden types of assistance, from advance commitments to develop life-saving pharmaceuticals to debt or rate buydowns.

While we build markets and institutions for the medium and longer term, the new multilateralism needs mechanisms to move much more quickly and effectively to help those who are most vulnerable when crisis hits. One example is the World Bank's new $1.2 billion rapid financing facility for those endangered by high food prices.

Another example could be the reform of humanitarian food assistance. With a modest modernization of donor support to the World Food Program – such as core or multi-year funding and a credit line – we could apply financial market tools to help the WFP manage liquidity, market, and operational risks. Working with the World Meteorological Organization, the WFP and the Bank could better prepare, cut costs, and respond more quickly. We also need a worldwide agreement not to apply food export bans or prohibitive taxes to humanitarian purchases, as well as an agreement to release national reserve stocks should an excessive price increase occur due to hoarding or speculation. These risk management tools are the 21st century equivalent to building big food stocks for security in eras past. But we need political leadership to break through old bureaucratic models.

The World Bank Group must also adapt more quickly to meet new needs of its clients and interests of its shareholders. We need to better align our governance with the realities of the 21st century. To look beyond our initial steps for changing voice, representation, and responsibility, I will assemble a high level commission to consider the modernization of World Bank Group governance – so we can operate more dynamically, effectively, efficiently, and legitimately in a transformed global political economy. I am delighted that Ernesto Zedillo has agreed to lead this work. I have asked Ernesto to work with colleagues looking at governance issues at the IMF.

In 1944, at Bretton Woods, the founding fathers of economic multilateralism seized a moment to build a better future. We must be no less ambitious today.

The WTO and the global trading system

The Doha global trade negotiations in the WTO are gasping on life support. It is vital that the WTO and an open global trading system not be buried with them.

Trade negotiations will continue elsewhere. Recent research has shown how FTA negotiations can support broader opening of markets. But FTAs and preferential arrangements that are not broad-based could weaken global liberalization. They need to be linked to global disciplines. And the multilateral system remains the only option for lifting the heavy hand of trade-distorting support for

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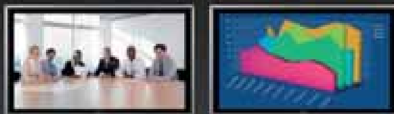

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agriculture, still running at some $260 billion per year.

Litigation in the WTO creates winners and losers. If not balanced with win-win negotiations, a WTO associated only with litigation will likely lose support. WTO members will need to consider how to continue to foster global liberalization.

One option is to shift trade facilitation from a negotiation to a development plan. There are opportunities to cut costs of trade far in excess of those imposed by tariffs and other trade barriers. The World Bank's "Doing Business" trading and "Logistics" indicators offer the diagnostic groundwork. Regional bodies such as APEC have pointed the way in practice.

We can help countries simplify and harmonize procedures and documentation across a supply chain. Countries can apply risk management techniques in border inspection and customs clearing, backed by electronic processing. And we can strengthen capacity, technology, and the availability of trade finance.

The original multilateral logic behind the GATT negotiations, which led to the WTO, was the "bargaining tariff." Even though it should be in a country's economic interest to lower tariffs and cut costs, political interests required "trading off" barriers that were defended by protected groups.

A new trade facilitation and development agenda puts the self-interest of lowering costs of trading to work for a multilateral interest of encouraging more integration, efficiencies, and opportunities – meaning, more jobs, more growth, less poverty. As the exporters and importers do more business, they may be able to increase their voice for liberalizing negotiations, too.

This is multilateralism by practical steps, moving ahead where it is possible to do so.

Energy and climate change

The new multilateral network must also interconnect energy and climate change.

World energy markets are a mess. Producers, fearful of collapsing prices, are wary of new investments. Consuming countries want lower prices for consumers, but prices high enough to encourage conservation, efficiencies, alternative supplies, and new technologies. And the most vulnerable countries and people are victimized by the whole confusion – as they are hit by high prices, price volatility, and climate change.

Most oil production is now controlled by national oil companies. These suppliers do not respond to market signals in the same way as private producers.

We need a "global bargain" among major producers and consumers of energy. The International Energy Agency organized OECD consumers, but does not include all the rising powers. A few years ago, China suggested that the major energy consumers organize to deal more effectively with the producers' cartel. This is an idea worth considering, though with a broader purpose.

At a minimum, such a bargain should involve sharing plans for expanding supplies, including options other than oil and gas; improving efficiency and lessening demand; assisting with energy for the poor; and considering how these policies relate to carbon production and climate change policies.

Developed countries need to create and bring new technologies to market, to help both developed and developing countries. Developing countries need to reduce costly subsidies and increase efficiencies, while coping with social instabilities. And everyone should have an interest in preventing energy resources from triggering national security threats.

Part of the bargain will be to provide an opportunity for developing countries to make longer-term investments to reduce vulnerability to high and volatile fuel prices while supporting the poor with safety nets. Energy access needs to be a critical complement to clean energy investments. Over one and a half billion people in the world do not have access to electricity, including about three quarters of the population of sub-Saharan Africa. At the request of key shareholders, the World Bank Group is developing an Energy for the Poor initiative to help the poorest countries meet energy needs in efficient and sustainable ways.

We might consider taking the global bargain further. There could be a common interest in managing a price range that reconciles interests while transitioning toward lower carbon growth strategies, a broader portfolio of supplies, and greater international security.

Multilateral understandings about energy futures – leading to clear pricing for carbon – might also be vital for the UNFCCC negotiations on climate change. Countries are fearful that in a world of uncertain energy costs, technologies, and supplies, a climate change treaty will limit their growth or flexibility to adapt. A bargain among key producers and consumers might counter these risks, making it easier to commit to cut carbon.

A climate change accord also will have to be supported by new tools. We need new mechanisms to support forestation and avoid deforestation, develop new technologies and encourage their rapid diffusion, provide financial support to poorer countries, assist with adaptation, and strengthen carbon markets.

In September, to help provide additional resources for these challenges, the Bank hosted a pledging session that raised $6.1 billion for new Climate Investment Funds.

The steering group should help push action on energy, the environment, and financing to assist the UN negotiations and the practical implementation of a treaty.

Fragile states: securing development

Nowhere is the new multilateral network needed more than in the fragile and post-conflict states where the "bottom billion" live.

Too often, the development community has treated states blighted by fragility and conflict simply as harder cases of development. Yet these situations require looking beyond the analytics of development to a different framework of building security, legitimacy, governance, and the economy. This is not security or development as usual. Nor is it about what we have come to think of as peace-building or peacekeeping.

Securing development is about bringing security and development together first to smooth the transition from conflict to peace and then to embed stability so that development can take hold over a decade and beyond. Only by securing development can we put down roots deep enough to break the cycle of fragility and violence.

Our appreciation of how best to secure development – to synthesize security, governance, and economics to be most effective – is still modest. We face critical gaps in international capabilities.

Ultimately, the most important element in fragile or post-conflict states is the people of those countries. But it will take much stronger and longer-lasting multilateral assistance to help these people shift from being victims to becoming the principal agents of recovery. Beyond assistance, it requires new networked relationships between peacekeeping forces and development practitioners, and a new approach to security.

Conclusion

The United States has elected a new president. Barack Obama will need to move beyond the fire fight of financial stabilization. Dealing with the economic aftermath will be one of the foremost responsibilities of the next administration.

That work is not about America alone. Obama has spoken about strengthening the sinews of America's ties with the world. How he will do this matters.

Fate presents an opportunity wrapped in a necessity: to modernize multilateralism and markets. ■

This article is based on a speech given by Robert B Zoellick at The Peterson Institute for International Economics, Washington, DC, on October 6, 2008

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Restoring Market Confidence

René Karsenti is the Executive President of the International Capital Market Association (ICMA)

The period of market turbulence since August last year has been the most testing time that market participants can remember. It has led to a severe loss of market confidence. As a result, banks have become reluctant to lend to each other, except for very short periods and on onerous terms, and the interbank market has ceased to function properly. The loss of market confidence matters, because it is seriously undermining the stability of the international financial system, destroying wealth on a massive scale and turning the prospects for growth in the international economy into recession. What can be done to restore market confidence and ensure that markets function properly, and what in particular can be done to re-establish liquidity in the interbank market?

Action by the authorities is a necessary condition for restoring market confidence. Central banks may be able to help restore market confidence by reducing interest rates, without jeopardising their inflation targets given the recessionary outlook, as they did on a coordinated basis on 8 October. Central banks are also continuing to play a critical role in providing the liquidity the market needs: for example, by frontloading the provision of liquidity during monthly maintenance periods, extending maturities, broadening the range of eligible collateral they are willing to accept in exchange, broadening their range of counterparties and even experimenting by lending unsecured.

When the solvency of a financial institution is threatened, the authorities have to decide whether the institution is too large or too interconnected to fail, or whether its rescue will create moral hazard in the future. In the US, where a number of financial institutions have been rescued, the failure of Lehman Brothers has had a knock-on effect on market confidence. The US authorities' proposals to establish a Troubled Asset Relief Program are designed to help restore market confidence inter alia by removing "toxic" assets from banks' balance sheets.

In Europe, within broad guidelines, individual member states have taken steps to help restore market confidence by: increasing the level of government guarantees on retail bank deposits, and in some cases removing the limits altogether; offering to guarantee the refinancing of maturing wholesale funding to help restart the interbank market; providing, and underwriting the provision of, new capital to banks requiring recapitalisation; and setting up emergency funds to buy assets from banks. In return for putting taxpayers' money at risk to rescue banks in these ways, the governments of member states are asking senior bank management to take full responsibility for past actions, limit executive pay in future and potentially restrict dividends to shareholders, while seeking a return for taxpayers. Where a number of member states together take steps to recapitalise banks, this may also provide a pointer to the unresolved question in Europe about how a large cross-border rescue would be organised and who would pay for it.

Separately, the authorities have to decide whether more regulation would help to restore market confidence. More regulation does not necessarily mean better regulation: new regulation needs to be considered carefully in advance to avoid unintended consequences later. For example, it is important to restore confidence in the process of setting credit ratings. But any approach to supervising credit rating agencies should be tackled globally; and if there is a risk of political interference in the ratings process, this will tend to undermine market confidence rather than help to restore it. Similarly, the market needs to re-examine the originate-to-distribute model. But Commission proposals to force EU originators to keep their "skin in the game" risk harming EU competitiveness.

Although the authorities' role is necessary in helping to restore market confidence, it is not sufficient on its own. The financial services industry itself has a vital part to play. This is mainly a matter for individual financial institutions themselves. A number have succeeded in raising new capital from their shareholders or from new investors, such as sovereign wealth funds. Consolidation has been taking place across the industry in the interests of achieving safety in strong balance sheets. In some cases, consolidation is being facilitated by the authorities: for example, by providing limited official guarantees or by waiving competition concerns. And the remaining independent global investment banks have opted to apply for full banking licences in the US, thereby submitting to stricter prudential regulation.

Financial institutions can also help to restore market confidence and ensure that markets function properly by addressing difficult issues in common: by ensuring maximum disclosure to investors; and by considering how to value securities when financial markets are closed, for example by allowing more flexibility in applying mark-to-market accounting in an attempt to prevent a downward spiral in asset prices. This involves a continuous dialogue between issuers and investors, and between the industry and the authorities. Trade associations like ICMA are playing a significant role in these areas, and are actively engaging with central banks, the European Commission, CESR and national regulators on their members' behalf.

> "... new regulation needs to be considered carefully in advance to avoid unintended consequences later"

ICMA also has an important self-regulatory role. ICMA and its members have for many years been centrally involved in creating an efficient and well functioning market through setting voluntary standards of good market practice. It is not widely appreciated how resilient the financial and legal market infrastructure has been during the recent period of market turbulence. I believe that ICMA's self-regulatory role in establishing and maintaining orderly markets by applying standard market practice across borders continues to deliver benefits in terms of flexibility, efficiency and cost-effectiveness.

Restoring proper functioning of the market is an essential first step to restoring market confidence, and the top priority is to re-establish liquidity in the interbank market. I welcome the steps that the authorities have already taken in an attempt to restore market confidence, especially when they have acted together. But given the scale of the emergency we face, I personally think that three additional steps need urgently to be considered:

First, we should build on government proposals to set up emergency funds to buy "toxic" assets from banks by encouraging banks to ring-fence the toxic assets on their balance sheets.

Second, we should build on the proposals by ECOFIN in Europe and the SEC in the US to allow more flexibility in mark-to-market accounting by permitting banks, if they choose, temporarily to suspend their use of mark-to-market accounting for well defined categories of balance sheet items.

Third, the creation of a central clearing counterparty for credit default swaps should be implemented as soon as possible to further improve the functioning of the derivatives market. ■

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Causes and Effects of the 2008 Financial Crisis

Carol Alexander is Professor of Financial Risk Management at the ICMA Centre, and author of the new 4-volume textbooks series *Market Risk Analysis*, published by Wileys. See www.marketriskanalysis.com

During the last few months the banking industry has been in turmoil, following the collapse of credit markets. By September 2008 the Treasury-Eurodollar (TED) spread exceeded 300 basis points, and it remains above 200 basis points at the time of writing. The value of stocks around the entire globe has fallen drastically and rapidly, reminiscent of the world stock market crash of 1929. Several exchanges have suspended trading on more than one occasion, and even then several markets have crashed by more than 10% in a single day. The currencies of some emerging markets, such as the Korean won, have plummeted in value against the US dollar. Markets in Europe have fallen more than 50% since the end of April, and some experts say further falls are imminent. Why is this happening? And what is the likely effect on the financial system? These questions are not easy to answer, as the crisis is still ongoing at the time of writing. All the reasons for, and effects of, a catastrophe are usually revealed only after the event.

Summary of events

There is a trigger for all financial crises, and in this case the first crack appeared with the sub-prime mortgage crisis in the US. During the years 2004 – 2006 stock markets across the globe surged as the cost of credit reached all-time lows. New ways of securitizing loans meant that counterparty credit quality mattered little to the salesman on commission. European banks, and investors in countries where yields had been extremely low for years, flocked to buy collateralized debt obligations (CDO) and similar new products. The main sellers were the five largest investment banks: Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers and Bear Stearns. Even retail banks began to rely on securitizing their loans and short-term funding via the interbank market rather than on a deposit base.

Whenever there is uncertainty in a free market economy, this promotes a cycle in which optimism can lead to exuberance, followed by doubt and finally panic. The basic principle underlying the CDO is sound – after all, if the senior tranche of a mortgage-backed security corresponds to two-thirds of the whole and the recovery rate on defaulting mortgages is 50%, it would only be affected if more than two-thirds of the creditors defaulted! So we had reason to be optimistic in the mid 2000's and there was a strong market for these new yield-enhancement vehicles. A fundamental problem was that their pricing lacked transparency. Because of the very considerable pricing model risk – the mark-to-model prices being crucially dependent on the assumptions made – doubts began to infiltrate the exuberance. And, as doubt turned to panic, the market dried up, so market prices became even more unreliable than the model prices. Given the mark-to-market accounting framework used by banks, a huge liquidity risk appeared in the trading book, and this was not covered by the bank's regulatory capital.

As liquidity fell out of the CDO market, banks turned to the interbank market to fund their liquidity gap. Because cash-rich banks demanded such high levels of collateral guarantees, other banks – and hedge funds, some of which were very highly leveraged – had great difficulty rolling over credit lines. Hedge funds were hit particularly hard. As the bull market turned, the values of their investments began to fall, and they had less collateral than usual to meet these larger guarantees. They have been forced to liquidate investments to meet collateral calls, increasing the downward pressure on stocks. The result was a crash in market prices across the globe during October 2008, with emerging stock markets and currencies being the worst hit, as US and European hedge funds liquidated their holdings in emerging markets.

The full extent of the current financial crisis first began to unfold in September 2008, with the failure of three of the five largest investment banks and of the US insurance giant AIG which, like the huge financial conglomerates Fannie Mae and Freddie Mac a few months before, was bailed out by the US government. Speculative short selling on the last two major investment banks, Goldman Sachs and Morgan Stanley, spread to the many retail banks in various countries that had been actively operating in capital markets since the repeal of the Glass-Steagall agreement in 1999, either buying CDOs or using proprietary trading in derivatives to boost profits. All three Icelandic banks defaulted, and with this some savers in other countries lost their capital. Volatility in banking sector stocks spilled over into energy, commodities and related stocks, on fears of a falling demand for oil and raw materials with the onset of a global recession.

Eventually governments responded by increasing deposit protection, lowering interest rates and providing additional liquidity. As a last resort, schemes for partial nationalisation of banks have been proposed – schemes that include caps on the remuneration of executives and traders – along with bans on short selling to attempt to stem the slide in stock prices. Regulators disregarded anti-monopoly laws as distressed banks were taken over by large cash-rich retail banks. The banking sector has now moved towards oligopolistic competition, with a few huge conglomerates such as JP Morgan dominating the markets. Given the unthinkable threat of a collapse of the global banking system in which the general public lose their savings, most governments have now raised deposit insurance ceilings.

Causes and effects

A catalyst for this particular crisis was Alan Greenspan's policy of promoting US growth by keeping US interest rates low. After the Russian crisis in 1998 US treasury rates were also brought down, but as the market recovered interest rates were raised to prevent inflation increasing. During the technology crash in 2001 and 2002 US interest rates were brought down to about 1%, which encouraged increased consumption and promoted US exports, and thus revived the US economy. After the recovery started Greenspan did not raise interest rates quickly enough. There were no fears of inflation. Yet, every time interest rates are held too low for too long, it creates a bubble. This time the bubble was caused by an 'easy credit' environment, culminating in the 'credit crunch' which marked the beginning of the 2008 financial crisis.

In relation to the underlying securities markets and in relation to world gross domestic product (GDP) the volume of financial derivatives traded is huge. At the end of 2007 the total notional outstanding on bond issues was about $80 trillion and the value of company stocks was about $40 trillion. Relatively few stock and bond holders hedge their positions because securities are often held by investors that hope to make a profit over the long term. Thus the notional size of the derivatives market required for investors to hedge is a small fraction of $120 trillion. Many companies involved with importing and exporting goods hedge their exposures to exchange rate fluctuations, and to rising interest rates. The size of these exposures is related to the value of all goods produced in the world economy. World GDP was about $75 trillion in 2007, so corporate hedging activities should amount to some small fraction of this. Thus the two hedging activities should result in a derivatives market with notional size being just a small fraction of $200 trillion. However, the total notional size of derivatives markets in 2007 was about $600 trillion.

Speculative traders include proprietary traders, hedge funds, companies making bets and day traders. They trade in capital markets for the purposes of making profits over a short-term horizon, which distinguishes them from investors, who buy-and-hold. Approximately half of the speculators in the derivatives markets are proprietary traders in banks. When interest rates are cut banks turn to the capital markets to make profits by increasing the volume of their speculative trading. As a result, huge bonuses are often paid to successful proprietary traders and their managers. But why should banks bet with the money of their savers and their clients? Apart from the possibility that they may be better at speculation than ordinary investors, because of better information or cheaper access to markets, banks need to create a liquid market in order to price derivatives. We need speculative trading in options, because the volume of trading creates a market where there is no reliable theoretical price. But we do not necessarily need speculative trading on futures, because we know how to calculate the fair price of a futures contract. One reason why there was approximately $25 trillion of speculative trades on futures last year is that senior managers and proprietary traders are

being driven by greed to acquire huge bonuses. This is why the recent nationalisation deals for UK banks has included a clause for limiting remuneration.

This huge casino, in which many times world GDP is bet every year, has proved impossible to regulate. Regulators always respond to crises by tightening rules and increasing the minimum level of risk capital to be held by banks. But this exacerbates the problem, since the only way out of the current crisis is to create liquidity. Injecting taxpayers' money into the capital markets is only a temporary solution; what is needed now is a complete reform of financial regulations. This does not necessarily mean tighter control on market operations, or increases in the minimum level of risk capital held by banks. Indeed, there may be government pressure to loosen regulation in order to establish a leading financial centre.

Financial engineering and risk analysis

Financial engineers and risk analysts use mathematical models to measure risk, and to price illiquid products using arbitrage pricing theory. The assumptions made by these models need constant testing and refining, so that superior models can be developed. With greater confidence in market to model prices, and in portfolio risk assessment, it may be easier to stem the panic when the next crisis comes. Clearly, better education in quantitative risk analysis is the key to developing effective risk models and accurate pricing models for financial institutions. ■

The ICMA Centre at Henley Business School, University of Reading, UK has innovative, practically oriented Masters programmes in both Financial Engineering and Financial Risk Management. For further details see www.icmacentre.ac.uk

The Future for Banking Supervision

Angela Knight is the Chief Executive of the British Bankers' Association

In October the British Bankers' Association held its 12th annual conference on banking supervision. Being the 12th such event, it didn't require much working out to recall that the first was in 1996, when supervision of the banks was with the Bank of England, securities trading with the SFA, investment management with IMRO, the IFAs were with the PIA, the building societies had their own regulator and insurance was still with the government. Two years later, the Financial Services Authority (FSA) was born and now, in 2008, a new Banking Bill has commenced its passage through Parliament which again addresses - among other matters - some of the structural issues.

The conference met last year just after the failure of the Northern Rock. At the time, we thought we were meeting at an historic time. Since then, the problems with the financial system have become evident around the world. Regardless of their initial expectations, governments have now intervened in a large number of countries: Ireland, Denmark and Greece have underpinned their entire industry; and Hungary, Iceland and the Ukraine have had to approach the International Monetary Fund (IMF). And when the UK announced its three-pronged proposal of recapitalisation, money market liquidity and guaranteeing certain financial instruments, the other major European countries of France, Germany, Italy and Spain also followed suit. In the US, the Paulson Plan was changed to be more akin to our own. And action is not confined just to these countries: Canada and Australia have also acted and there will be more to come.

The causes of the current crisis are many. Low inflation and a relaxed credit environment played a part, with governments growing economies on the back of consumer consumption and a rising housing market. Investors sought higher returns in this low inflation period and that played a part, too. The pro-cyclicality of Basel II and the Capital Requirements Directive have also played their parts, as has the volatility brought about by fair value accounting and the mark to market rules, particularly as some markets have ceased to function. Regulators either did not recognise or capture properly the issues either here or elsewhere; and when money markets started to seize up, actions taken by central banks were sometimes slow and initially were local. Following Lehman Brothers' failure on September 15th, the withdrawal of even short term funding into the system by other institutions accelerated and demonstrated the lack of confidence felt around the world.

The causes, therefore, of the extraordinary events of these last 15 months are diverse, but it is clear that one of the causes was the failure by some significant elements of the banking industry to measure risk effectively. The crisis is a global one and the responsibility for it is shared by the industry and by others. The industry must take its share of responsibility for this and it does. Not all banks have been appropriately vigilant in managing risk. For that omission, and for the expectations of the industry's customers and clients and other stakeholders which have been disappointed, the industry expresses regret.

Now, as we look to the future, there is a real need to ensure that pragmatic, sensible and practical measures underpin what changes need to be made. We must ensure that banks can continue to take managed risks and are not so restrained by the regulatory consequences of this crisis that risk taking stops. A banking system that removes all risk is a system that fails to serve society.

Taking the Banking Bill first, it is immensely important that our tripartite authorities (the Bank of England, FSA and HM Treasury) have clearly established their roles, responsibilities and co-ordination. We believe that a 'no surprises regime' should be the norm for the tripartite, particularly the point at which the special resolution regime (SRR) - that is the early intervention mechanism envisaged by this legislation - is triggered. From the perspective of the industry the order of priority is:

1. that attention be paid to good, effective regulation (hence we support the FSA's decision to recruit more high quality individuals);
2. that, should it not be possible for effective regulation to move a bank out of difficulty, the FSA be responsible for the decision to trigger the SRR; and
3. that the Bank of England be the authority responsible for deciding which of the SRR tools to use, and for operating the SRR.

We are supportive of this legislation but, importantly, as it is currently drawn, it does not give sufficient certainty, particularly for netting contracts. That is potentially significantly detrimental. Without a clean legal opinion on netting, capital has to be held gross; if that does not change, many activities will cease to take place here in the UK. We are therefore in discussion with the Treasury and members of both Houses of Parliament to seek to amend and clarify the Bill accordingly.

In Europe, it is obviously necessary to ensure that pan-EU supervision is effective and that the development of supervisory colleges continues apace. However, many of the international banks operating here in the UK already work with significant colleges of regulators and not only from just one region. We believe that using the best from this experience is the way forward, applying the home supervisor principles as set out in last year's BBA publication *Regulating a Multi Jurisdictional Bank*.

It has been noticeable that whilst central bankers seem to have been able to act effectively together without any new structure, regulators appear to have found it harder. Whilst there are obvious differences, nevertheless the central bank experience provides a template for how regulators, regardless of their country or their region, can cooperate effectively together. If this crisis has shown anything, it has shown that globalisation of markets means a problem in one country can infect others around the world and that there is no such thing as a regional solution for an international industry. The EU must keep the international context firmly in its sights and not be tempted by inward-looking solutions.

Looking at specific issues, the list is quite long. It includes better and

more coherent risk management for the banks; and from the regulators a focus that is more holistic than the current approach, which tends to be picking on one particular aspect or another of banking activity.

Also on the list are solvency, liquidity, more disclosure and more transparency (the kind that is understandable), as well as moves to mitigate the effects of pro-cyclicality in capital. The securitisation model is on the list too, and this is being reviewed by both the industry and by regulators. One aspect that is essential to remember is that securitisation can be an appropriate way of spreading risk. It would be a great pity if actions were taken now that had the effect of preventing this activity in future.

Credit rating agencies require a more appropriate framework, too. I am aware that one of the agencies sees that change is essential and, as a result, has altered its model substantially to resolve the inherent conflicts. That agency is now touring the world offering up what it is doing as a standard to authorities, with its only criteria being that whatever the result it should be universally applicable, as ratings are used universally. Different criteria in different jurisdictions will evidently not help investors nor the industry in future.

These are only some aspects. The basic principle that should guide all of these reforms should be that clear and sensible changes should prevail and not the more politically expedient hasty or detrimental actions. Honesty too is essential, because for far too long it has been a view far too popularly held that the credit crunch was only an Anglo-Saxon problem. It was not and is not. The UK has been very open about the difficulties here - and the solutions - and we look forward to others following suit. Some regulations will change and some new requirements will be set.

However this is an industry that has powered the economies of this country and many others. If the UK is careful in its response to the crisis we will come out of it with a big international banking centre quartered in London. But if we over-regulate or if we take steps that are not necessarily required in the heat of the moment, either here or in Brussels, then we will jeopardise our future. This is because the big economic growth countries of the next ten years are much more likely to be in the East than they are in Europe or the US, and we will simply accelerate the gradual drift in that direction.

So with the analysis of the current situation up and running, and some of the attention now on the future, putting it all together is going to be a complex piece of work and one in which the industry is and will continue to be fully engaged.

And meanwhile the UK along with other major trading nations is juggling with the R word. Are we in recession, or not quite? For my part I can only say that here are three things to remember about a recession. They are not easy and they seem dire at the time; but there is still business to be had; and they do pass. ■

ICC Arbitration: Enabling Globalization

Jason Fry is the Secretary General of the ICC International Court of Arbitration

The continued growth in international trade and investment has been the main driver of the global economy for many years now. Effective dispute resolution is invaluable to this ongoing process of greater economic interdependence and globalization.

Recent research has indicated that when contracts, especially between partners from different cultures, are inevitably exposed to strain, misunderstanding and even flagrant abuse, ICC arbitration is the preferred method to for resolving these disputes.

A study published this year by consultancy PricewaterhouseCoopers, "*International Arbitration: Corporate attitudes and practices*" confirms this fact. The report highlights that arbitration is the method of choice for cross-border transactions and disputes relating to foreign direct investment.

The survey also showed business prefers international arbitration and amicable dispute resolution procedure as an alternative to transnational litigation to resolve these international disputes. Arbitration institutions pointed to savings of time and costs and safeguarding business relationships as the main reasons for choosing arbitration over other methods.

What is more, the corporations polled in the PwC survey said the reputation of the arbitration institution, and the convenience of having the case administered by a third party, are the main reasons for opting for this method.

A large number of corporations in the survey – 45% in fact – said they preferred to submit their disputes to ICC.

ICC's stature as the leader in international arbitration has a long history - dating back to its founding in 1919, when the International Chamber of Commerce was created to combat insularity and protectionism in world trade. From the very beginning, ICC saw dispute resolution as an indispensable part of the services it was to provide.

Today, ICC maintains its large leadership margin by offering enterprises across the world an effective means to restore order in their commercial relations, so that trade can be resumed under normal conditions as quickly as possible.

ICC arbitration is inspired today, as it was in the beginning, by three important qualities: neutrality, flexibility, and predictability. These qualities provide a framework within which parties can shape proceedings in accordance with their needs, whilst being assured of appropriate control when required.

Neutrality is ensured by rules defining the procedure. These are drawn up by drafting committees made up of ICC members from many different countries around the world, who are guided by the need to transcend cultural differences. The rules are not oriented towards either common law or civil law, but have a universal application. ▸▸

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- Flexibility allows parties to determine key aspects of the proceedings. This could be the place of arbitration, the rules used to resolve the dispute, the language in which proceedings are conducted, the manner in which evidence is presented, the identity of arbitrators who decide the dispute, and even the time limits.

Predictability is achieved through fallback measures when parties are unable to agree. It is also achieved through the coherence in the administration of cases, objective criteria for determining costs, and the binding and final nature of awards rendered.

Businesses can choose one or several ICC dispute resolution services tailored to their circumstances. For example, for urgent measures, arbitration can be combined with a pre-arbitral referee procedure; an expert's opinion can be obtained on a point at issue; or to encourage a settlement by mutual agreement, an amicable dispute resolution procedure can be used.

What sets ICC apart from other arbitration options is the ICC Court of Arbitration. The Court is a unique body, not only in its composition, but in the way it operates. The diversity of the members of the Court and its Secretariat – professional, geographical, and cultural – is what gives ICC arbitration its unparalleled scope.

The most eloquent proof of the wide appeal of ICC arbitration today lies in the ever-widening global distribution of its users: last year, parties to the cases filed with ICC's Court of Arbitration came from 126 different countries and territories, the highest ever, from economies of all types and at all stages of development.

Today, the Court is used for international disputes of all kinds, from the simplest sales agreement to the most complex build-operate-transfer arrangement or shareholding structure. ICC procedures are also used to resolve investment-related disputes through bilateral investment treaties.

The most striking expansion of ICC arbitration is currently taking place in Central and Eastern Europe and in Latin America, where the number of cases filed with the court has effectively doubled in the past two decades. At the same time, the number of parties from each of these regions has tripled for Central and Eastern Europe and grown 10-fold for Latin America and the Caribbean over the same time frame.

ICC continues to extend the global reach of its dispute settlement activities. In recognition of the growing importance of the Asia-Pacific region, the ICC Court and the Secretariat of the ICC Court will open new offices in Hong Kong and Singapore. A branch of the Secretariat of the Court will be located in Hong Kong. A liaison office dedicated to ICC dispute resolution services will debut in Singapore.

Already, the Court has regional representatives serving as contact points and coordinating outreach in the Africa, the Americas, the Middle East and the United Kingdom.

Alongside its dispute resolution activities, ICC also has a policy-making body that remains alert to legal and commercial trends in a changing economy. This corpus of 450 members around the world pools ideas, and studies practical legal and procedural issues relating to international dispute resolution.

It is this dual capability that gives ICC arbitration a competitive edge: ICC's unique position as the voice of enterprises worldwide due to its presence in 130 countries. ICC's global scope means ICC has a special understanding of business needs, and a truly global perspective on trading issues, with direct experience of business practices.

As globalization continues to evolve, ICC has its ear to the ground, and is able to mobilize these resources to ensure international arbitration remains a highly efficient and effective method of dispute resolution in tune with the times - today and tomorrow.

ICC Hearing Centre opens for business

Members of the international legal community gathered at a special event in October to celebrate the opening of the ICC Hearing Centre.

Conveniently located in the centre of Paris, the ICC Hearing Centre is dedicated to arbitration hearings and other forms of commercial dispute resolution. It is the first such facility in Paris and can be used for disputes arising anywhere in the world.

The 800 square meter Hearing Centre has opened in response to growing demand from business and legal communities. Last year, the number of new cases filed with the ICC International Court of Arbitration hit a record high of 599.

The increasing pace of globalization in recent years has naturally led to a growing number of business disputes worldwide. The ICC has drawn on its many years of experience monitoring arbitration and mediations proceedings to create the custom-designed Hearing Centre.

The Hearing Centre is specially designed to meet practitioner's needs and conduct hearings in optimal conditions. It comprises 10 soundproofed and secured rooms fully equipped with microphones, internet connections, air conditioning, TV screens and projection systems. The rooms vary in size from 23 square meters to 110 square meters, with seating capacity up to 40 people. The largest rooms are also equipped with translation booths.

The ICC Hearing Centre is available for any kind of institutional or ad hoc arbitration hearings as well as for the conduct of amicable dispute resolution (ADR) procedures. It may be reserved for hearings that use the ICC Rules of Arbitration and ICC ADR Rules, and those that do not.

Please visit www.icchearingcentre.org to review rates or to make a reservation. ■

For more information about ICC's Dispute Resolution Services, please visit www.iccwbo.org/court

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An Energy Agenda for the Next Administration

Peter M Robinson is President and CEO of the United States Council for International Business

The next US presidential administration will face a number of important international challenges requiring prudent and effective action. Near the top on anyone's list is energy and climate change.

Energy is the lifeblood of the global economy. American business is a vital player in the production and transport of energy all over the world, and of course our society consumes more energy than any other nation. We have made tremendous strides in developing cleaner technologies and energy sources, while improved efficiency has boosted our competitiveness as well as environmental protection. Nevertheless, as a trip to the gas station will attest, energy costs are a challenge for everyone, including global companies. Indeed, some say we may need to adapt to an era of permanently higher energy prices.

However, energy can never be seen as just a "business" issue. Indeed, it is a fundamental prerequisite for social and economic development across a broad range of areas. Pick almost any of the Millennium Development Goals – progress toward which is a key goal of this year's UN General Assembly session – and you will find an energy-related component. Clean water, health care, poverty eradication: how can any of these be effectively addressed without greater access to energy?

Of course, much of the debate over energy has focused on climate change. What is the best path to a lower-carbon future? And how can we best use our energy resources to mitigate and adapt to the effects of global climate change, while still ensuring we meet the needs of a growing world? Global solutions are called for, and our next president will need to take the lead in crafting international rules to tackle both the energy and climate challenges. ▸▸

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For USCIB members and other global firms, the way forward is clear: the only way to provide dependable, affordable and cleaner energy is through international action and cooperation to deploy and upgrade energy systems worldwide.

We have worked hard to advance understanding of these issues at the highest levels, in global talks under the UN Framework Convention on Climate Change, where countries are seeking to forge agreement on broader and more inclusive post-2012 actions as the Kyoto Protocol reaches the end of its first round commitments, and in the G-8 as well. We have leveraged our unique affiliations with the International Chamber of Commerce and the Business and Industry Advisory Committee to the OECD to advance a coordinated and integrated approach to climate and energy around the world.

There can be no doubt that American companies are up to the challenge. The next administration must therefore frame a vision of US leadership on energy and climate that places a high priority on our proven technological know-how and the business community's ability to commercialize and disseminate the fruits of innovation. This vision should be optimistic, driven by an understanding of the power of markets and international trade to deliver results.

"The path to cleaner, affordable energy is through international cooperation"

A new vision on energy and climate should encompass four essential goals:

- Broaden the energy mix. Diversifying energy portfolios is a proven strategy to manage tradeoffs and uncertainty in the near and long term. We should not foreclose any energy options in international discussions.
- Foster innovation. The transfer of new and cleaner energy technology to emerging markets such as China and India will be critical. But to make this happen, private-sector innovation needs to be fostered, and intellectual property rights protected.
- Embrace markets. The International Energy Agency puts the bill for meeting global energy needs over the next two decades at $20 trillion. The lion's share must come from the private sector. To do this, we need open markets, protection for investments and trade liberalization.
- Regulate wisely. We need long-term international policies, often called "enabling frameworks," that are consistent and predictable, encouraging investment, securing property rights and promoting public-private partnerships for energy innovation.

The next administration must work closely with other nations, not just in established settings such as the UN, but in new arrangements that enable countries best placed to move forward to do so with a minimum of impediments. It is a time for creative leadership, not dogma.

American business is ready to build our energy competitiveness in the global marketplace, to grow our economy and to move decisively towards a sustainable energy future. We hope the next president is up to that same challenge. ■

Hedging Market Risk in Islamic Finance

Kazi Hussain is the Head of Islamic Finance, Europe Arab Bank plc, and Fahad Mehboob is Associate Director of Islamic Finance at Europe Arab Bank plc

The purpose of this article is to give the reader an understanding behind a few of the Islamic structures designed for risk management and hedging, including structures that have been developed within a Shariah framework to create the economic effects of conventional hedging tools. Thus we will consider the underlying structures of a profit rate swap and an Islamic FX swap, equivalent to (in conventional finance) an interest rate swap and an FX swap respectively.

Islamic financing techniques

Islamic Finance is based on the fundamental tenets derived from the Holy Qur'an and the Prophet Muhammad's traditions, the Sunnah. These tenets are embedded in what is defined as the Shariah – a framework of Islamic law.

The Shariah is as clear with regards to personal law as it is with regards to economic and commercial transactions. There are four distinct prohibitions when it comes to the jurisprudence of Shariah law in regards to commercial transactions, namely the prohibitions on: (i) receipt and payment of interest (riba); (ii) uncertainty (gharar); (iii) specific forbidden activities (haram); (iv) Gambling/speculation (maysir).

Given the specific injunctions listed above, the Shariah has been used to develop certain structures involving commercial contracts acceptable in Islam. The complexity of a specific Islamic transaction will be dependent on how many types of these contracts are structured so as to achieve a certain economic/commercial outcome. There are a few basic structures which have lent themselves to the foundations of modern Islamic financing techniques. These forms of Shariah contract can be divided into three main types:

- contracts of sale (eg, murabaha, istisna'a, salam);
- contracts of lease (ijara); and
- joint enterprise arrangements (eg, musharaka, mudaraba), each with its own parameters.

For the purpose of this article we will consider only the murabaha structure.

Murabaha (cost-plus financing)

A murabaha is a tri-lateral sale arrangement whereby a financier/intermediary purchases goods from a supplier and sells them to an end-user at a deferred price that is marked-up to include the intermediary's profit margin. This profit margin is permissible since the intermediary takes title to the goods, albeit possibly only briefly, and hence accepts the commercial risk of their ownership. Possession is a key factor – title must change from the intermediary to the end buyer. Possession can be only either physical or constructive, and not both simultaneously. Financiers generally use Libor as a reference only for profit margin – this is not interest per se and should not be seen as such.

Shariah scholars have allowed the referencing of Libor rates as permissible. This view is from the majority of scholars; for instance Justice Taqi Usmani has specifically referred to an example in his book, *An Introduction to Islamic Finance*. In the majority of transactions the intermediary appoints the end-user as its agent to purchase the goods from the supplier on its behalf. The intermediary bears the risk of ownership after the end-user, acting as its agent, purchases the goods and before the intermediary sells the goods to the end-user.

The basic murabaha contract has been used in various forms in Islamic finance. The application of this structure has given banks (both Islamic and conventional through the use of Islamic windows) a liquidity management tool for interbank transactions (with the exception of no overnight trades as settlement of trades takes longer) and now Islamic hedging tools, which we explore later in this paper. Murabahas have also been used as the basis of trade finance transactions, where generally banks have financed working capital requirements by the purchase, for example, of an inventory and then sold this on to the end user of the financing.

The 'commodity murabaha' structure used by banks for liquidity management and other purposes comprises the purchase and sale of commodities (standard Shariah practice has been the use of non-precious metals from the London Metal Exchange) by the intermediary to the end user through the use of brokers. This is

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illustrated in Exhibit 1. Metals are bought from broker 1 by the financier and then sold to the end user (client) on deferred payment terms, the client will then sell the metals at spot price to broker 2 who will pay for the metals, and broker 2 will then sell these metals to broker 1 at spot price. Thus the end result being that the client is left with cash while the bank is left with a payment obligation comprising principal plus profit where the profit was derived by a sale of the underlying commodities by the bank to the client.

Islamic hedging instruments

The growth of the sector has given rise to the need for more solutions within Islamic finance. Thus as banks offering Islamic solutions take on more difficult financing structures and more aggressive client requirements, they have had to look at their risk management tools – both from their own perspective and the client's viewpoint.

Islamic banks' retail product offerings tend to be generally fixed-rate murabaha-based products to customers, while the corporate customers are offered facilities based on floating benchmarks. Thus from the banks' point of view there is a liquidity mismatch with Islamic deposits being much shorter tenor (3-6 months) compared with Islamic investments of longer maturity, and also fixed versus floating rate exposure. Corporate clients also require a more sophisticated product set to manage their own risk positions through the banks. Therefore, Islamic banks require Islamic tools to manage interest rate risk and FX risk. Hence the development of the profit rate swap and the Islamic forward FX contract.

There are a number of financial institutions that offer Shariah-compliant hedging solutions for the above mentioned risks, however the standardisation of the documentation is still not complete compared to conventional contracts. For this reason Shariah-compliant hedging remains unattractively priced when compared to conventional hedging products. However, as the market develops pricing should cease to be a problem.

The objective behind an Islamic profit rate swap is effectively the same as that underlying a conventional interest rate swap, namely to manage exposure to interest rate movements. Thus it is designed to protect financial institutions from fluctuations in borrowing rates and to provide a risk control mechanism. The wide-spread availability of hedging instruments acceptable in Islamic finance will ensure that investors and customers with different banking requirements, as well as Islamic financial institutions who require balance-sheet management, can enjoy benefits which conventional banks have been experiencing for many years.

Profit rate swap

An Islamic profit rate swap is basically an agreement to exchange profit rates between a fixed rate party and a floating rate party, or vice versa, implemented through the execution of a series of underlying Shariah contracts. In the current market a further contract called the wa'ad contract is being utilised so as to ensure the swap reaches maturity.

A wa'ad is a binding unilateral promise and is binding one way only. Before each commodity murabaha stage and reverse murabaha stage in the following structure, a wa'ad is given by each counterparty respectively. The wa'ad ensures that the promissee undertakes to enter into that relevant commodity murabaha or reverse commodity murabaha trade. This will continue until the swap expires.

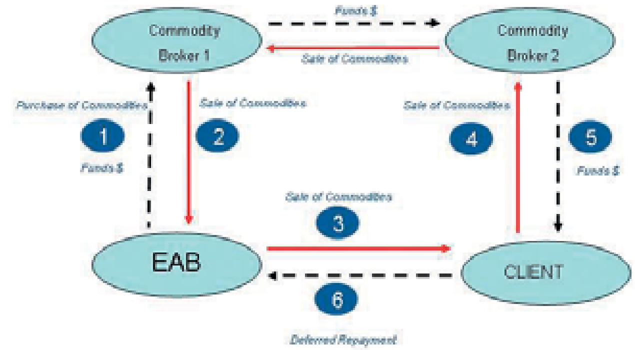
Commodity murabaha structured profit rate swap

The most common underlying structure for a profit rate swap is linked with a Shariah asset-backed structure using a plain vanilla commodity murabaha. Structured in this way using a commodity murabaha the prohibitions mentioned in the section above are adhered to, that is it must be free from any elements of riba (usury), gharar (uncertainty) and maysir (gambling). Each party's payment obligation is calculated using a different pricing formula. In an Islamic rate profit rate swap, the notional principal is never exchanged as it netted off using the Islamic principle of Muqasah (effectively defined as a set off).

The following is an example of a basic profit rate swap using a murabaha structure:

1. Bank A has a fixed rate investment profile from its purchase of Islamic assets maturing in five years and paying semi annually.

Exhibit 1: Commodity murahaba structure



Source: Europe Arab Bank plc

2. Bank A wishes to swap its fixed rate payment profile with a floating payment profile. Bank A may decide to enter into an Islamic profit rate swap with counterparty Bank B.
3. Bank A receives a cashflow from its investment every six months on a fixed rate profit margin.
4. Bank A gives a wa'ad thereby promising to enter into commodity purchase.
5. Bank B (counterparty) sells an asset (base metals) to bank A on a murabaha basis at a selling price that comprises both principal and profit margin to be paid upon completion of subsequent transaction (floating rate portion). Thus the commodity murabaha transaction is executed.

Floating profit rate

6. Prior to six months, bank B gives a wa'ad so that it promises to purchase commodities from bank A. Bank A will sell an asset to bank B at a selling price of notional principal, plus a mark-up based on the prevailing profit rate (agreed spread plus current benchmark). Thus the reverse commodity murabaha is executed by the two parties (reverse commodity murabaha as seen from bank B's point of view).
7. Payment of selling price by both bank A and bank B is netted-off.
8. The net difference is profit, and is paid to the swap counterparty as initially agreed between both counterparties in the master agreement.
9. Floating profit rate is repeated every six months until maturity.
10. During commodity trades bank B can also act as agent for bank A in the commodity trades between the brokers and facilitatethe individual legs involved in the process.
11. The costs of the actual commodity trades vary from broker to broker, generally over the last few years brokers will cost between US$20 – US$30 for every million traded.
12. The pricing for the swap is undertaken in the usual conventional approach.

In the swap no actual payment is made as the principal amount upon which total payments are based are merely notional, this is in line with what happens in a conventional IRS. From Shariah the principle of muqasah (set-off) has been utilised. Exhibit 2 summarises the salient features of a profit rate swap compared with a conventional interest-rate swap.

Exhibit 2: Islamic profit rate swap and conventional interest rate swap compared

Conventional interest rate swap	Islamic profit rate swap
ISDA master agreement	Islamic swap master agreement
Trade confirmation	Trade confirmation
Payment advice	Two sets of asset purchase and asset sale agreements (commodity murabaha followed by reverse commodity murabaha)
Transaction netting is practiced to net-off payment between fixed and floating leg	Transaction netting is allowed to net-off payments between the four asset purchase and asset sale agreements to arrive at net payment

Source: Europe Arab Bank plc

FX risk hedging

There are a number of ways a Shariah-compliant FX hedge can be executed. Each one has its pros and cons with the wa'ad structure being the most preferred in terms of consensus view amongst the scholars.

Forward FX involves essentially two dissimilar ribawi (interest based) items, that is, two different currencies. The Shariah position with regards to the exchange of two dissimilar ribawi items is that the

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exchange of two counter values must be spot or simultaneous (hand to hand).

Forward FX entails that the rate of exchange is locked in today (the day of contract) but delivery of two counter values is being deferred to a future date where the delivery of these two counter values will be made on spot basis.

Shariah, however, requires delivery to be made on the day of the contract, that is, 'hand to hand' which is not the practice in the current FX market. However, Islamic law does not prohibit promise to buy and sell currencies on one date and delivery to be made on another date because the proper contract only concludes on the day of delivery. Under the wa'ad structure, only one party (obligor/promisor) promises to buy/sell as the case may be wherein he is bound by that promise (binding promise). The other party/promisee/obligee, however, is not bound to proceed with the promise undertaken by the promisor. Under Shariah binding, promise from only one party is not deemed as a contract. Therefore, this can facilitate Islamic FX contracts.

(i) Back to back interest free loan

A very simplistic approach has been to execute a Shariah-compliant FX hedge by execution of two back-to-back, interest-free loans of different currencies. The loans do not carry any interest or any other benefit. The agreements are separate and neither one cross references the other.

This is a very simplistic FX hedge, and does not conform to the conventional FX hedging, as the conventional hedging mechanism takes into account the forward FX rates, the tenor etc. This simplistic method has been used in day-to-day dealings between local traders and in small amounts.

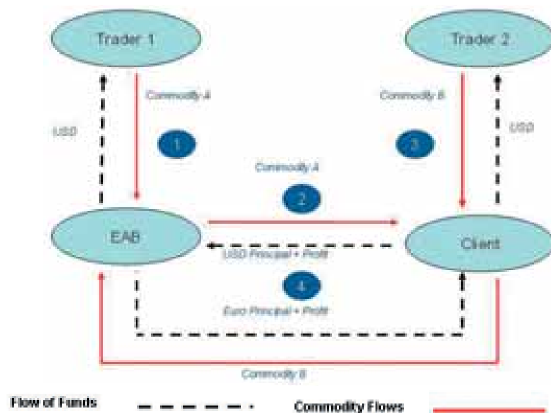
(ii) Murabaha based contracts

A second common mechanism is based on the commodity murabaha mechanism (see Exhibit 3), by which the customer and the bank enter into two separate murabaha transactions to facilitate the FX forward contract. The customer will buy a commodity for spot value and sell it to the bank for purchase price plus agreed profit (the basis point in a conventional FX forward deal), payable on a deferred basis.

To address the other side of the FX forward deal, the bank will buy another commodity and sell it to the customer, again for purchase price plus agreed profit, on a deferred basis. Both the customer and the bank typically will sell the commodity back into the market to recover their initial investment.

This has been quite widely used by Islamic financial institutions as it is very similar to a normal murabaha contract which nearly all Islamic money market operations incorporate, however the cost associated with incorporating a commodity in the transaction has given the impetus for Islamic institutions to seek other ways of hedging their FX exposures. Exhibit 3 illustrates the murahaba based FX contract.

Exhibit 3: Murahaba based FX contract



Source: Europe Arab Bank plc

(iii) Wa'ad based contracts

A third common Shariah compliant hedging mechanism that has been developed over the last few years has been based on the concept of wa'ad. Essentially, party A, who is looking for a hedge, will provide an undertaking (a wa'ad) to purchase a specific currency at a future date. The promise cannot be conditional on any event, and will have details of the amount of the currency to be purchased along with the future date of purchase.

The following describes a wa'ad based FX hedge.

Step 1:
Parties ("Islamic Bank" and "Customer A") enter into a "Master Agreement for the Sale and Purchase of Currencies" (the "Agreement").

Step 2:
Customer A identifies his requirement, for example he has surplus funds denominated in US$ and wishes to invest in a £ denominated investment opportunity. However, Customer A is concerned that £/US$ exchange rate fluctuation may expose him to cash flow uncertainty and therefore wishes to mitigate this risk.

Step 3:
Customer A and Islamic Bank agree the commercial terms of the spot transaction over the telephone, ie., Islamic Bank and Customer A conduct an ordinary spot foreign exchange transaction pursuant to which Customer A remits US$1.86m to Islamic Bank's designated account. Upon evidence of receipt of the funds, Islamic Bank remits £1m to the Customer A's designated account.

Customer A and Islamic Bank agree the commercial terms of the hedge over the telephone, that is:

- Currency: £/US$
- Purchase price: £1m
- Current £/US$ spot exchange rate: 1.8600
- Promised exchange ratio: 1.8400

Step 4:
Customer A sends Islamic Bank a "Promise to Purchase" whereby Customer A undertakes and promises to purchase US$1.84m for £1m on a specified future date for settlement two working days later (the "Purchase Date") on the terms and conditions outlined in the Agreement.

Step 5:
Islamic Bank acknowledges the promise by duly signing and returning the Promise to Purchase to Customer A.

Step 6:
Two working days prior to the Purchase Date, Customer A sends Islamic Bank an "Offer to Purchase" whereby Customer A offers to purchase from Islamic Bank US$1.84m for £1m for settlement on the Purchase Date.

Step 7:
Islamic Bank sends Customer A an "Acceptance Notice" accepting Customer A's Offer to Purchase. It is important to note that the Promise to Purchase has now been converted into a spot equivalent transaction for settlement on the Purchase Date.

Step 8:
On the Settlement Date, Customer A remits £1m to Islamic Bank's designated account. Upon evidence of receipt of the funds, Islamic Bank remits US$1.84m to Customer A's designated account.

Conclusions

As the Islamic market develops and products are innovated, basic hedging and risk management tools need to evolve within the boundaries of Shariah so as to maintain not only Shariah compliance credibility, but also to expand trade between banks, intermediaries, and of course corporates.

It is vital that counterparties have access to such products, in order for Islamic finance to continue to grow and an increased level of financial intermediation to occur as a result, with a deepening of the Islamic market. This can only be beneficial for finance as a whole. ■

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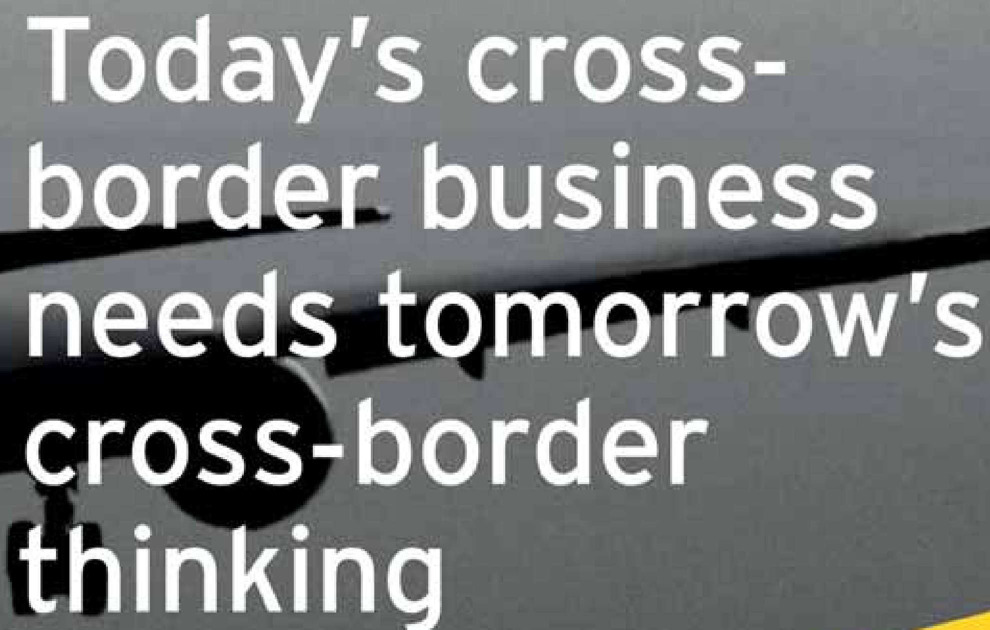

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Transfer Pricing Aspects of Business Restructurings

Caroline Silberztein is Head of Transfer Pricing Unit, OECD Centre for Tax Policy and Administration

On 19 September 2008, the OECD released an important discussion draft entitled *"Transfer Pricing Aspects of Business Restructurings"*. This document is the result of three years of discussions among OECD member countries on what is today one of the hottest topics in international taxation.

What is at stake? Business restructurings that are addressed in the discussion draft consist in the cross-border redeployment of functions, assets and risks within multinational enterprises. They often have dramatic effects on the reallocation of the profit (or loss) potential among the members of a multinational enterprise group, and accordingly on the amount of corporate income tax paid in each of the countries where the group operates. Typically, they involve the conversion of affiliated full-fledged manufacturers into contract- or toll-manufacturers, the conversion of affiliated full-fledged distributors into limited risk distributors or commissionnaires, operating for an affiliated principal that will act as the main "entrepreneur" for the group and centralise intangible property rights, risks and profit (or loss) potential.

Business restructurings raise particularly difficult issues in the international tax area, especially for the application of tax treaties and in the area of transfer pricing, for the determination of the quantum of the tax base allocated to each country where a multinational enterprise operates. There are also issues in relation to the possible application of domestic anti-abuse rules. The discussion in the September 2008 discussion draft is limited to the transfer pricing aspects of business restructurings.

The international consensus on transfer pricing is found at Article 9 of the OECD Model Tax Convention – an article that is reproduced in several thousands of bilateral tax treaties between countries. Under this provision, the conditions of transactions between associated enterprises should be "arm's length". This means that tax administrations can determine, for tax purposes, whether the conditions of a transaction between associated enterprises – for instance, a restructuring transaction – differ from those which would be made between independent parties. Where this is the case, tax administrations may adjust the taxable profits of the enterprise to include the profits that would have accrued "at arm's length" but have not so accrued, by reason of these special conditions. Guidance for the application of the arm's length principle is found in the OECD Transfer Pricing Guidelines for Tax Administrations and Multinational enterprises.

Examples of transfer pricing questions that may arise during an examination include whether the new allocation of risk that results from the restructuring is arm's length; whether the restructured entity should have been indemnified at arm's length for the detriment suffered in the restructuring; whether the remuneration for the post-restructuring transactions is arm's length; and whether the tax administration should recognise the restructuring transaction or may disregard it.

Today, countries have differing experiences and approaches in their transfer pricing examinations of business restructurings. This lack of a common understanding of how the arm's length principle should apply to business restructurings creates significant uncertainties for businesses and for tax administrations. One objective of the OECD project is to discuss the extent to which the reallocation of profits that typically follows from a restructuring is consistent with the arm's length principle and more generally how the arm's length principle applies to business restructurings, in order to achieve a greater consensus, clearer guidance, less uncertainty and less risks of double taxation – or of unintended double non-taxation.

In light of the importance of risk allocation in relation to business restructurings, the discussion draft provides general guidance on the allocation of risks between related parties from a transfer pricing perspective. Theoretically, in the open market, the assumption of increased risk must also be compensated by an increase in the expected return, although the actual return may or may not increase depending on the degree to which the risks are actually realised.

Business restructurings involve transfers of functions, assets and/or risks with associated profit/loss potential between associated enterprises. Restructurings can also involve the termination or substantial renegotiation of existing arrangements. The discussion draft discusses the circumstances in which at arm's length the restructured entity would receive compensation for the transfer of functions, assets and/or risks, and/or an indemnification for the termination or substantial renegotiation of the existing arrangements.

For the OECD, the profit/loss potential is not an asset in itself, but a potential which is carried by some rights or other assets. The arm's length principle does not require compensation for loss of profit/loss potential per se. The question is whether there are rights or other assets transferred that carry profit/loss potential and should be remunerated at arm's length, taking account of the perspectives of both the transferor and the transferee.

The discussion draft discusses situations where at arm's length the restructured entity would be entitled to an indemnification for the detriments it suffered as a consequence of the restructuring. There should be no presumption that all contract terminations or substantial renegotiations give rise to a right to indemnification at arm's length. In order to assess whether an indemnification would be warranted at arm's length, it is important to examine the circumstances at the time of the restructuring, particularly the rights and other assets of the parties as well as the options which would have been realistically available to the parties at arm's length.

There are also some important issues in relation to the exceptional circumstances where a tax administration may consider not recognising for transfer pricing purposes a transaction or structure adopted by a taxpayer. Tax administrations should not ordinarily interfere with the business decisions of a taxpayer as to how to structure its business arrangements. The OECD considers that apparent non-arm's length behaviour should as much as possible be dealt with on the basis of pricing adjustments, rather than by not recognising transactions. In some situations, however, it may not be possible to arrive at an appropriate transfer price in the circumstances of the case.

The full text of the discussion draft is available at www.oecd.org/ctp/tp/br. Interested parties are strongly encouraged to provide written comments by 19 February 2009, as this is a not-to-be missed opportunity for the business community to contribute to the shaping of the international consensus on this very sensitive subject.

The views expressed are those of the author, not necessarily those of the OECD and its members. ■

This article first appeared in EUcommerz (www.eucommerz.com) in November 2008.

Business Restructuring: OECD Releases Discussion Draft on Application of Transfer Pricing Guidelines

Oliver Wehnert is a Partner at Ernst & Young AG, Germany

For a number of years, tax authorities around the world have been considering how to deal with issues associated with cross-border business restructuring. The OECD has now released its long awaiting discussion draft[1] addressing how the OECD Transfer Pricing Guidelines ("the TP Guidelines") and the corresponding treaty rules should apply to a business restructuring ("the draft"). The draft

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addresses transactions between related parties in the context of Article 9 of the Model Tax Convention. It has been issued to seek input from the taxpayer community.

Applicability of the draft

A business restructuring is defined as "the cross-border redeployment by a multinational enterprise of functions, assets and/or risks (among related parties) with consequent effects on the profit and loss potential in each country".[2] Business restructuring includes for example the conversion of full-fledged distributors (manufacturers) into limited-risk distributors (manufacturers) or the transfer of intangible property rights to the principal within the group.

The discussion draft comprises four "issues notes" which are summarized below.

Issues note 1: special considerations for risks

This note provides general guidance on the allocation of risks between related parties in an Article 9 context.[3]

The draft recognizes that contractual terms, including assignments of risk, should generally be recognized as structured by the parties. According to the draft, the taxpayer does not have to identify a transaction where independent parties assumed the same risks and functions as the controlled parties as long as controlled parties receive arm's length consideration for functions performed, risks assumed and assets used in the controlled transactions.

However, contractual terms will not be recognized if the terms have no economic substance. Economic substance will be primarily determined by analyzing the conduct of the parties, setting the focus on the risks and functions assigned and whether risks, if any, can be financially born. The draft also concludes that changes in profits following a reallocation of risk must be consistent with the economic significance of the risk assumed. For example if inventory risk or credit risk is assumed, how significant have inventory or bad debt losses been in the past? The attribution of profit should reflect the realistic amount of the risk assumed.

The draft provides helpful guidance regarding determination whether contractual risk allocation is one that might be expected to have been agreed between unrelated parties. The factor that is suggested in the draft relates to examination which party has control over the risk. The OECD considers that in the context of paragraph 1.27 of the TP Guidelines, "control" should be understood as the capacity to make decisions to take on the risk (decision to put the capital of the entity at risk) and to make decisions on whether and how to manage the risk, internally or using an external provider. The exercise of managerial control over risk requires the company assigned the risk to have people – employees or directors – who do perform these control functions. Thus, if one party bears a risk solely by hiring another party to administer and monitor that risk on a day-to-day basis, tax authorities will not recognize the transfer of the risk to that other party.

The OECD considers that in order to control a risk one has to be able to assess the outcome of the day-to-day monitoring and administration of functions by the service provider. The level of control needed and the type of performance assessment would depend on the nature of the risk. Another factor that may influence an independent party's willingness to take on a risk is its anticipated financial capacity to bear that risk.

Thus, for example, contract R&D is possible with the principal being located in a different jurisdiction so long as the principal has people who can plan, control and monitor the research; and the necessary financial capacity.

Issues note 2: arm's length compensation for the restructuring itself

This note provides guidance on the arm's length nature of compensation for the restructuring itself, including the circumstances in which at arm's length the transferor would receive compensation for the transfer and/or an indemnification for termination or substantial renegotiation of the existing arrangements.

The draft states that business restructuring or the potential loss of profit of a taxpayer is not a taxable event per se. However, business restructurings will usually be scrutinized to determine whether rights that are compensable under general transfer pricing principles, especially intangibles, have been transferred in connection with a business restructuring. The options available to the parties engaging in the restructuring will need to be examined as part of the analysis of rights transferred in a restructuring transaction as well as the profit (or loss) potential given up as part of the restructuring. In some cases an indemnification payment may be required under local law or such a payment may be inferred.

Issues note 3: remuneration of post-restructuring controlled transactions

This note covers the application of the arm's length principle and transfer pricing guidelines to post-restructuring arrangements, based on existing guidance on the selection and application of transfer pricing guidelines.

The draft indicates that the same transfer pricing principles should be applied to analyze a controlled transaction entered into as part of a business restructuring as would be used if the transaction was entered into as part of a business formation or other business transaction. The draft notes that the choice of a transfer pricing method will be determined by general "best method" and comparability considerations. For example, use of the TNMM to determine the profit target range for a manufacturing entity does not turn the manufacturing affiliate into a limited risk manufacturer merely because the TNMM is used. Rather, the use of TNMM should be based on the risk profile of the controlled manufacturer in comparison to the comparables.

The draft explores two specific examples: centralized purchasing and location savings.

Issues note 4: recognition (or non-recognition) of the actual transactions undertaken

This note discusses the application of the transfer pricing guidelines to the recognition of actual transactions undertaken referring to business restructurings. Specifically, the OECD emphasizes that an examination of how the arm's length principle has been applied to controlled transactions should start with the transactions actually undertaken by the related enterprises. The contract terms will play a major role in the transfer pricing analysis, but a mere review of the contract terms is not sufficient. The draft accepts that non-recognition of transactions as structured should be "exceptional". However, some examples are provided of "commercially irrational" transactions or transactions that impede tax administration and thus should not be recognized as structured.

The OECD's position is that when a dispute arises over the nature of the transaction, tax authorities may re-characterize the nature of the transaction and that the tax authority is not limited to making a transfer pricing adjustment of the transactions as structured. In this respect, reference is clearly made to general or specific anti-abuse provisions.

The draft also contains three examples that discuss when tax authorities would recognize or not recognize transactions undertaken as part of a business restructuring.

Implications for taxpayers

The OECD recognizes the fact that multinational enterprises are free to organize their business operations. The OECD considers that as long as functions, assets and/or risks are actually transferred, it can be commercial rational from an Article 9 perspective to restructure in order to obtain tax savings. Moreover, the contractual allocation of risk between associated enterprises should be respected to the extent that the risk allocation has economic substance, determined by reference to the actual conduct of the parties, and transactions are conducted for arm's length consideration.

The arm's length principle does not require that tax authorities observe third parties in engaging in similar transactions, but the real question is what would have third parties agreed as the arm's length consideration in a similar situation.

It is not sufficient from a transfer pricing perspective that an arrangement makes commercial sense for the group as a whole. The

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transactions must be arm's length at the level of each individual taxpayer, taking into account its assets, expected benefits from the restructuring agreement, and realistically available options.

Tax authorities will consider if the contractual arrangement is consistent with the actual allocation of risks.

The arm's length principle does not of necessity require compensation for loss of profit/loss potential. The question is if there are assets transferred that carry profit/loss potential and should be remunerated at arm's length. In some circumstances, indemnifications will be appropriate.

The draft envisages that tax authorities could assume contractual relationships in extreme circumstances. For example, a business restructuring of an entity that significantly invested in the local jurisdiction might be required to demonstrate either that its pricing included a risk premium for loss of market opportunity or remuneration for abandoning its business opportunity in the local market.

Taxpayers will need proper documentation describing: comparability (including functional) analysis performed both for the pre- and post-restructuring arrangements and a description for the actual changes that took place upon the restructuring, what the business reasons for and the anticipated benefits from the restructuring were, and what options would have been realistically available for the parties at arm's length. The functional analysis may have to cover also a transition period over which the transfer is being implemented.

Closing remarks

The draft is the first focused transfer pricing analysis from OECD member countries on how they may treat controlled transactions entered into as part of business restructurings. The analysis recognises the rights of taxpayers to rationalize their operations, but certain provisions in the draft could result in "exit" charges for affiliates that are restructured in whole or part for the benefit of the group. While this is a draft document that is being issued for public comment, the document contains the thinking of a significant number of OECD countries. Many of the positions presented in the draft are already being taken in examinations of business restructurings by many tax authorities. ■

1. *Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment 19 September 2008 to February 2009, http://www.oecd.org/dataoecd/59/40/41346644.pdf.*
2. *Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment 19 September 2008 to 19 February 2009 page 2.*
3. *Particularly regarding the interpretation of par. 1.26 to 1.29 of the TP Guidelines.*

The Rise of Luxembourg Partnerships

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Private equity is essential in the financing of most companies. It gathers capital from high net worth individuals or institutional investors to engage in various categories of ventures such as investments in innovative companies, real estate, ports, highways or even hospitals. Initiators in that field often structure their investment vehicles in the form of Anglo-Saxon limited partnerships located in offshore jurisdictions, to achieve flexibility, limited liability and favourable tax treatment. The pre-eminence of such partnerships could be challenged in the near future by the rise of limited partnerships established under Luxembourg law, namely *sociétés en commandite simple*. This article will outline the main rules applicable to Luxembourg limited partnerships as well as the recent reforms that increase its efficiency.

Long tradition

The Luxembourg limited partnership directly finds its origins in the *commenda* agreements used by Venetian merchants to finance their maritime ventures. Under such agreements, the merchant would use limited partner's contribution to engage into various businesses. On that occasion, the merchant would incur unlimited liability while his investment partners' liability would be shielded. This contract was adopted by merchants over the centuries in continental Europe and recognized in Colbert's Ordinance of March 23, 1673 under its current name of *société en commandite*. This was later developed in the French Code of Commerce of 1807, which was applicable in Luxembourg and in the Luxembourg law of August 10, 1915 on commercial companies. In the meantime, the usefulness of this type of company was recognized in the United Kingdom where it was introduced by the Limited Partnership Act dated 1907.

"In recent months some initiators have elected to establish their limited partnership in Luxembourg"

Simple regulation

Few rules apply to the Luxembourg limited partnerships. These companies are organized along the following principles, which have been confirmed and developed by an important case law.

Private deed. A Luxembourg limited partnership may be established in an informal way by an agreement between one or several general partners, who will be the only ones to incur the unlimited liability, and one or more limited partners. Such agreement may be made under private seal. Information that needs to be filed with the register of commerce and companies and published in the official gazette, the *Mémorial*, is minimal and essentially aims at informing third parties on (i) the names and powers of the general partner(s), (ii) the purpose of the company, (iii) the amount of the contributions by each partner and (iv) the duration of the company. The identity of the limited partners must also be filed with the registry but is not published in the official gazette. Overall, this leaves the partners with the possibility to organize their relationship in the most discrete fashion, since the rules on profit participation, decision taking or transfer of shares are not the object of publication.

Legal personality. As a rule, the Luxembourg limited partnership will have an unlimited legal capacity and will be regarded as a separate legal entity. This implies that the property of the limited partnership will be treated as the partnership's property. The partnership will also have its own name, which will comprise the general partner's name.

Contractual freedom. The respective rights of the partners may be established with a maximum flexibility, which opens the possibility to craft the agreement as closely as possible to the needs of the partners. The contributions shall adopt the form of assets or cash for the limited partners while the general partner's contribution may also consist in its personal skills, experience and industry. Transfer of shares may be restricted or extended to increase the liquidity of the participation.

The general partner(s) shall manage the company in the way decided in the agreement. Sometimes, more than one general partner is appointed, and only some of them are given management powers. A manager or investment managers may also be appointed to assist the general partner in his tasks. The general partner may also be assisted by advisory or investors' committees. The only limits to the organizational freedom of the partners are twofold: limited partners shall ensure that their name is not included in the partnership's designation and that they do not actually manage the company. An infringement of these requirements would expose limited partners to unlimited liability. ▸▸

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- The partners may also freely decide on how they will allocate the profits and losses of the company. In that way, elaborate profit sharing schemes may be established to provide the managers with appropriate incentives and allow optimal distribution to the limited partners. Partners may however not be entirely deprived from their entitlement to profits. Also, if dividends are distributed in the absence of profits, thus decreasing the partnership's capital, they may be recovered from the partners.

New developments

Luxembourg limited partnerships may submit themselves to the status of companies in risk capital subject to the Luxembourg law of June 15, 2004 on companies in risk capital (SICARs), which organize an advantageous legal, regulatory and tax regime. This law has recently been clarified by a new law of October 24, 2008 to increase the attractiveness of Luxembourg limited partnership for risk capital structuring purposes.

Conditions for the SICAR status. The Luxembourg SICAR regime may be elected for by a partnership located in Luxembourg in its constitutive agreement if it meets the following conditions:

(a) The company's purpose must be to invest in securities representing risk capital, being understood as the contribution of assets to entities in view of their launch, development or listing on a stock exchange. A SICAR could therefore invest in any type of investment in unlisted companies whether in the form of equity or debt without any geographical restrictions. Listed companies may also qualify as risk-bearing investments to the extent the investment aims at the financing of a new business development.

(b) The company's securities are reserved for well-informed investors, meaning an institutional investor, a professional investor or any other investor who has confirmed in writing that he adheres to the status of well-informed investor; and invests a minimum of €125,000. Investors who do not meet this threshold may also be certified by credit institutions, investment firms or management companies. Managers of the company are also exempted from this requirement.

(c) The custody of the company's assets must be entrusted to a depositary credit institution established in Luxembourg.

(d) The company's capital increased by the issue premium must reach a minimum capital level of €1 million within 12 months of its authorization as a company in risk capital.

(e) The company must draw-up a prospectus which must include the information necessary for investors to be able to make an informed judgment on the investment proposed to them and of the risks attached thereto.

(f) The company must be authorized by the *Commission de Surveillance du Secteur Financier*.

Variability of capital. The new law expressly allows Luxembourg limited partnerships organized as a SICAR to have a variable share capital, by providing in the partnership agreement that the amount of its share capital shall at all times be equal to its net asset value. As a consequence, variations in the share capital shall be effected by law. The partnership will not have to comply with any measure regarding publication in the *Mémorial* and registration with the register of commerce and companies.

In parallel, the new law allows the managing general partner of such partnerships with variable share capital not only to make profit distributions but also any other payments whether they represent interests, gains, dividends or capital. This would not trigger the possibility that a limited partner be obliged to repay any interest and dividend that have not been paid out of real profits. Such a structure thus allows the managing general partner not only to return profits on investments to investors but also the acquisition cost of any realized investments. This enables a flexible and efficient repatriation of excess cash to investors.

Compartments. The new law has also created the possibility for SICARs to be constituted with multiple compartments, each compartment corresponding to a distinct part of its assets and liabilities.

Compartments allow initiators and managers to combine different investment policies within the same legal entity and permit a "vintage" year approach whereby investors may participate in different investment tranches over time. The compartmentalization will furthermore allow the introduction of certain "excused investor" provisions, allowing for the creation of segregated side-pockets for assets in respect of which certain investors may not participate in. To this end, the partnership agreement must expressly allow the creation of compartments and need to foresee the applicable operational rules. The prospectus must also describe the specific investment policy of each compartment.

Unless otherwise provided for in the constitutive documents of the SICAR, the rights of investors and of creditors relating to a specific compartment or which have arisen in connection with the creation, operation or liquidation of that compartment, shall be limited to the assets of that compartment. Consequently, the assets of that compartment are exclusively available to satisfy the rights of investors in relation to that same compartment and the rights of creditors whose claims have arisen in connection with the creation, the operation or the liquidation of that compartment. Again, unless the constitutive documents provide otherwise, for the purpose of the relations between investors, each compartment will be deemed to be a separate entity. Each compartment may thus be separately liquidated. When the last compartment is liquidated, though, the SICAR itself will be deemed liquidated.

Clarifications. The Anglo-Saxon practice consisting in capitalizing the partnership with a minimum share capital, the balance being satisfied on the basis of interest free loan commitments consented by each general partner in proportion of its contribution in the partnership's capital, has also been validated in the course of the discussions preceding the adoption of the new law.

Tax regime. The tax features of the limited partnership having elected the SICAR status may be easily summarized. Although the limited partnership is a legal entity separate from its partners, it is not liable itself for income or net wealth taxes in Luxembourg. The limited partnership is to be treated as transparent for Luxembourg tax purposes, and profits received from a partnership as well as capital gains realized on the disposal of a partnership interest by non-resident partners will not be subject to Luxembourg tax, either by withholding or assessment. It may furthermore be worth noting that management services rendered to a SICAR will not be subject to VAT. Whether a SICAR itself has to be regarded as a VAT entrepreneur has to be determined on a case-by-case basis.

Outlook

In recent months some initiators have elected to establish their limited partnership in Luxembourg. Not only does this latter provide them with the same flexibility they have been used to with the partnerships located offshore, it also presents the advantage of being located at the same place as intermediate holding companies which they often use in any case. In addition, the review of the partnership agreement and the prospectus by the Luxembourg *Commission de Surveillance du Secteur Financier* and the supervision of the partnership's assets by a regulated custodian increase the investor's confidence in their vehicle. This is also the reason why it is now expected that more of these partnerships will be established in Luxembourg rather than offshore.

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Ireland - Still a Premier Destination for International Investors

Kevin McLoughlin is a Tax Partner at Ernst & Young, Dublin, Ireland

For over fifty years now Ireland has been building and adapting its tax system as an important plank of its national economic strategy to attract and retain overseas investment. The precise incentives have changed significantly over that period as the focus of particular employment initiatives has changed, newer industries and business models have emerged, and in more recent times to ensure that the Irish tax system is in compliance with European law. One of the other positive features about the Irish tax system is that it is transparent ie. entitlement to benefits is very much driven by legislation rather than negotiation of rulings or tax holidays. The success of this strategy is manifest in the fact that Ireland plays host to the most significant global technology companies, nine out of the world's 'top 10' pharmaceuticals have significant operations in Ireland, and that Ireland is now recognised as one of the more important global financial services centres, particularly in the area of investment funds.

The continual adaptation of the Irish tax system is critical in the face of increasing competition for mobile international investment among established, emerging and high growth economies, and it was reassuring to see the Irish government through the Minister for Finance recently confirm its commitment to maintain the 12.5% rate of corporation tax in the face of a difficult exchequer budgetary position. One would expect that with the impact of the current economic situation likely to reflect in increasing government budget deficits and rising unemployment, tax will be used more and more as an instrument to facilitate foreign direct investment and support domestic investment as a means of creating employment.

In addition to creating a business friendly tax regime, the Irish government has invested significantly in infrastructure and education to create an attractive climate for business to invest and grow.

The rest of the article will summarise briefly the current tax environment highlighting recent changes.

Corporation tax rates

Until relatively recently, the rates of corporation tax have largely tended to operate on a two tier basis whereby lower, incentive rates would apply to income earned from specified activities. The '10%' tax rate – which is due to expire at the end of 2010 – applies to manufacturing activities which was defined very broadly and included, for example, data processing, software development, and certain financial services activities. There was also a regional aspect to the rate in that certain activities were taxed at 10% only if carried on in the Shannon Free Zone[1]. Those companies not carrying on manufacturing activities were taxed at the standard rate of corporation tax which was as high as 40% back in 1991.

"The continual adaptation of the Irish tax system is critical in the face of increasing competition for mobile international investment among established, emerging and high growth economies"

As part of the EU-wide initiative against harmful tax competition in the late 1990s Ireland, along with other member states, adapted its tax regime. Specifically in the area of corporate tax rates, Ireland announced a plan to phase out the 10% manufacturing tax rate, and introduce a standard rate of corporation tax of 12.5% which would apply to the income from most trading activities, the exceptions being in the area of exploration and exploitation of natural resources, and certain dealings in land. The transition to 12.5% was on a phased basis but came fully into effect on 1 January, 2003. This has been a very positive development as it has had the effect of attracting businesses to invest in Ireland which were not eligible for any benefit from the 10% tax rate.

Specific tax incentives

In addition to a low standard rate of corporation tax, there are other specific tax incentive regimes particularly in the area of innovation which merit separate mention.

Research and development

In 2004, the government introduced a tax credit regime for qualifying incremental expenditure on research and development ('R&D') activities, and for investment in qualifying R&D infrastructure. This was introduced to encourage businesses to carry on R&D activities in Ireland with a view to facilitating stated government policy of moving businesses 'up the value chain'; it was also considered as part of general EU strategy to increase the percentage of GDP spend on R&D activities throughout Europe.

The credit operates such that, in addition to being able to take a deduction for research and development expenditure, a tax credit of 20% of that incremental expenditure is available for offset against a company's corporation tax liability. In its short existence, the mechanics of the credit have evolved in order to make it more attractive culminating in freezing the base year at 2003 right up to 2013, and in the recent budget proposal to increase the rate of credit to 25%.

Intellectual property

There is a complete exemption from tax for certain income from the exploitation of patents up to a limit of €5m annually, provided the development work is carried on in the European Economic Area. There are also exemptions from stamp duty on the acquisition of intellectual property, which is broadly defined for this purpose, regardless of whether acquired from third parties or affiliated companies.

In a further positive development, in the recent budget, the Commission on Taxation was asked by the Minister for Finance to consider broader incentive measures which might be introduced into the tax code to encourage the development, ownership and exploitation of intellectual property.

Indirect Tax

As pan-European taxes, VAT and customs duty are very difficult to adjust in order to provide national incentives. Having said that, the codes for both taxes in Ireland can operate in a way which facilitates cash flow advantages to businesses. For example, companies which export more than 75% of their production outside of Ireland, can avail of an authorisation which allows suppliers to that business to invoice for goods or services at a 0% rate of VAT instead of in many cases, the current standard rate of 21%, thereby giving rise to cash flow benefits.

General tax landscape

In recent years we have seen a continual review of legislation to amend and improve its attraction and effectiveness. Some recent examples would include domestic based exemptions from withholding taxes on dividends and interest particularly where paid to recipients based in countries with which Ireland has tax treaties.

In the area of taxation of dividends, while the introduction a fully fledged participation exemption system for dividends and gains would be the optimal solution, the current tax credit regime for dividends sees dividends from trading sources taxed at 12.5% with a very expansive credit based relief for foreign taxes which applies subject to de minimis ownership thresholds, regardless of the number ▸▸

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of tiers in a corporate structure, and regardless of whether those subsidiary companies are treaty based or not. There is a full exemption system for capital gains, subject to certain conditions.

In terms of flexibility for funding businesses in Ireland, under company law there are very manageable minimum capital requirements, no prescribed debt to equity ratios, and no capital duty on funding or otherwise capitalising companies. This does provide companies with a lot of flexibility as to how they finance Irish operations in themselves, and within overall group treasury requirements.

Tax authorities

Part of the role of the Irish revenue commissioners is to consider how the tax system is best used as an instrument to promote foreign direct investment into Ireland[2]. While there is no formal ruling system the tax authorities are very much open to consulting with businesses in relation to tax issues and operate a system of technical opinions in response to technical issues raised by investors. Part of the tax authorities' strategy is to work particularly closely with larger businesses, through its large case division framework, to better understand businesses and their issues and therefore be better able to assist those business with their compliance.

Also, the revenue commissioners tend to consult with business in terms of how the tax system meets their needs, and any improvements required. A particularly good example of this was the Taoiseach[3] 's committee which was established as a joint government and business group to work out how best to establish the International Financial Services Centre ('IFSC'), and which continues to operate today even though the preferential incentives available to IFSC companies expired at the end of 2005.

Conclusion

Ireland has a lot of competitors for the types of business it is trying to attract, and its tax regime has evolved over the years to try and meet that competition, and anticipate the next wave of investment. The government has recently reaffirmed its commitment to the tax system as a key instrument of its industrial strategy through its commitment to the 12.5% rate of corporation tax. As such, when combined with the operational factors which are key to location decisions, such as availability of a qualified work force, language capability, ideal base for regional growth, Ireland continues to be one of the most attractive locations for foreign direct investment. ■

1. *A defined area of the country in the locality of Shannon Airport.*
2. *"We will make sure that we play our part in creating an environment that promotes economic growth and improves Ireland's competitiveness", extract from 'Revenue Statement of Strategy 2008 – 2010', p.11.*
3. *The Taoiseach is the Irish Prime Minister.*

Bermuda: The Smart Island

Although the effects of the global financial crisis have not yet concluded, one great truth has been revealed: that business must be ready for anything. Even 1-in 100-year events happen, sooner or later. It is no longer enough to talk about protecting one's business from unexpected catastrophe; consideration, anticipation and action are required.

As the world addresses the financial disruption that has dominated the international headlines in 2008, businesses around the world are assessing the new operating environment in which they find themselves. Stability has always been the holy grail of business; recent developments have merely underlined that fact. More than ever, from a jurisdictional perspective, the degree of technological sophistication that a company has taken on board can greatly improve the likelihood of success.

By the start of the millennium, we spoke of everywhere being a single click from anywhere else. To an extent that is still true, but the concept was always supported by the comparative ease and relatively low cost with which travel between business centres was achieved. In more difficult economic conditions, with the cost of oil and therefore air travel on the rise, the notional distance between jurisdictions may be said to be widening, making telecommunications an ever greater key to operational efficiency.

Business, in short, must think smart, selecting international jurisdictions that already have in place, rather than merely promise, the necessary, efficient technology infrastructure.

Bermuda

The consensus is that Bermuda is the leading location for international financial services. Extremely high broadband uptake among both corporate and individual users has led to Bermuda being referred to as the "wired island". New, powerful cables link the island to the world, bringing enormous bandwidth. The development of the telecommunications sector has long been strongly encouraged by the Bermuda government, which has always been in the forefront of public sector awareness of the importance of IT to the modern economy.

Among the reasons why Bermuda is an ideal location for conducting e-business:

- Regulation: the regulation of international business in Bermuda is fair and reasonable. Bermuda has a flexible regulatory framework that conforms to international standards.
- Professional support: Bermuda is a sophisticated financial and legal centre. The legal and fiscal system is based on English law. Company formation is fast and streamlined. Banking, trust, accounting, custodial and legal services on the island are of a high international standard. A strong technology support network is in place with online publishers, web designers, software and hardware vendors and ISPs.
- Infrastructure: an excellent telecommunications network is in place, comprising four diverse bandwidth routes, top quality hosting facilities with maximum security and full redundancy, as well as the spectrum of telecommunications options including WiMAX and 3G mobile services.
- Location: being an hour ahead of the Eastern Seaboard, four hours behind the UK, and seven to twelve hours behind the Middle East and Far East countries making Bermuda an excellent location for operating international businesses. Easy access is available by air to most international centres. Bermuda, with the appeal of a sub-tropical paradise and an ICT literate, helpful workforce, is one of the most convenient places in the world to hold business meetings.
- Political stability: Bermuda is politically, economically and socially stable, and strenuously safeguards its reputation.
- Taxes: no income taxes, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance taxes apply. Foreign-owned Bermuda companies are usually granted exemption by the Bermuda government for an exemption from paying any taxes until 2016.

Brain, not brawn

Bermuda, of course, will never be home to giant server farms or Amazon.com-style warehouses. The infrastructure necessary to support such on-the-ground activities, operating from bricks and mortar buildings even if their public face is electronic, would place an unacceptable strain on Bermuda's resources. Bermuda offers brainpower, rather than brawn.

One area that has been identified as critical for the mid-Atlantic island is business continuity and disaster recovery (BC&DR). This was identified long before recent events proved the point. In the constantly evolving IT universe, the importance of data security and the ability to recover seamlessly from a crisis has finally reached management's front burner. In the past 12 months, no other single issue has received such attention throughout the business community.

Data security is still taken lightly in some parts of the world, as a series

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Ministry of Energy, Telecommunications and E-Commerce
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of headlines lately has revealed. Data has been compromised or even lost, often in ways that would be comical were the consequences not so dangerous or costly. Public records, in particular, have in several cases proven very slippery once they were taken out of the protective custody of their home base.

Here, Bermuda has an edge. Both the public and private sector have been for quite some time ahead of the curve on data security, so much so that, at times, it has felt like treading a lonely path. Bermudian IT people will tell you that, some years ago, even discussing data security was a hard sell. Where business interruption has been addressed, insurance has been the main line of defence.

The traditional focus has been on maintaining the administrative effort, and hoping that operational continuity would recreate itself as events unfolded. Internationally, businesses, it seemed, had concentrated on developing IT skills for internal purposes and have only belatedly come to appreciate that, without a similar stress on what happens when service is interrupted, operations cannot be called reliable.

Hubs

Globalisation has crystallised the supply and distribution channels around the concept of business hubs, operating virtually in much the same way as the major US airlines have chosen to operate physically. Bermuda is ideally positioned to be of service in such a capacity, standing at the crossroads of North and South America and Europe, with a time zone all its own and excellent air links to the east and west. Physically separate, yet only one click away in a secure network, Bermuda offers the perfect data security mix of near and far.

A solid support network has taken hold in Bermuda, making it possible for companies to run global operations from the island that are fully equivalent to systems in use anywhere. Individual companies in the Bermuda market have developed unique skills, bringing worldwide innovation to such areas as multi-currency payment processing, in which the island is a world leader, as well as meeting the day-to-day demand for high-level operational support. The degree of sophistication that Bermuda has attained might surprise you.

A focus on sensible regulation allows the island's telecommunications industry to offer tried and tested services. The driver for the industry's development has been the growth in Bermuda of a world-leading reinsurance market, capitalised in excess of $100 billion. Bermuda companies now have their own networks around the world, with headquarters operations on the island. Enterprises of that size take for granted the most up-to-the-minute facilities, and Bermuda's major companies could not compete globally unless their operations were fully secure, and operating at maximum speed. By one report, the Bermuda insurance market employs nine times as many people around the world as it does in Bermuda.

Insurance is the largest industry, but others of size include the banking, trust and fund administration sectors. These businesses are only as good as the support Bermuda provides for them. The island's growing influence in the financial services arena is testimony to the reliability of its various networks. Bermuda has never opted to rest on its laurels. The required speed of development has continually been flat out.

When Bermuda first set its sights on supporting international financial services, it quickly realised that it would have to do so at the highest level — or not at all. A sterling reputation for integrity has always been the island's major asset. In a tightly focused field such as telecommunications, a shared understanding of the ways in which Bermuda can best support business has led to a surprising conclusion: clustering and the consequent ability to share and develop ideas without delay mean that, in this case, small is beautiful.

Partnerships

Bright people are employed in the many industries that support our online lives and other bright people regulate their activities. The best results seem to follow when the public and private sectors work together, for the good of all. Bermuda has been a pioneer in managing such partnerships.

"Business, in short, must think smart, selecting international jurisdictions that already have in place, rather than merely promise, the necessary, efficient technology infrastructure"

Since being among the first countries in the world to pass legislation specific to e-commerce, almost a decade ago, the island has kept a steady focus on the electronic possibilities, both internally and externally.

Recently, Bermuda placed 17th in the world in the 2008 e-readiness rankings prepared by the Economist Intelligence Unit in co-operation with the IBM Institute for Business Value, ahead of Japan, France and a host of other countries.

The drive to bring government fully online continues apace, with several ministries now offering a complete range of services online. Steps have been taken to automate the vehicle registration process and offenders are now electronically identified. The island's Tech Innovation Awards have gone from strength to strength.

In 2006, Bermuda was accepted as a member of the World Information Technology and Services Alliance (WITSA), a consortium of almost 70 information technology industry associations from around the world. In 2009, Bermuda will host the sixth biennial Global Public Policy Summit (GPPS), a flagship WITSA event. More than 500 senior executives, government officials and policymakers from around the world will attend the conference, which focuses on global policies affecting the IT industry. The conference is being organised by the Bermuda Chamber of Commerce's Business Technology Division, in partnership with the Ministry of Energy, Telecommunications and E-Commerce.

Government initiatives

The Ministry of Energy, Telecommunications and E-Commerce (METEC) has been highly active of late. A new minister has taken the helm. The Hon Terry E. Lister, JP MP, is a senior member of cabinet, whose portfolio recognises that the greater the country's achievement in the electronic field, the greater the impact on the country's energy usage.

In recent comments that amounted to a mission statement, the minister said:

"It is my vision that through the coordinated effort of the five departments that make up the ministry, we can deliver to Bermuda and the global village services that are second to none. I believe that in this ever-evolving digital world, Bermuda must be positioned and equipped to maintain our place on the global business stage. This means that we must and will continually adjust to and embrace emergent technology as well as becoming early adopters of modern technology, embracing innovation, and becoming partners in the creation of new ideas that will benefit every citizen of Bermuda. The government is committed to the creation of a Bermuda where everyone in this community benefits from increasing access to information and support from communications technologies."

Bermuda's corporate legislation was recently updated and an ongoing review is being carried out to assess ways in which government can increase the number of "e-friendly" elements that make it easier for Bermuda-based companies to operate solely in an electronic environment. Key provisions in the legislation include the ability to file documents online with the Registrar of Companies and to serve members or shareholders of a company electronically.

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Early adoption

Much of Bermuda's success in the electronic field has derived from its early realisation that its IT infrastructure would be critical to the island's forward motion. Bermuda was the first to elevate e-commerce to a cabinet post, a clear sign to industry participants of its serious intent.

The Electronic Transactions Act, one of the first in the world, was enacted into law in 1999. The heart of the legislation was a mechanism for building a suitable national platform on which business-to-business e-commerce could thrive. The subsequent Standard for Electronic Transactions (Code of Conduct), introduced in 2000, was designed to ensure that those engaging in e-commerce in Bermuda operate in a manner that would maintain the island's reputation as a premier international business jurisdiction.

Bermuda first had to define its role in the electronic world. The insurance, banking and trust sectors, and the other international industries that operate on the island, are critical to the economy, and a solid foundation was needed on which customised solutions could be developed to meet specific needs.

Bermuda has for more than a decade imposed strict limitations on the material that may be hosted from the island. Gaming and pornography have always been banned. Now anti-child pornography and internet luring legislation has been enacted, with all-party support.

METEC has established www.cybertips.bm, a solid source of information on internet safety. The site provides practical tips, resources and contact information to help parents, children and educators to use the internet safely and be on guard against online predators and other inappropriate online content.

Conclusion

Because of the island's remote location, telecommunications has been the lifeline for more than a century. The government's consistent focus on e-commerce and its possibilities keeps the world's leading financial services jurisdiction at the forefront of the march of electronic commerce.

Thanks to this forward-looking approach, Bermuda is a full player in the global economy and a veritable hive of activity. The island is among the world's most highly wired communities. Just about every business is online, and more than three-quarters of Bermuda homes are wired. Given that the island is 800 miles from its nearest neighbour, the embrace of the electronic future has broad support throughout the community. ■

Optimising Employee Benefit Plans

Margrit Schmid, Head of Swiss Life Network, talks to Tom Page about developments in employee benefit plans

Margrit Schmid has been with Swiss Life for over 17 years, during which time she has been responsible for several Swiss Life European operations, and for finance and business development for Swiss Life's International Division. She was appointed Head of Swiss Life Network in July 2006 and CEO Corporate Solutions in January 2008. A full member of the ASA (Association of Swiss Actuaries), Ms Schmid has a profound understanding of every aspect of life insurance, as well as extensive experience of working in international and multicultural business environments.

Can you explain multinational pooling and how multinational companies can optimise their employee benefit plans?

Multinational pooling is a sophisticated insurance technique for international corporations. It allows companies to draw added value from their employee benefit plans in different countries by combining various contracts together, known as a multinational pool. All the main group benefits with risk elements (lump sum and pension) can be included: group life and survivors' benefits, disability, medical, accidental death and dismemberment, critical illness. Combining the various local benefits into a global pool unlocks the power of risk spreading and enables to optimise costs for risk covers. Pooling benefit plans also offers important additional advantages such as transparency and information and underwriting benefits. Companies can use the detailed information on their employee benefit plans provided in the context of multinational pooling to check that their corporate guidelines and benchmarks are adhered to – and thus avoid inefficient over-insurance. The potential savings achieved by many companies though pooling and the information provided in the context of pooling also help companies reduce the cost of employee benefits.

Companies around the world are finding themselves increasingly responsible for setting up retirement solutions for their employees. They need a well-constructed plan to attract and keep staff. What are the benefits of using an international employee benefits network?

International employee benefits networks bring an extraordinary amount of experience and knowledge to the table. The Swiss Life Network, for example, has over 45 years of experience in multinational benefits, and we work in around 70 countries through top local providers serving hundreds of multinationals of every size and in every sector. It is this sophisticated expertise that attracts our clients to us – and keeps them coming back.

International employee benefits networks understand the legal requirements for retirement and other employee benefit plans in each country, and have a good overview of the local insurance markets. So they are able to help companies set up the local plans they need to attract and keep staff. In addition, since international employee benefits networks only work with top local insurers, using their local partners is a further guarantee of quality in terms of plan construction and service.

Beyond this, the staff at international network headquarters generally have an excellent overview of trends in the global employee benefit arena. They can thus help their multinational clients construct plans that keep them ahead – or at least in the game - in the global battle for talent.

Multinational organisations face rapidly changing local regulation and legislation. Growing numbers of multinationals are seeking expert advice. What should they be looking for when making their choice of supplier?

Multinationals need a global supplier with an extensive network of strong local partners. These expert local insurers will be aware of the latest legislation regarding social security, labour laws and taxes – and should be able to actively promote their clients' interests. While local intelligence is essential, the multinational also needs a single, central partner to work with – at network headquarters for example – who can channel all the information in an efficient manner, and provide proactive updates as well as fast and reliable advice on request.

How does the current credit crunch impact on employee benefits?

The potential business slowdown from the credit crunch will put many companies under greater financial pressure, and we anticipate that the inevitable need to make cost savings will affect employee benefit programmes. Hence the cost-efficiency factor of employee benefit solutions – through their provision of information and potential cost savings - will play an even more important role. We are convinced, however, that adequate employee benefit schemes are not just a cost - but are a positive contribution to the successful performance of our customers. ▶▶

Don't let your resources drain away.

Pool them

Your company's employee benefit plans are a valuable resource. Too many multinational companies waste their resources by not pooling their employee benefit plans. The Swiss Life Network is a leading provider of tailor made international employee benefit solutions allowing you to pool your local plans and thereby control your costs, claims and benefit levels worldwide. Nothing could be simpler. Or clearer, thanks to our transparent, consolidated reports which will provide you with new insight into your hidden resources. To tap this source, contact us. Stop your resources from running dry.

www.swisslife-network.com

How does Swiss Life view long-term prospects for employee benefits?

There is no doubt that occupational employee benefits will continue to grow in importance. Significant demographic changes are happening all over the world. Workforces are ageing, people are living longer after retirement, and birth rates are decreasing. The strain this places on social security and pension systems means that governments are putting more responsibility onto companies – and individuals – to provide for retirement. These demographic factors are also adding to the shortage of qualified personnel, and good employee benefits will continue to be crucial for attracting and retaining good people. Globalisation, and an increasingly mobile workforce, are also increasing the need for cross-border and expatriate solutions.

As a result, we see a very promising future for employee benefits. Given the significance of these plans in terms of costs and resources, however, as well as their potential advantage as a competitive factor, it is vital for multinational companies to choose their international employee benefit partner with the greatest care. ■

The Role of the Private Sector in Promoting Healthy Behaviour

Shaun Matisonn is the CEO of PruHealth

Historically, members of the public only came into contact with healthcare providers when they were ill. However, the recent rise in chronic diseases has led to a greater focus on prevention, which in turn has highlighted the role that the private sector can play in encouraging healthy behaviour in people before they become ill. While the responsibility of government in promoting public health and preventing disease has been long established, the role of the private sector in this area is somewhat underdeveloped.

Not only are people now living longer, they are also healthy for longer than at any other time in history. However, this progress is not without its problems. While medical advances have saved lives, other developments in the modern world mean that people now lead much less active lives than ever before. This, coupled with increasingly unhealthy diets, has led to an obesity explosion throughout the developed world, which raises concerns about whether the trend towards increased longevity is sustainable.

The 2007 Foresight report[1] highlighted that we live in an "obesogenic" environment, with the UK lifestyle making it relatively easy for individuals to gain weight. Almost two-thirds of English adults are thought to be obese or overweight - a proportion that is expected to rise rapidly to 90% over the next 40 years. This rise in obesity is forecast to result in a corresponding cost of around £50 billion per year by 2050 as a result of the increased vulnerability to cancer, cardiovascular disease and diabetes.[2]

The Foresight report warned that if the problem is not addressed, there is the distinct possibility that the generation growing up today may live shorter lives than did their parents.[3] Moreover, obesity-related diseases threaten to put significant strain on the resources of the NHS, which is spending more and more on the treatment of essentially preventable diseases.

While the statistics and projections are alarming and do give due cause for concern, the problem is not insurmountable. Obesity and its related risk factors are preventable through diet and physical activity. However, for this to happen, people need to be motivated appropriately and given easy access to healthy lifestyle choices.

Tackling the problem

Motivating people to make these healthy choices is no easy task. There is no single campaign that can be effective in encouraging everyone who is overweight to change their lifestyle, particularly if the healthy choice is not readily available, affordable or attractive. However, if we can offer a wide enough range of tailored interventions so that the needs of individuals are met, we can make the changes needed to halt, and hopefully reverse, the seemingly inexorable trend towards obesity.

The causes of obesity and the means by which to tackle it are already becoming well embedded in the private sector. Given the complex factors behind the rise in obesity, involving market forces to bring about lifestyle changes is likely to result in positive outcomes.

Many private sector organisations use health and wellness initiatives as part of their approach to staff recruitment and retention. One sector where the incentives for tackling the implications of lifestyle diseases are particularly keenly felt is that of health and protection insurance providers. For these organisations, the health of consumers is more closely linked to the bottom line of company profits than in any other sector.

One consequence of the freeing up of labour markets over recent decades has been a reduction in the incentives for employers to take account of the long-term health of their staff. Forty years ago, when a job in many organisations meant a job for life, it made perfect economic sense for an employer to invest heavily in a wellness programme that might show returns over a 10-year period. Now, as the average length of employment with the same company is continually decreasing, this investment is less evidently attractive.

In spite of this, some companies in the UK have begun to look at the return on investment of their health programmes over as little as three or five years, in recognition of their value in terms of reduced absenteeism, recruitment and retention.

For health insurers who cover a portion of the healthcare costs of many of these employees, the benefits of investing in wellness are even stronger. Since customers are expected to be covered for many years, insurers can take a long term view on the impact that lifestyle changes can have on healthcare costs.

This means that there are strong financial reasons to make short term investments to encourage scheme members to make healthy choices. An insurer that invests substantially in wellness activity is likely to benefit from a greater credibility in the marketplace among both individuals and advisers.

The private sector together with the government

Typically there is a high degree of alignment in practice between the health messaging put out by the private sector and by governments. However the private sector is generally less risk averse and is frequently more willing than government to consider innovative approaches to delivering better public health outcomes. This is particularly true in the area of incentivising healthy behaviour, where businesses have greater freedom to form links with other private-sector organisations by, for example, providing ways to reward people for looking after their health.

There is therefore significant scope for business and government to find common ground and benefit from each other's experiences. Lessons can be learned from the private sector with regard to incentivising behaviour change, and these models can be transferred successfully to the NHS for the benefit of the wider population.

Health and wealth

There are well-established links between the level of a person's individual wealth and their health and life expectancy. Equally, a change in health status is one of the strongest determinants of a change in financial position. Health has a major impact on more than simply the ability to work and to be productive. A recent report noted that when an individual's health status deteriorated from good to poor, his savings decreased five times, and that changes in health had a larger impact than any other factor in levels of savings.[4]

The net effect of this is that there has been an opportunity to develop new insurance models that recognise these links between health and wealth. If protection products can go beyond simply paying out when people are ill, to helping them to become healthier, then the financial ▸▸

Figure 1. 81% of consumers think it is important for health insurers to help their customers manage and improve their health.

Source: PruHealth's Vitality Index Research, July 2008

savings can be shared to give better protection, to more people, at lower cost. The way that insurance schemes have sought to achieve this has been to make use of financial incentives to encourage this move to healthy behaviour.

Financial incentives

The impact that financial incentives can have on behaviour is increasingly being recognised. A survey from the King's Fund[5] found that incentives can be effective in persuading people to make lifestyle changes that will be beneficial to their health. They seem to have greatest impact when the actions being rewarded are simple, and when the rewards are immediate. Furthermore, there seems to be additional, sustainable motivation in the rewards being part of a consistent incentive programme rather than as one-off payouts.

Incentives can be used to reduce the financial barriers to engagement with certain behaviour. For example, reductions in the cost of gym memberships can be used to incentivise exercise. They can also be used to reward behaviour change where the benefits of better health are perceived as being too uncertain or long-term.

The rising burden of chronic disease is going to be perhaps the single most important health issue over the first half of this century, and the private sector will be an essential partner for government in the task of improving public health. Many companies will find that their own financial interest is directly aligned with improvements in their members' health, and some of the ideas used by these companies to encourage consumers to make more healthy choices are likely to have value in the public sector. With both the public and private sectors playing to their respective strengths, there is evidence emerging that significant progress can be made in reducing obesity over relatively short timescales. This is not to imply that the problem is solved, but it does give significant cause for optimism.

For more information please visit www.pruhealth.co.uk or email shaun.matisonn@pruhealth.co.uk ■

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Doing Well AND Good Even in Times of Crisis

Dr Wolfgang Amann is Vice-Director of the Executive School of Management, Technology & Law, University of St Gallen, St Gallen, Switzerland

Sustainability can easily overwhelm

The current reality of strategising and corporate success is quite sobering. Our research suggests that companies, by and large, are up the proverbial creek without a paddle when it comes to pulling off successful strategies and creating financial value. More than 80 percent of the strategies are not implemented as planned. The majority of smaller new strategic initiatives fail as well. Regarding contemporary idea management, only one in 300,000 ideas lead to a product – and when they do, up to 90 percent of these new products are not profitable. 95 percent of employees in larger companies are not even aware of their company's strategy.

Little then does it surprise that they are left out in the cold when it comes to the implementation of the enterprise's strategy and create a healthy financial bottom line. These figures describe a reality that appears puzzling given the extent of the talent now available to companies wherever they are in the world. The game has become tougher; its rules are changing constantly. The sub-prime crisis and its repercussions have not made it easier. This holds true for other business models relying on debt or businesses in general as global recessions may characterize the next years.

When strategies for 'doing well' in financial terms struggle to deliver intended and promised results, calling for an additional end in itself, namely 'doing well AND good', will challenge managers even further. This additional dimension can easily complexify corporate activities and thus overwhelm managers. This is not a fatalistic situation as once success patterns for sustainable strategies are understood, managers can prepare themselves better for the challenges when aiming to do well and good. A pioneer here is the Anglo-Dutch multinational Unilever. In India, where Unilever has been active since 1930 and is better known as Hindustan Lever (HLL), this best practice company innovated a new sustainability strategy. HLL fully integrated sustainability into its growth strategy as outlined in the following. Several lessons can be learned from this success story.

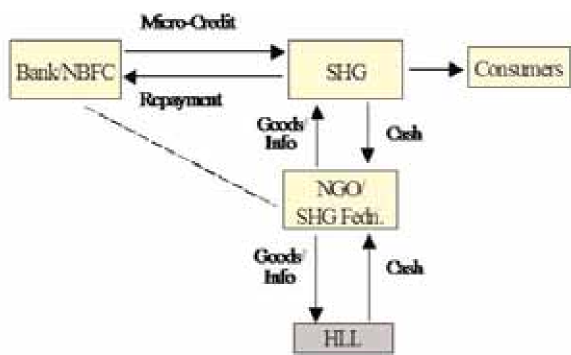
Unilever in India

HLL's Project Shakti is one of a comprehensive set of seven new initiatives to tap the vast pool of potential customers in non-urban India. Shakti means "strength" or "power" and represented an ambitious plan to stimulate new demand at the lower end of the market by creating a self-sustaining cycle of business growth through people growth. HLL planned to develop a win-win partnership with rural self-help groups by helping them to access micro-credit, buy HLL products and sell them in their villages. If successful, the initiative would create hundreds of jobs, train new entrepreneurs and extend HLL's distribution reach to the most inaccessible of India's rural villages.

Penetrating the informal sector in this way was a potentially risky endeavour; furthermore, was it really the company's role to develop rural areas? At that time, the management had been concerned about potential channel conflicts with the existing, successful distribution network. Coordinating with governmental and NGO partners was a key success factor, but this also brought its own complexities. Training mostly illiterate women in sales and promotion techniques was a major challenge, although the payback in terms of new markets and wealth creation was potentially enormous. Like many new venture and innovative sustainability projects, Shakti was clearly not risk-free.

The Hindustan Lever distribution network

India was one of the fastest-growing economies in the world, with a population of more than one billion, which could clearly drive large sales volumes. This was the main growth area for HLL. HLL's potential distribution outreach in India was 3,800 towns and 627,000 villages. However, of the total number of villages, the existing distribution network only reached 300,000. HLL's dilemma was how to extend this into the 327,000 smaller villages in inaccessible rural areas. ▶▶



A macro opportunity based on a micro model

As depicted in the above figure, HLL's growth strategy was to ask self-help groups to operate as "rural direct-to-home" teams of saleswomen, who would accomplish several tasks by raising awareness and educating people about HLL products as well as selling the products directly within their communities.

The idea was for the women to not only act as salespeople, but also as veritable brand promoters, often physically demonstrating products, such as shampoo, by offering hair washes at religious festivals, or by performing hand washing experiments to compare washing with soap to simply washing with water. Apart from selling, the women would work on changing people's mindsets - for example, convincing them that a simple wash with water did not guarantee hygiene, or that shampoo could be used as a grooming product for the hair instead of just using soap to clean it.

A pilot initiative was set up in the Nalgonda district of Andhra Pradesh in November 2000, with 50 self-help groups in 50 villages with between 1,000 and 2,000 inhabitants participating.

The first reality check

As many sustainability ideas need adaptation in the implementation phase, Shakti was soon in serious trouble, providing the women with little earnings, a major reason why they were dropping out of the scheme. HLL did, however, learn more about the situation deep in the villages. Woman had to help their husbands during harvesting seasons, which drastically lowered sales but created no stable income. As there was a stigma attached to door-to-door sales, sales lagged behind expectations. The customers needed time to change their habits and to get used to the new products to be sourced from these self-employed women. Besides, there was no transport for door-to-door selling - it had to be done on foot.

Changing the system or giving it time to take off?

HLL believed in the market potential and the idea. Massive changes were triggered. HLL representatives accompanied the self-employed women in this scheme to give them legitimacy, credibility and confidence in order to overcome the stigma attached to door-to-door sales. HLL thus ensured these visits actually took place as well. Furthermore, the supply chain was streamlined and a larger margin granted to the self-employed sales women to make their efforts more attractive financially. Instead of seeing local dealers as competitors and creating a channel conflict, the self-employed women actually started to sell to them as well. The latter thus had the opportunity to conveniently fill up their shelves again. HLL in turn invested heavily in ensuring this idea would not run out of fuel.

By 2007, Shakti had already been extended to about 50,000 villages in 12 states. Shakti already had about 13,000 women entrepreneurs, reaching no less than 50,000 villages and 15 million people in rural areas, in its fold. Shakti was thus undoubtedly creating opportunities for rural women to improve their living conditions and, most likely, their self-esteem, while changing their families' overall standard of living for the better. HLL had a daring vision for 2010. By then, HLL envisaged 100,000 self-employed woman covering 500,000 villages and benefiting 500 million people.

Localizing sustainability strategies

HLL's strategy was so successful because it was sensitive to and cleverly incorporated local idiosyncrasies. It understood that women in India had no other training or promising job opportunities, which prevented them from changing their roles in their households, villages and society. By providing them with unique income possibilities and education, the women became thankful, loyal program participants, creating true win-win situations. HLL also relied on common practice and established micro-credit idea to largely finance the distribution system. Such local particularities should not be understood as a complexifier, but as an opportunity to create meaningful and differentiated local sustainability strategies.

Applying network thinking to sustainability strategies

The main success pattern to be learned from HLL's growth strategy in India is based on network thinking. Networks between entrepreneurs throughout the system are the best means of ensuring that each element in the network maximizes the opportunities. HLL managers did not only get committed network members on board, they also trained network members and empowered them. The company thus created a system that allowed this committed sales force to build trust and use these relationships of trust on a local level. Once relationships have been built for the distribution of products, growth becomes easier when the product offer is expanded and consumption increases. Customers then build brand loyalty. This system was highly scalable as well.

Such networks also match the complexity in HLL's targeted area. As little is known about the actual demand of diverse regions, only a decentralized system is open enough to learn what is needed. The networks had to be based on the trial-and-error principle, as no manager in the far away HLL headquarters could possibly anticipate which products would work best – practically none of the HLL products had originally been known in these remote village.

Networks have to rely on exclusivity though if HLL aimed to maximize benefits. Consequently, HLL succeeded in ensuring that the self-employed women only distribute HLL products and visibly benefit from increased sales. In the past, strategizing efforts often suffered from a lack of clarity: should a company be the first mover or fast follower?

Applying network thinking actually helps to answer this question more easily. If companies are able to build exclusive networks and a distribution system that cannot be copied easily, there are undoubted first mover advantages. Not only does HLL have good products, but it also has a unique network in place with households in villages satisfying their consumer goods needs with the help of their trusted Shakti friend.

This is a system that no competitor could break easily. Public product demonstrations at weekly markets make customers even more familiar with HLL products. The organization has built a unique competitive advantage with tremendous sustainability impact, using a modern logic to develop a dynamic, exclusive, and scalable network.

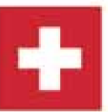
Anticipating adversity

Strategizing current reality is quite sobering. Many companies struggle. Consulting companies provide a plethora of services to anybody willing to cover their fees. Company-internal strategists, the CEO or board members represent a positive selection of people as well. However, all this is no longer enough in today's challenging environments. HLL experienced the same pattern.

A well-designed idea almost failed in the implementation process – at least initially. Unanticipated events and behaviours cause adversity and would do so again in the future. Examples include 1) the stigma attached to door-to-door sales, or 2) women dropping out during harvesting season, as they have to help in their village, or 3) the regional distribution centres being a good idea, but offering practically no added value in return for their 3% margin. Any great sustainability idea is thus likely to experience a 'valley of tears' before adaptations eventually lead this idea to success. Such learning is not failure though; it eventually ensures the sustainability strategy's success. Dealing with adversity is part of the sustainability strategizing process.

Dealing with complexity in sustainable strategizing

Many sustainability strategies comprise environmental contributions as a key element. HLL's strategy was successful in increasing the household income of the country's poorest of the poor. It provided training opportunities for women who would otherwise have been ignored. This in turn allowed HLL to prosper.



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Dealing with complexity represents yet another crucial element in successful sustainability strategies. HLL first focused on the financial and social dimension. By trying to integrate an environmental dimension from the very beginning – most likely in vain – would have rendered the project too complex. There were no easy solutions, no low-hanging fruits. The same stakeholder dialogue would have been necessary to organize recycling or garbage collection, but would have overwhelmed the project managers in the early stages of the project.

This is especially true, as neither the project's success, nor its scale was by any means certain. By omitting the environmental dimension and, thus, decreasing the complexity was a key success factor for HLL's Project Shakti. Furthermore, in general, simplicity is a formula for well-functioning, sustainability strategies. Similar thoughts apply when dealing with the ambiguity – another complexity driver.

Is it really in the women and India's best interest to have Western patterns of consumption perhaps imposed on them? If society survived without consumer goods such as HLL shampoo and toothpaste for centuries, is a shift towards them really the indisputable way forward?

The list of Project Shakti's shortcomings is by no means short, but substantial income for the country's poorest, an improvement in hygienic conditions, providing hungry people with food and providing training and jobs inarguably enhance HLL's social footprint in India. The women participating in Project Shakti most certainly agree. Ambiguity is part of every sustainability project; it should not be ignored, but accepted.

Conclusion

It is fair to say that such a unique business model is relatively safe to operate even in times of large, global crises. With a business case to create financial value built into the core of the concept, doing well AND good does not depend on recessions.

The key success factor lies in sound strategising. HLL teaches several crucial lessons on truly sustainable approaches which explicitly includes financial sustainability. The field of sustainability needs companies that will come up with innovative, partly localised solutions. These solutions have to be scalable so that their functioning patterns can be multiplied and leveraged. Complexity should not overwhelm and cannot be ignored, but has to be dealt with.

Somewhere in the strategizing process, simplifiers are required. Starting with a good idea – which may not be the perfect one yet – and subsequently improving it as HLL did, is of greater value than lengthily and in vain attempting the best option possible. HLL developed a sustainable strategy and helped thousands of women and even more households and villages, reaching up to 15 million people. An aggressive growth plan aims at 500 million people in the not too distant future. HLL thus sets the standards that are required to create dynamics at the bottom of the pyramid in India – and elsewhere. The HLL example should inspire companies to come up with equally effective initiatives in other settings - despite the current crisis. ■

Bratislava Goes Beyond Its Borders

Bratislava is enjoying a building boom on a scale that has never been seen before and is unlikely to in the future. It is envisaged that almost 400,000 sq m of new office space will be available in the next two years, with the record volume of 220,000 sq m expected this year. Investors and developers are attracted by vacant space in particular – Bratislava is perhaps the only European capital city to offer enough space for development.

Virgin land is being developed and converted into prime development sites. Bratislava's new Land Use Plan identifies over 4,000 hectares of new development land for office facilities, residential schemes and multipurpose developments. The municipal authorities' vision is to convert the city "by the river" to the city "on the river". All development changes have this vision in aim.

The new urban concept on both the Danube waterfronts, the historic centre of the city, the castle – complete with its extramural settlement, and other listed urban buildings, illustrates the importance beyond Bratislava city. The Port Zone has a specific role. The new plans focus on the area along the south bank of the Danube, between the Old Bridge and the Port Bridge. Bratislava will also develop to the southwest in the direction of Austria, in Quadrant Four, where some 3,500 hectares of land is available. Approximately 10% is urbanised, while 5% of the area is for sports and relaxation. The rest, with a high quality natural environment, are especially suitable for recreation, leisure and tourism.

The city centre will undergo a fundamental transformation. It will be wider, more attractive and livelier. Modern architecture will replace former city-centre factory sites. The emphasis will be put on the construction of multipurpose developments with quality housing, prime office space, shopping and leisure areas, such as parks, playgrounds and sports facilities. A modern boulevard, several kilometres in length, will be created along both banks of the Danube.

Bratislava is getting new development opportunities thanks to Slovakia's recent accession to the Schengen area, and the city is getting ready for development in the borderland and so-called Quadrant Four. The city's vision is to provide its inhabitants with access to the border area to the southwest and northwest of Bratislava. Regulation of the development in these suburban areas is needed in order to maintain good relations with nearby foreign communities, as well as to prevent devastation of the natural environment and the green belt. The city will carry out a study to provide a framework for the territorial planning documents of the three countries. It is not the aim to cover all vacant land with development.

Bratislava expects that the potential for development will be gradually developed in the borderland, and its territorial and functional relations with the neighbouring countries will be renewed. Numerous communities in Austrian and Hungarian border areas are closer to Bratislava's centre than some of the traditional city districts. "Only now we are coming to realise that the development of Bratislava was unnaturally affected and pushed away towards the southeast, the northwest and the northeast due to the border established less than three miles of the city centre," says Andrej ëurkovsk˘, Mayor of Bratislava. "What we are witnessing these days is a regular public transport service to Wolfsthal located near the border, together with the creations of new lanes of one-family houses owned by the people of Bratislava in nearby towns, in Austria or Hungary respectively." ■

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Malta – the Regional IT and Financial Services Centre

Now in the eurozone, the small but highly ambitious island of Malta has become one of the most attractive investment locations in the region, and is well on its way to achieving its vision of becoming the regional centre of excellence in IT and financial services.

Just four years into European Union membership, having adopted the euro as its currency on January 1 2008, the tiny island state of Malta is beginning to enjoy the results of years of sustained efforts to transform its economy into a sharply-tuned instrument of growth, custom-designed to address the challenges of the globalised world. Positioned strategically between Europe and North Africa, the island promotes itself as a stepping stone between the two continents, and is building a strong reputation as the ideal regional hub for expansion-focussed businesses.

The island's legislative and regulatory systems, formulated and implemented over the last fifteen years to create a solid yet flexible framework for business, its state-of-the-art telecoms infrastructure and wealth of highly skilled professionals in every field, plus the injection of EU structural funds accelerating the upgrading of the general infrastructure, combined with its central Mediterranean location and unique sun-kissed lifestyle are coming together to help Malta win both investment and international recognition.

History

With a history that spans seven millennia, the island, already blessed with the exquisite natural beauty of its golden limestone, crystal clear sea and charming rural landscape, is a treasure trove of historical heritage. From the extraordinary 7,000 year old Neolithic temples, the oldest known human structures in the world, decorated with their sophisticated statuary and carvings, Phoenician shrines and burial places, ancient Roman villas, bath houses and olive oil presses, medieval chapels, baroque palaces and Renaissance cathedrals, the island provides a living snapshot of an enduring and fascinating history.

Malta's history is intrinsically linked with its location right in the centre of the Mediterranean Sea. Just over 100 square miles in area, the Maltese islands, comprising Malta, Gozo and Comino, lie midway between Europe and North Africa, 60 miles south of Sicily and 120 miles north of Libya. Malta's 390,000 inhabitants are among the most international of peoples: its 7,000-year history brought a succession of foreign conquerors to rule the island, from the Phoenicians, the Romans, the Arabs, the Normans, the Bourbons, the Knights of St John, the French, briefly, and finally the British until 1964, when Malta won independence from Britain after 160 years. Today, the islanders are among the most creative and determined of peoples, blessed with the unique ability to adapt to new ideas and adopt, and improve, the best of them to their ultimate advantage.

Economy

Malta's GDP stands at around €5.5 billion and the island registered growth rates of 3.3% in 2006, 3.8% in 2007. These encouraging statistics, coming after some four or five years of low or negative growth, are reflected in the amount of inward investment the country attracted in the same period: close to €1.3 billion in 2006. This is more than double the €510 million for the whole of 2005, and well over three times the €333 million for 2004. Optimism that this trend will continue is high, particularly since Malta has joined the eurozone, a move that is widely expected to be significantly advantageous for the island's future prospects.

The island's current success was not achieved overnight: in the four decades since independence, the foundations for a sustainable economy based on tourism, industry and services were laid. Initially, from the mid-sixties to the mid-eighties, Malta sold itself as a manufacturing base for products like textiles and electronics, using low wages and plentiful supply of labour as its main selling point. However by the end of the eighties it was recognised that educating the work force to include highly qualified professionals would attract higher value added products and services to the island.

Reaching the euro goal

Achieving this change required decisive action: privatisation of many government enterprises, radical restructuring of state-owned companies, tight control on government expenditure, higher effective taxation and a stringent tax compliance regime were some of the measures aimed at reducing the country's deficit and establishing a stable fiscal platform for the island's economy. Concurrently, EU membership since 2004 and efforts towards euro adoption in January 2008 added further challenges as Malta's government introduced often unpopular measures to meet the Maastricht criteria for euro adoption: to reduce the deficit to below 3%, cut back levels of public debt to below 60% of GDP and rein in inflation and unemployment.

Now, as Malta celebrates its adoption of the euro, it is already clear that achieving these goals was worth the sacrifices: Malta today boasts new industry sectors, knowledge-based activities that barely even existed two decades ago, such as ICT and financial services, which are now jostling the shoulders of the upgraded traditional leading sectors of tourism and manufacturing as they compete for the title of fastest growing sector. In addition, the island is now one of the most respected jurisdictions in the region and can offer investors and businesses the security and stability of operating not only within the EU, but also within the euro area.

Opportunity sectors driving the economy

Malta's accession to the EU in 2004 brought significant sector-specific advantages. One of the main reasons Malta has become such an

Figure 1. Siegfried Generics, Malta

Figure 2. Methode Electronics, Malta Ltd, Malta

attractive domicile to many financial services firms is the passporting rights firms enjoy to other EU and EEA areas, which has led to Malta becoming a magnet for insurance and fund management firms.

Other areas are also doing well. Remote gaming is fast becoming a major revenue earner and employer, again driven for the most part by effective regulation. The ICT sector is also on a roll, with Malta-based firms enjoying success on an international stage. Malta-developed software is making substantial leaps forward, and the new SmartCity project, with an investment of Lm300 million[1] by the developers of Dubai Internet City, Tecom, can only accelerate that trend.

Tourism, despite disappointing results in 2006, has turned a corner, and new investment in five star hotels and conference and incentive travel facilities continues to strengthen the island's product offering. The recent decision to open up the market to low cost airlines has given the industry a massive boost, and new niche segments such as weekend visits and short breaks are successfully attracting a previously untapped, less seasonal-centric, market. The continuing success of the conference and incentive business (MICE) is being matched by the cruise liner business, with arrivals rising steadily every year.

Financial services, ICT and tourism, as well as high end manufacturing, are the drivers of the economy at the moment, but a couple of other, much smaller, industries are also helping raise Malta's international profile. With productions such as Spielberg's *Munich*, the *Da Vinci Code*, *Troy*, *Gladiator*, *The Count of Monte Cristo* and a host of others choosing Malta as their principle filming locations, the international film community of directors, producers and artists are learning that Malta's facilities, including the ease of doubling up for multiple locations, the multi-lingual work-force and the island's natural beauty and wealth of historical sites, make it ideal for filming full-length productions, TV series and commercials.

The bottom line

Malta offers foreign investors the security and ease of operating within EU borders yet within easy reach of the emerging markets of North Africa and the Middle East, supported by top class legislative framework, a stable political and economic environment, and a cost-effective, driven workforce. For foreigners working in Malta, the combination of an efficient business climate and excellent infrastructure enhanced by the relaxed holiday environment in which they operate offer a unique and magical opportunity to do business in the sun successfully. ■

1. *Maltese lira. The euro replaced the Maltese lira as the official currency of Malta on 1 January 2008*

Enterprise Performance Management

Maqsood Khan is a Vice President at Cranes Software UK Limited

Business performance management is seen as the next generation in business intelligence; it plays a critical role in helping companies make sense of their operational and financial performance in a very complex environment. BPM is a set of processes that help optimise performance of the organisation. It is a framework for organizing, automating and analysing business methodologies, metrics, processes and systems that drive business performance. It helps in use of financial, material, human and other resources within an organisation efficiently.

There are various methodologies for implementing BPM. It gives companies a top down approach by which to align planning and execution, strategy and tactics, and business unit and enterprise objectives. Some of these are Key Performance Indicators (KPIs), activity-based costing, total quality management, economic value-added integrated strategic measurement, and corporate governance. The key performance indicators are widely adopted in performance management methodology. KPIs are typically tied to an organisations' strategy through techniques such as balanced scorecard. Many pure methodology implementations fail to deliver the anticipated benefits because they are not integrated with the fundamental BPM processes.

It is commonly said that "One cannot manage what cannot be measured". For business data analysis to become a useful tool, it is essential that an organisation understands its goals and objectives – essentially that they know the direction in which they want the enterprise to progress. KPIs help organisation define and measure progress towards organisational goals. To help with business data analysis, KPIs are laid down to assess the present state of the business and to prescribe course of action. KPIs are critical in prioritisation of what is to be measured. Identifying the key metrics and determining how they are to be measured helps the organisations to monitor performance across the board without getting deluged by a surfeit of data; a common scenario plaguing most companies.

Key performance indicators differ from business to business on metrics and goals. The key to identify the KPIs is to have clearly identified and defined goals for a pre-defined business process, having a quantitative/qualitative measurement of the results and comparison with set goals.

While defining KPIs, care should be taken that they are:

- Specific
- Relevant
- Achievable
- Measurable
- Time-bound

Once KPIs are defined, the next step is to monitor the KPIs in accordance with the organisational performance.

The BI reporting solutions should empower business users and decision makers to extract information when they want and how they want. Many companies have chosen iCapella™ as the best solution to break the barriers to their data. iCapella™ a 100% web based tool utilizes the internet technology to provide and distribute information throughout the organisation. A true enterprise-wide business performance management solution, iCapella™ enhances your organisational performance.

Feature advantage in iCapella™

Web-based reporting and analysis: iCapella™ provides a full suite of ▸▸

tools for end-user reporting and analysis. This suite includes a powerful, user-friendly, web-based interface with secure and fully interactive capabilities.

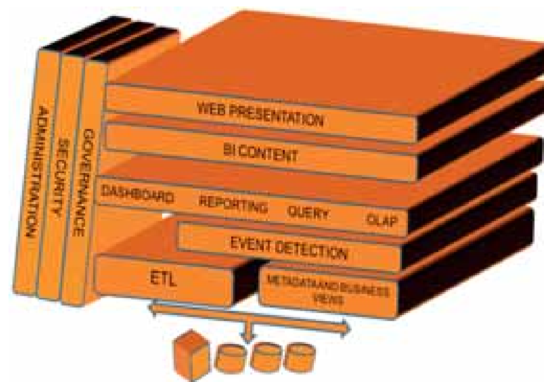
Information delivery timely: Delivery of relevant information to users within and beyond the enterprise is critical. iCapella™ proactively delivers and schedules reports and alerts. And it uses a broad array of popular media, including HTML, PDF and Microsoft Excel. It can even deliver reports to wireless devices

Microsoft Excel-based reporting and analysis: Many organisations rely on Microsoft Excel for spreadsheet-related applications. iCapella™ offers those organisations the ability to leverage the familiar Microsoft Excel interface as a fully functional interface for all reporting and analysis needs. This approach minimizes end-user retraining and lowers the total cost of ownership.

Advanced analytics: iCapella™ goes beyond simple data aggregation to provide a full range of sophisticated analytical capabilities, including advanced functions and the fullest range of multidimensional analysis available. This analytical sophistication enables you to extract hidden insight via fine-grained customer segmentation, deep analysis of terabytes of data, and more.

Personalised information delivery via corporate dashboards: Corporate dashboards and performance indicators should not be restricted to the boardroom and senior management. True organisational performance optimisation can only be achieved when all stakeholders who include staff can personally relate their individual goals and performance to the overall corporate goals. The concept of having a 'golden thread' which creates a clean and definable chain throughout the organisation which relates: goals, objectives and performance are fundamental to implementing a successful BPM solution that embraces all stakeholders and motivates them to achieve the corporate goals.

The iCapella™ dashboard portal provides the ideal interface for personalizing BPM goals and performance measures. Fundamental to the iCapella™ approach is the way information is presented. Gone is the traditional discovery approach, of reams of computer reports or worse a high level corporate dashboard where an individual needed to drill down to discover how they are performing. A more effective approach is to present exception based information. iCapella™ provides the flexibility of presenting data in various forms to make it easy for stakeholders to respond. Information can be delivered: in tabular form, as gauges indicting performance against a target, highlighted fields which lead the user from summary to detail transactions.



Governance dashboard

Business rules processing is an inherent feature of the dashboard presentation. Organisation business rules are defined which identify performance risk measures. These are used to deliver specific information and highlight risk performance factors. As they are processed in real time, it means that stakeholders can react quickly and avoid problems. For example, it is of little use to inform a stakeholder that orders or contracts have been executed which are outside corporate guidelines. It is better to advise them before the event so that action can be taken. This monitoring and advice process is fundamental to the iCapella™ dashboard and alerting process.

Dashboards are fully personalized. Users can add what objects they want on their display. Typical to the approach is the presentation of summary information. And the immediate drill down to transaction details. Gauges and alerts help users to focus.

Governance

The sub-prime crisis has created a global economic crisis impacting the markets. This manifestation of systemic financial risk involves a system-wide financial crisis. In all cases, systemic financial risk involves the spread of instability throughout the financial system as a whole which impacts the real economy.

Dashboards are fully personalized. Users can add what objects they want to on their display. Typical to the approach is the presentation of summary information. And the immediate drill down to transaction details. Gauges and alerts help users to focus.

Individual organisations and firms are adversely impacted. Leaders of industry and government have moral responsibility towards maintaining their organisations. The economic uncertainty and external factors can quite easily operate to move focus from meeting governance requirements to focusing on the immediate operational pressures. It is time that organisations ensure that governance requirements are met and are able to demonstrate they are in control of their organisation, aware of the risk facing their specific organisation and have implemented the necessary risk mitigation strategies.

With the evolving guidelines over the last few years for the organisations which have been framed by: SOX, Basel, Cadbury to identify and define 'good' governance.

The explicit guidelines for specific industries and sectors do vary. However, there is core or fundamental approach and guidelines to determine 'good' governance practise. An ideal governance environment is one where all stakeholders are able to immediate view governance measures on an on-going basis via the organisation Governance Dashboard.

iCapella™ Governance Dashboard helps organisations to integrate into the core information delivery framework. Governance is fundamental to any organisations success and should be incorporated into the basic BPM process. Particularly, as governance is a fundamental constraint in the organisations business model. Many present the proposition that the directors and stakeholders need to achieve KPI and key BPM success measures to maintain the viability of the organisation.

Some of the governance indicators to be included in the Governance Portal: directors - roles and responsibilities, the board, key corporate indicators, performance indicators, infrastructure, staff and the organisation. To give relevance they would need to be industry and sector specific.

iCapella™ provides a key feature: 'One version of the truth'. Using iCapella™ as a unified single reporting portal provides the means of ensure that reporting is accurate and there are no disputes regarding the performance indicators that are reported. To assist this from a technical aspect iCapella™ provides the means of: monitoring and auditing all changes to reporting objects, business rule monitoring and auditing, benchmarking standards, auditing and reporting changes to reporting structures.

This approach will not eliminate the inherent organisational risk; however it will clearly demonstrate the actions that organisation leaders are taking to mitigate the risk within their organisation. ■

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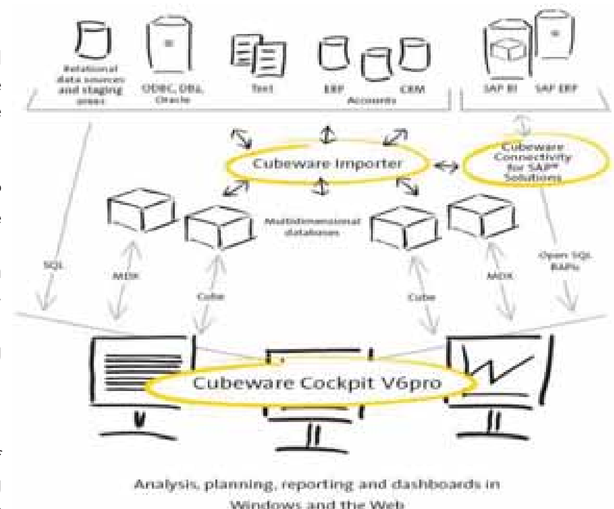

Multidimensional databases

Cubeware supports a wide range of multidimensional databases including Microsoft SQL Server Analysis Services, Infor Alea and PM OLAP, Cognos TM1, PowerOLAP from Paris Technologies, Palo (open source) and SAP Business Information Warehouse. Each OLAP database has its advantages with some designed to handle large, complex data volumes and others to support end-user administration, integrated planning functions or a distributed architecture. With Cubeware, you get a solution that fits your unique requirements. And should your needs ever change, Cubeware's open architecture ensures the highest level of scalability and security. ■

Cape Town International Convention Centre - Africa's Top Conference Destination

Cape Town, Africa's number one conference destination, will be home to the continent's first six-star green building when Cape Town International Convention Centre (CTICC) expands in 2012.

CTICC, which has welcomed more than three million delegates and visitors since opening in 2003, sits on Cape Town's northern foreshore, beneath Table Mountain, and provides flexibility and world-class amenities. Its impressive modern structural design is prominently located alongside the main highway into Cape Town and its convenient location at the gateway to the city provides delegates with easy access to transport terminals and major road networks.

The flexible facility provides a variety of sub-divisible and adaptable convention and exhibition venues.

CTICC currently offers 11,200m^2 of dedicated exhibition and trade show space, two raked auditoria seating for 1,500 and 620 delegates and a 2,000m^2 grand ballroom which can dine up to 1,200 people. It also has a special roof terrace meeting room with spectacular views of Table Mountain for dinners and special events as well as more than 33 break-out rooms varying in capacity from 25 to 330 people each. In the centre there are three different restaurant facilities and a popular new café that is fast becoming the hub of delegate networking.

The new 30,000 sq m development, of which 9,500 sq m will be exhibition space, will incorporate water and energy saving technologies including special wind turbines to harvest electricity, while simultaneously ventilating the parking garages.

In the context of climate change, sustainable business development and being in a competitive industry, CTICC's focus is on minimising its carbon footprint and the environmental impact of the planned expansion. CTICC Phase 2 is due to be constructed to the requirements set by the Green Building Council of South Africa and will be designed to use 40% less energy per square metre than the present CTICC, 95% less potable water and 25% less waste to landfill.

CTICC's expansion will not only propel Cape Town into the forefront of sustainable building design and management, but will continue to drive the city's rise as one of the leading business tourism destinations worldwide.

The CTICC is within walking distance of the city's major hotels and just 20 minutes drive from Cape Town International Airport. Nearby hotels provide more than 3,500 rooms of three-star quality or more, including the 483-room five-star Westin Grand Cape Town Arabella Quays, which faces CTICC across Convention Square. CTICC is close to Cape Town's leading recreational amenities, shopping areas and cultural attractions, among which is the internationally acclaimed Victoria and Alfred Waterfront.

After five years of operation, CTICC has continued to attract the very best in conferences and conventions and is widely regarded as the leading convention centre in the southern hemisphere, with two thirds of all international meetings taking place in South Africa being held in Cape Town and one out of every three international meetings in Africa taking place in Cape Town.

While the 2007/2008 financial year saw CTICC far surpassing its revenue target, the business is built on the principles of a triple bottom line, and also measures its effectiveness through the criteria of its environmental and social performance. CTICC recognises that the sustainability of its operation relies heavily on its efforts to minimise the impact it has on the environment.

Since inception, CTICC has contributed more than R9.5 billion to the South African economy. Projections are that by 2012 the centre will also have contributed some R3 billion in tax revenue to the South African government.

CTICC's has a diverse and expanding workforce with much effort and money invested in the development of both permanent and part-time staff.

At the core of the centre's ethos is a policy of local procurement, with the bulk of its supplies and products being sourced from companies based in and around Cape Town.

CTICC obtains goods and services from 390 suppliers of which 87% are based in the Western Cape. Local expenditure amounts to R42m.

With a strong commitment to encouraging local enterprise, CTICC has enabled many Small and Medium Enterprises (SMEs) to develop along with it, perceptibly stimulating small-business growth in the province.

CTICC also constantly seeks to uplift the communities in which it operates and has formalised a Corporate Social Investment Programme, focusing on various charities to which the centre contributes through donations of excess produce and equipment.

The past financial year saw the revenue generated by CTICC rising by 28.5% to R129 million, which is a clear demonstration of the attractiveness of the centre as a venue for national and international conferences and other events. Having established a solid foundation over the past five years, CTICC is well positioned to continue growing its bottom line for the benefit of all stakeholders, and maximise the financial contribution of the centre to the ongoing growth of the provincial and national economies.

The centre presently has a well-filled portfolio of 134 international congresses booked for the next eight years until 2016.

Going green

CTICC considers the effective reduction of its carbon footprint to be of immense strategic importance. This is partly because environmental considerations are increasingly becoming an important factor for event organisers when selecting a venue, but also because the centre recognises its responsibility to address issues like climate change and the preservation of the environment for future generations.

CTICC recognises and understands the responsibility it has to use its resources wisely, minimise its impact on the environment and, wherever possible, reduce its carbon footprint for the good of the planet. From the first day of construction, the centre has paid careful attention to its environmental impact. As a direct result, a recent evaluation by Green Buildings for Africa revealed that CTICC has achieved 77.1% compliance with the South African Energy and Demand Efficiency Standards. On completion of its new extension, the centre intends applying for a Six Star rating from the Green Building Council of South Africa.

Ultimately, it is the desire of CTICC that, through its actions and operations, it will not only limit its impact on the environment, but also serve as a benchmark against which the South African events and hospitality industry will measure the environmental friendliness of its operations.

International accolades

CTICC continues to scoop international accolades in both the local and international arena. In 2008, CTICC coveted the prestigious "Best of Cape Town Certificate of Excellence" in the category "Creative Cape Town". CTICC continues to enjoy international recognition for its services and facilities and was recognised in 2008 by the *Business Britain* publication as its "Convention and Exhibition Venue of the Year 2008".

Earlier this year the international magazine *European CEO* also named the CTICC it's "Convention Centre of the Year 2008". At the Meetings and Incentives Travel Awards held in London, the centre was also awarded the bronze medal in the "Best Overseas Conference Centre" category.

CTICC's inclusion this year among the Top 500 companies in South Africa is further testament to the centre's service excellence. The Top 500 Companies list recognises South Africa's leading businesses.

"*If you can imagine it, we can host it*" so choose Cape Town and CTICC as your premier conference business destination. ■

NBAA Continues Leading the Way for Business Aviation

EBACE2008 posts eighth record year

Business aviation in 2008 continued to benefit from recognition by businesses of all sizes that use of general aviation aircraft is an important tool in today's increasingly competitive global marketplace.

Just as businesspeople in the United States, Europe and Asia recognize the efficiencies that can be gained through the use of technology, there is more understanding of the value that general aviation brings to businesses through improved efficiency, employee productivity and increased access to new markets.

This trend is seen each year in the enormous popularity of the annual conferences and exhibitions hosted by the National Business Aviation Association and its partners in Europe and Asia.

The European Business Aviation Association (EBAA) and NBAA concluded another record-shattering European Business Aviation Convention & Exhibition (EBACE) in May in Geneva, Switzerland. A total of 13,692 attended, a 21.5 percent increase over last year.

EBACE2008 surpassed other records, as more than 440 Exhibitors, an all-time high, displayed the latest products and services across a total of 1,958 booth spaces at Geneva PALEXPO, a 38-percent increase over the previous year. The Static Display of Aircraft on Geneva International Airport also saw the highest-ever total of 60 state-of-the-art business aircraft and three aircraft mock-ups.

Likewise, EBACE's Second Annual European Safety Standdown was a big success, drawing more than 140 people from 19 countries to the special event co-hosted by NBAA, EBAA and Bombardier, and focused on reducing human error in aviation. During the Standdown, NBAA President and CEO Ed Bolen, EBAA CEO Eric Mandemaker and others recognized six businesses with outstanding safety records with the inaugural European Safety of Flight Awards.

The next EBACE event is scheduled for May 12 to 14, 2009, at Geneva PALEXPO and Geneva International Airport. EBAA and NBAA have secured dates for EBACE through 2012.

ABACE experiences similar demand in Asia-Pacific

ABACE is the premier event for business aviation's top vendors, industry leaders and experts from around the world to come together with representatives of the emerging Asian market that is eager for information and products that can assist them as they continue to grow into a strong economic leader.

The Asian Business Aviation Conference & Exhibition (ABACE), following another highly successful event in February, will return to Hong Kong on Wednesday, February 11 and Thursday, February 12, 2009. Indoor exhibits will be located at the new AsiaWorld-Expo, adjacent to Hong Kong International Airport, with a Static Display of Aircraft at the Hong Kong Business Aviation Centre. This year's event included numerous sessions featuring industry experts discussing airspace and regulatory issues for operating in the Asian region.

In the US, NBAA plans exciting agenda for 2009

On the heels of a record-setting 60th anniversary Convention in 2007, NBAA continued the tradition of providing its members with the world's largest civil aviation trade show, at the 61st Annual Meeting & Convention (NBAA2008) in Orlando, FL.

A total of 30,811 people attended NBAA2008. As evidence of the value NBAA members find in the opportunities available at the ▸▸

Convention, Association President and CEO Ed Bolen noted that NBAA2008 set a record for exhibit booths, with 5,302 compared with last year's all-time high of 5,257. The 1,183 exhibitors at the event represented the spectrum of business aviation, from business aircraft firms to a host of firms that provide products and services to the business aviation industry from all over the US, and internationally as well. Finally, a record-setting 139 piston, turboprop and jet aircraft were on display at nearby Orlando Executive Airport.

NBAA2009 will be held in Orlando, FL, October 20–22, 2009, at the Orange County Convention Center. But the New Year also promises another exciting new event from NBAA.

New event just for light business airplanes

Business owners or operators of small business airplanes – or just as importantly, business owners considering using a light plane to make their businesses more efficient – should know that Thursday, March 12 through Saturday, March 14, 2009, in San Diego, NBAA will host an inaugural event solely for this segment of the business aviation community.

The first Light Business Airplane Exhibition & Conference (LBA2009), at the San Diego Convention Center, is designed to answer questions such as these for global entrepreneurs:

1. What are the top five things that businesspeople using, or wanting to use, an airplane should know?
2. What are the most important considerations for entrepreneurs wanting to move up to more capable airplanes?
3. How can the internet and other mobile technologies help owners make the least expensive, most effective use of light business airplanes?

These questions and many more, covering everything pilots and entrepreneurs need to know to make the most effective use of light business airplanes – from single-engine pistons, to turboprops, to light jets – will be part of this exciting new NBAA event.

The show will feature exhibits involved in nearly every aspect of light business airplane use. Attendees will also be able to get an up-close look at dozens of light business airplanes on display just minutes from the convention center at San Diego International Airport.

The show's educational sessions will cover everything from the tax benefits of using a single-pilot airplane for business, to the various types of business uses for GA aircraft and the regulatory frameworks that govern them; to medical certification standards for pilots.

The show's Opening General Session will feature keynoter Rich Karlgaard, publisher of Forbes magazine, and a general aviation enthusiast who uses a Cirrus SR22 for business.

"I'm delighted to be a part of this event, and I look forward to being there on opening day, to share what I've learned about using an airplane for business, and exchange helpful tips and tools with people like me." ■

Energy Performance Contracting: New Mind Set – Big Return on Investment

Scott Petersen is Marketing Director – Energy Solutions, at Honeywell Building Solutions, Europe, Middle East, Africa and India

It's a brave new world out there, one that calls for a new mind set if businesses are to survive and profitably grow. Today's shared agenda demands that businesses do more with fewer resources – that they be more energy efficient, reduce their carbon footprint, cut costs and deliver measurable performance improvement.

This same scenario applies on a personal level – take your journey to work. Maybe your usual drive is no longer a viable choice. Rising petrol prices, tax hikes, new legislation, toll charges, modern car engines, new infrastructure and alternative means of transport, will have changed the mix. New options will, very likely, deliver a more efficient and financially prudent solution – a quicker and cheaper way to travel.

It's the same with contract tendering. The traditional buying scenario sees the heating, ventilation and air conditioning, energy, fire and security management systems and maintenance services purchased separately. With the construction industry locked into this short-term, product-focused set up, it is forfeiting big business benefits, not least the opportunity to leverage the expertise of specialist energy services' providers and to work with them to implement strategic energy demand management. The prevailing contractor selection process does not tap the full return on the investments made in automation controls nor the big energy and operational savings to be gained from a results-orientated approach.

> "Look to the longer term and break away from the traditional contractor selection process to buy guaranteed results"

A new way of working

Energy Performance Contracting (EPC) offers a new way of working and contractor selection process.

It is a well-proven, retrofit approach to reducing a facility's energy consumption. It is the solution of choice for the 2007 Clinton Climate Initiative which, with Honeywell's help, is working with the world's 40 biggest cities to implement local EPCs to combat a global issue – to drive energy conservation and reduce carbon emissions.

An EPC is a self-funding initiative enabling building owners and occupiers to make capital improvements – practical engineered upgrades to existing energy plant and systems' infrastructure - that enable better energy demand management. It uses future guaranteed savings in utility consumption to finance modernisation today – without the need for upfront capital. Better still, all risk transfers to the performance contractor who guarantees the performance improvement. No savings and the contractor doesn't get paid; in fact it makes up the difference. Any savings beyond that predicted over the term of the contract and that's the customer's to keep. What could be better?

Contrary to the traditional tender selection process which is invariably governed by price, successful performance contracting is driven by results with the very best EPCs spanning 'report to results'. Many organisations, public and private alike, have, however, yet to see the full value of this practical, retrofit approach to energy demand conservation. Indeed it is the buying of outcomes, as opposed to equipment, that sets a performance contract apart and this is what the customer/procurement department has to understand. ▸▸

Very likely different EPC contractors bidding for a job will offer alternative approaches so making it difficult to compare 'like with like'. One may look to upgrading an ageing boiler and use top-of-the-range building management controls while another may prefer to replace the existing boiler and use mid-range controls; different processes, different equipment, different costs but a shared goal nonetheless – measurable and guaranteed energy savings.

This new way of working offers key advantages. Consider the facts. With tendering there's a risk that the service provider might be tempted to cut corners to get the job done and boost (their) short term margin at the expenses of sustainable performance improvement. But even more fundamental, tendered contracts do not carry a guarantee of measurable outcome.

Figure 1. Royal Gwent Hospital saw savings of £1.5 million a year

Performance contractors, on the other hand, seek maximum performance improvement. Being bound by contractual guarantee, they actively seek maximum efficiency gain and equipment reliability. Granted equipment uptime and the knowledge of skilled energy engineers might cost a bit more at the outset but, over time, it delivers a much bigger return on investment. As well as enabling a customer organisation to plug an in-house skills shortage, an EPC taps into the specialist resources required to implement technology optimisation into the energy mix – competent engineers who can help to plan and budget for capital improvements, maybe a boiler upgrade, new energy efficient lighting or a modern building management control system, and so reduce energy and operating costs, increase equipment life span and enable cumulative efficiencies over time.

Their expertise can help companies to implement a sustainable energy management strategy and so address environmental and financial targets. Many Honeywell customers have, for example, been able to realise operational cost savings of 20 per cent or more - money that has been turned into a revenue stream for facility modernisation or directly to operating income. Besides, the money to fund the necessary enhancements is, very likely, already in the budget and being spent but on wasted energy – as much as 20% according to the UK Carbon Trust[1].

In the UK for example, a Honeywell EPC has brought about a significant reduction in CO_2 emissions and slashed the Royal Gwent Hospital's energy bill. In fact, Honeywell guaranteed savings of £1.13 million and in 2007 delivered £1.5 million, the extra £400,000 going straight to Gwent NHS Trust. On the Continent, a similar initiative is saving the Atrium Hospital Complex in The Netherlands more than €150,000 annually on its utility bill.

A different start-point

Whereas the traditional tendering process is based on exact drawings, building specifications and bills of quantities – and usually offered as one of three competitive bids – an EPC sees the performance contractor come from a very different start point. Honeywell for example will conduct an audit of a facility's infrastructure to establish a mutually agreed baseline and identify where energy consumption can be reduced and by how much. With this common understanding in place, it is Honeywell's responsibility to implement practical solutions and preventative maintenance services that deliver on the guaranteed energy efficiencies. Throughout the full term of the contract, the equipment upgrades and system enhancements are monitored and evaluated so as to track performance, measure results and reconcile annual savings.

For the customer this necessitates a break with tradition. Rather than CAD drawings, contractor pre-qualification is an important first step. That said, it is a step without risk as that is borne by the contractor. Get it right and there are big energy and operational cost savings to be made, not least peace-of-mind and the freedom to focus on your core business – better patient care in the case of Gwent and Atrium. Of course, you should look for an energy performance contractor with a proven track record in automation control technologies, a skilled project team and financial stability – 25 year EPCs are not unheard of so you'll want a supplier that will be around long term - and the organisational structure to deliver.

Honeywell, for example, has a 100 year history in energy management services. A pioneer of the EPC concept in North America, it has, over the past 25 years, successfully implemented more than 5,000 energy efficiency projects around the world saving its customers in schools, healthcare, airports, industry, government and commerce more than £1.7 billion. Indeed half of all Honeywell products and services target energy conservation.

Seek independent recommendation. Earlier this year (2008) Frost & Sullivan awarded Honeywell an Industry and Advancement Award for its leadership in energy demand management solutions. "Honeywell not only demonstrates a clear expertise in energy services but also possesses a keen knowledge and understanding of a shifting and volatile energy landscape," said F&S research analyst, Devin Castleton. "It has a robust track record in developing a full-circle strategy that actively monitors and controls energy supply, energy-using assets and real-time interaction between supply and demand."

Figure 2. Energy Performance Contracts (EPC) require specialist knowledge to implement energy-saving improvements

These factors can help the prospective EPC buyer's final selection process – to adopt what is effectively a speculative proposal backed by the credentials of the bidder. So what are you waiting for? If you want to save energy, reduce your carbon footprint and drive performance improvement without compromising comfort and productivity, it is time to look at new ways of working; to adopt a new mind set and do things differently. With energy such a big and growing operational expense, an Energy Performance Contract is a prudent choice in the current economic climate.

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1. *www.carbontrust.co.uk*

DO YOU USE YOUR AIRPLANE TO HELP YOUR BUSINESS SUCCEED?

FINALLY, AN EVENT JUST FOR YOU!

Your Business. Your Airplane. Your Show.

To address the unique challenges and needs of operators who rely on their GA airplanes to help their businesses succeed, the National Business Aviation Association (NBAA) has unveiled a new Light Business Airplane Exhibition & Conference (LBA2009). The event will take place from Thursday, March 12 through Saturday, March 14, 2009, in San Diego, CA.

The three-day event will showcase airplanes that can be flown single-pilot and provide invaluable information sessions, including a single-pilot Safety Standdown, tax seminars and a variety of panel discussions on topics generated by the operators themselves. Exhibitors from every aspect of light business airplane use will be featured in the award-winning San Diego Convention Center. And a Static Display of Aircraft with approximately 50 airplanes will be a mere minutes away at Landmark Aviation Services on San Diego International Airport.

Learn more about this three-day event hosted by NBAA at www.nbaa.org/lba.

Join NBAA Today at www.nbaa.org/join.

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Are you interested in globally-proven solutions that guarantee to improve building performance and reduce energy consumption & carbon emissions?

Honeywell can help you to reduce the carbon footprint of your building portfolio, replace ageing equipment, improve comfort conditions for your staff and visitors as well as ensure compliance with current legislation...all at no addition to current operational budgets. And we can engineer a range of improvement measures that will reduce energy consumption and carbon emissions including renewable energy solutions. Based on completing more than 5000 energy efficiency projects in facilities across the globe, we are so confident in our abilities, we can guarantee the results and take on the performance risk, funding the improvements from the savings we make. You see the positive impact directly on your bottom line whilst at the same time meeting your corporate responsibility objectives.

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